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Judicial Foreclosure Process Hurting More Than Helping

We noted a few months ago that Freddie Mac's monthly *Insights and Outlook* had changed in both format and publication schedule and credited those changes to its new chief economist Sean Becketti. Another innovation is their feature "In Closing" which learns more toward an editorial than a news piece. This month the subject is titled "the **cost of delaying the unavoidable**" and it looks at the impact of state level foreclosure laws.

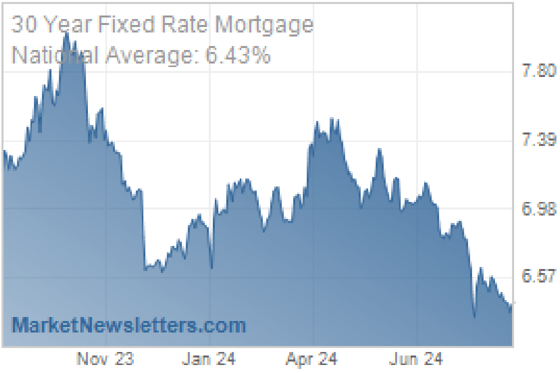
The Great Recession brought about a lot of regulatory changes to financial services, especially in housing, in an attempt to avoid a repeat of the devastation. As bad as the downturn was there was substantial variations in its impact across the states, usually as a result of differences in each states economic composition. But Freddie Mac says some can be traced to differences in state laws regarding lending as well. Especially important to the impact of foreclosure has been whether a state uses a **judicial or a non-judicial** process to do so.

In non-judicial states, contract law **allows lenders to sell** the property if the borrower is delinquent. A letter of default to the borrower, properly documented to authorities in the jurisdiction can be followed by a sale of the property if the borrower continues to remain delinquent. In judicial states, the lender must file a notice with a judge documenting the amount of the debt, the delinquency, and why the delinquency should allow the lender to sell the property. The borrower is notified of the filing and given a chance to respond. If the court finds the claim is accurate, the lender is allowed to sell the property.

Inserting the courts in the process is **intended to protect** the rights of delinquent borrowers and to prevent mistakes or abusive practices by lenders. While judicial reviews may provide important protections they also delay resolution. The average time from default to foreclosure is 390 days in a non-judicial jurisdiction, 570 in a judicial one; a difference of 180 days. The longest timeline - 22 months in New Jersey, a judicial state - is twice as long as the shortest timeline - 11 months in Michigan and Missouri, both non-judicial states.

Freddie Mac admits that **delays can be useful**, providing time for borrowers to cure delinquencies or to negotiate a loan modification. In cases where default is unavoidable, borrowers and lenders may be able to use the time to arrange for a foreclosure alternative such as a short sale or a deed-in-lieu agreement.

National Average Mortgage Rates



	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

Recent Housing Data

		Value	Change
Mortgage Apps	Aug 28	226.9	+0.49%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

		Value	Change
Builder Confidence	Mar	51	+6.25%

But these delays can be **counterproductive** as well. Distressed borrowers are likely to **defer maintenance** on the home, increasing losses to lenders and guarantors. The resulting deterioration can reduce the value of whole neighborhoods and the salability of its houses with abandoned properties becoming magnets for crime.

Costs to lenders can increase through delays even where the property is maintained. The **cost to service** non-performing loans is **15 times higher** than the cost to service performing loans. Where securitized loans are involved servicers typically must continue to advance interest payments to investors and keep property taxes and insurance payments current even though they are receiving no money from the borrowers.

Time-related costs of foreclosure have increased, especially in judicial states. Before the Great Recession, these costs represented an average of 12 percent of total foreclosure costs nationally but 16 percent in judicial states against10 percent in non-judicial states. In the wake of the housing crisis, the share of time-related costs has **increased 67 percent -** to 20 percent of total foreclosure costs - and the percentage increase has been greater in judicial states - a 106 percent increase compared to a 40 percent increase in non-judicial states.

Freddie Mac cites research that finds that the longer timelines for judicial reviews do not, in fact, produce better outcomes for borrowers and may even make late-stage modifications less likely. Other research documents the negative impact on neighborhoods of lengthy delays in liquidation.

The company says the recent crisis **revealed weaknesses** and deficiencies in the servicing of non-performing loans and in the foreclosure process. The disclosure of robo-signing and foreclosures brought against deployed military personnel outraged the public and led to legal settlements between lenders, servicers, and state attorneys- general. "These shortcomings provide a reminder that distressed borrowers are in a vulnerable situation and merit legal protection. However, the lengthy delays that are common in some judicial states may be just as damaging," the company says.

These delays increase losses to lenders, financing costs to borrowers and tend "to drag out the healing process in the wake of the housing crisis." Freddie Mac suggests that states be thoughtful in finding ways to balance the need to protect distressed homeowners with "the equally compelling need" to support a well-functioning housing system.