



**Single Family Mortgage Default Processes:
A Discussion of the Value of Interventions by Nonprofit Programs**

J. Michael Collins¹ and Rochelle Nawrocki Gorey

June 9, 2005

This paper was supported by the Fannie Mae Foundation.

¹ Corresponding author: mcollins@policylabconsulting.com / 607-592-3113

1.0 Introduction

This paper reviews the foreclosure process from the perspectives of borrowers, the financial industry and nonprofit organizations in order to help practitioners understand their value in mitigating mortgage defaults, primarily by avoiding the costs of foreclosure. While the financial industry continues to improve its ability to provide alternatives to foreclosures for borrowers in default, nonprofits have inherent advantages that can increase a lender's ability to work with borrowers. First, nonprofits have relationships with borrowers and can facilitate communication between borrowers and lenders. Second, nonprofits can provide a trusted, third party source of information and advice for borrowers. Also, nonprofits can help assess information for loan servicers to develop more effective strategies. Finally, locally-based nonprofits can bring value to the property disposition of foreclosed properties. Their knowledge of local real estate markets and ability to access housing subsidies can reduce the number of foreclosed properties which become vacant or abandoned.

The intent of this paper is to stimulate dialogue regarding the gross economic benefits of foreclosure prevention efforts. This paper does not present a formal accounting of costs and impacts, but rather a stylized discussion of the potential savings due to interventions designed to prevent or mitigate the costs associated with defaulted mortgages. Based on a number of assumptions regarding the economic value of various activities, organizations can better assess their role in partnerships and the appropriate fees and policy changes necessary to better guide intervention strategies.

2.0 Overview of the Foreclosure Process

When a consumer takes out a typical single-family mortgage to purchase a home, refinance an existing loan, or borrow home equity, they are entering into a contract. That contract stipulates the borrower will make payments under very precise terms. If the borrower does not pay as scheduled, they are in violation of the mortgage contract.² After 90 days, or three missed payments, lenders generally begin aggressive actions to recoup past due payments and lay the groundwork to foreclose on the home. Depending on the state and the borrower's circumstances, borrowers may have their home sold at a foreclosure auction. However, recent emphasis on foreclosure intervention has led to earlier efforts by lenders to engage the borrower in foreclosure avoidance activities.

Foreclosure is costly for borrowers, lenders and communities. Lenders typically lose \$50,000 or more on a foreclosure, between lost interest payments, legal and other fees, and losses in the value of the property that serves as collateral for the loan (Quercia, Cowen and Moreno, 2004). The financial industry is rapidly developing innovations in "loss mitigation" efforts to reduce both the incidence and costs of foreclosures (Cutts and Green 2004). But, local communities also face significant costs. Homes in the foreclosure process can become vacant, providing a place for crime or other problems in the neighborhood (Immergluck and Smith, 2005). Estimates of losses to local municipalities range from \$400 to \$34,000 per foreclosure, depending on the

² A small number of loan products have been created which allow borrowers to miss a limited number of payments without violating the terms of the mortgage. These "skip-payment" loans are relatively rare, however, and carry elevated fees and interest rates.

circumstances (Apgar, Duda, Gorey, 2005). There is strong motivation for lenders and local government to work to prevent the number of foreclosures from expanding. Meanwhile, borrowers themselves have much to gain from remaining current on their loan from avoiding financial losses due to a foreclosure as well as the long-term negative impacts on their credit record.

3.0 Interventions for Defaulted Loans

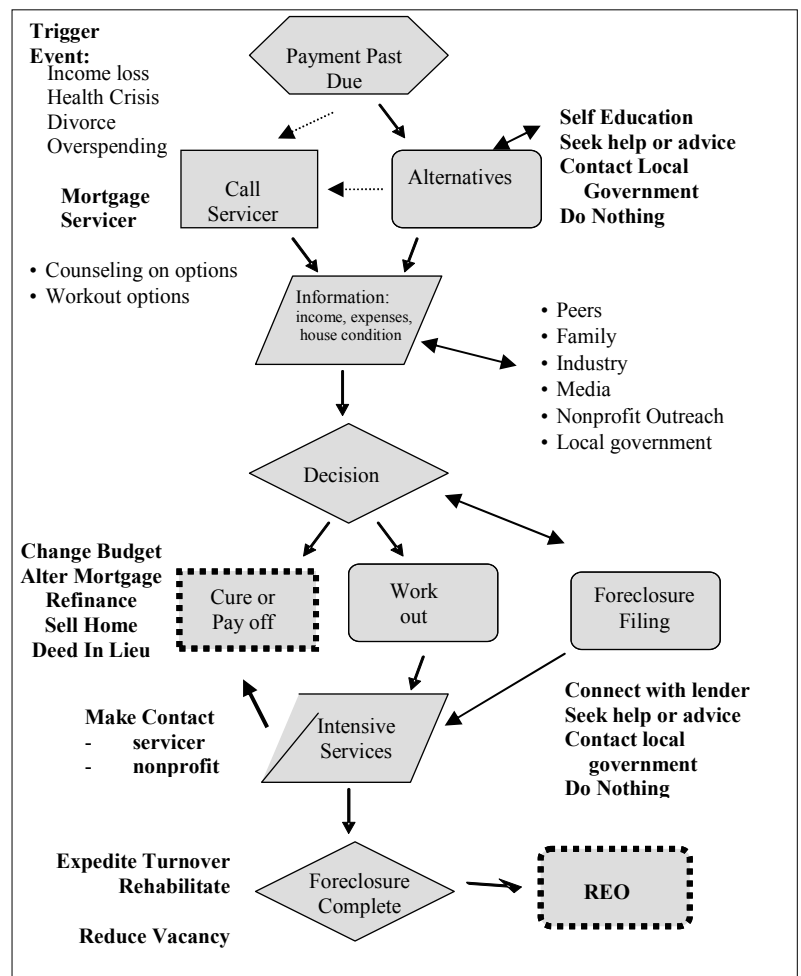
Typically borrowers default on a loan due to some event in their lives, such as a job loss or mismanagement of their finances (Collins and Gorey, 2005; Moreno, 1998). There are several alternatives to foreclosure for borrowers in financial distress. Typically, if borrowers can work directly with their loan servicer, they can develop the appropriate workout solutions by taking advantage of loss mitigation techniques now standard in the industry (Cutts and Green, 2004).

Delinquent borrowers have several options, shown in Figure 1. If they are not afraid to contact their lender, they may be able to secure an agreement to enter into a loan workout. If they are not communicating with their lender, they may seek out financial assistance and advice from family, friends or nonprofit organizations, such as credit counselors or housing organizations.

Borrowers then face decisions. They can sell their home and pay off their loan. They might also pursue a deed in lieu of foreclosure, where the borrower assigns the property's title to the lender without going through the foreclosure process. Another option is for the borrower to refinance their loan into another loan with more manageable terms.

If the borrower does not pay off the loan or enter into a work out agreement with the lender, then foreclosure filings will take place. Still, as many as half of borrowers will avoid foreclosure even at this stage (Cutts and Green, 2004). For some borrowers it is the shock of the foreclosure filing which motivates them to contact their lender or seek out help.

Figure 1: The Default Process



For those properties which do complete the foreclosure process, they become part of the lender's REO (real-estate owned) inventory. Some will be quickly sold at auction, while others may remain in REO for months or years depending on the local market and property conditions, bringing additional costs for both lenders and neighborhoods as the property sits vacant.

4.0 Borrower, Lender, Servicer, Investor and Local Government Perspectives

Before the value of foreclosure interventions can be estimated, a theoretical framework regarding the potential impacts for each participant in the process is required. Additionally, because the costs of foreclosure vary by the stage at which services are provided, this framework must include a combination of these stages and the participants involved. At each stage of a mortgage, borrowers, lenders, loan servicers, investors in pools of mortgages and neighborhoods may have a stake in the status of a loan.

Figure 2 (page 7) represents each stage of the process of the mortgage and the interests of various parties involved. The stages of foreclosure are self-explanatory, but the each participant in the process requires further clarification.

“Borrowers” are the consumers taking on a mortgage. “Lenders” are the financial institutions actually originating a loan and responsible for that loan over its life. In some cases the lender may rely on a third-party originator such as a mortgage broker, correspondent or mortgage banker to handle the loan application and origination. But the term lender here is intended to refer to the institution which manages the flow of payments from the borrower and is legally the mortgagee on the contract.

“Investors” may be the same entity as the lender if the loan is held in the lender's portfolio and not sold into the secondary market or bundled into a collateralized mortgage obligation. Investors usually buy certain portions of a pool of loans. For example, an investor may buy the lowest-risk portion of the pool in return for relatively low returns if they can be guaranteed the first dollar of interest and/or principal payments. Other investors may be willing to take on riskier portions of a loan pool. Ultimately, the lender and some investors in the high-risk portion of the pool may end up taking on the first dollar of any loss due to foreclosure. It is these parties who are most motivated to avoid foreclosures.

“Servicers” again may be the same entity as the lender. In other cases, the lender will contract servicing to a third-party entity. Most servicing is performed using high-volume, call center-based payment collections systems. Once a loan enters into default, servicers are the first line of defense in contacting borrowers, seeking payment, and if necessary arranging alternative payment plans. Importantly, they also serve as the borrower's interface with the lender. Third-party servicers are limited in their ability to pursue aggressive workouts, and in many cases loans are moved to specialty servicers to manage severely delinquent loans in the foreclosure process (sometimes called “scratch and dent” servicing). Lenders and investors may also retake servicing from a third-party at some stage of default. Finally, “neighborhoods” or “communities” consist of the property owners surrounding a mortgaged property and the municipalities providing local services to that property.

1-2: Loan Search and Application & Loan Origination

Even before a mortgage is originated borrowers ideally should understand their options before they take out a loan. They will select the best loan for their needs with terms they will be able to repay. Lenders and investors want loan application data to be accurate and predictive of the future performance of that loan.

Neighborhoods are best served by a balance of easily accessible credit and the risks of foreclosure which could undermine local housing markets. Residents ideally should understand their options and understand the potential risk to the neighborhood if their home endures a prolonged foreclosure process.

3: Payments Current

When a loan is current, borrowers gain most from preventative work which helps them stay current on their loan. An example of such work would be workshops or educational materials to inform borrowers about options available should they find themselves in financial trouble down the road.

Lenders, servicers and investors rely on timely mortgage payments which can be quickly and efficiently processed. Any relatively low-cost intervention which increases the efficiency of collecting and managing payments may be perceived as valuable by lenders and loan servicing operations. To the extent these services can be appropriately targeted to those borrowers most at risk, the efficiency of the intervention is enhanced.

4: Payments Initially Delinquent

When a payment is initially delinquent, borrowers begin their scramble to recover from an adverse event. They must assess their ability to regain their financial footing, and make plans to catch up on their loan by budgeting, seeking financial help and negotiating with the lender. At this point servicers are not receiving full payments. In some cases they may be advancing payments to the lender on the borrower's behalf, thus taking on financial risk and interest costs.

The servicer also must manage multiple communications with the borrower, including mailings and call center services. This increases their costs, although the scale of high-volume servicers is such that the marginal costs are low. To the extent borrowers catch up and pay late fees, the revenue generated may exceed the costs of delinquency for servicers at this stage. Lenders and investors, if they are separate from the servicer, will encourage the servicer to pursue strategies which cost less than the expected future revenues from delinquency interventions.

5: Payments Severely Delinquent

After a borrower moves into severe delinquency (approaching 90 days or more past due), the borrower must begin to contemplate options including selling the home. Lenders and investors

have a heightened interest in more aggressive workouts and may now move servicing into specialized operations focusing on distressed borrowers.

6: Foreclosure Filing

Once the initial intent to foreclose is initiated, documents are filed (lis pendens), and the borrower must quickly show the lender a workout can succeed, including the potential to increase his or her income and cut expenses. The lender and investor begin a dual-track of workouts and loss mitigation, assessing the borrower's ability to repay and also the value of the property which may be foreclosed.

The servicer, still not receiving full payments, is ideally communicating with the borrower while managing brokers and property inspectors' reviews of the home as collateral. Communities hope to reduce the negative effects of a foreclosure sale on nearby property values and resident confidence to invest in their home.

7-8: Foreclosure Complete & REO

After a foreclosure is complete, borrowers now need assistance to find an alternative to ownership, typically with a relative or in a rental unit. The lender and investor face significant losses at this stage. They will seek out interventions in order to reduce their expected net losses. Usually this means accelerating the disposition of the home from the foreclosed borrower to another owner.

The lender accumulates maintenance and utility costs, as well as tax payments in this stage. The longer the unit is vacant or the owner is uncooperative, the larger these costs will become. Neighborhoods also benefit from a rapid turnover of the home, particularly into the hands of another owner-occupant who will invest in the property and contribute to the community.

The pace and extent of options at each stage vary from borrower to borrower, and from community to community. In fact, state and local foreclosure laws have a strong effect on the options of borrowers and lenders (see Table 1 of Cutts and Green, 2004). State laws can result in foreclosures proceeding in as little as 2 months after a missed payment. In other areas foreclosures can stretch out for 12 months or more. Lenders and servicers are keenly aware of the regulations in each state, and the costs entailed under each set of laws.

Figure 2: Understanding Motivations throughout the Mortgage Loan Management Process

	Borrower Priorities	Lender Priorities	Investor Priorities	Servicer Role	Neighborhood / Community Issues
(1) Loan Search and Application	Making optimal choices & tradeoffs in loan terms	Quality loan package	Avoid fraud or misinformation	--	Public awareness of risks of mortgage borrowing; provide information
(2) Loan Origination	Informed contracts – disclosures & counseling		Standardized loan documentation	--	Disclosures; prosecute fraud
(3) Payments Current	Budgeting and planning for mortgage and non-mortgage payments	Collect regular stream of payments with minimal costs	Timely, regular payments with low default & prepay rates	Regular payments with low administrative costs	
(4) Payments Initially Delinquent	Tapping savings or re-arranging resources	Develop & Maintain contact with borrower; levy late fees	Encourage servicers to use own resources for forbearance	Predict payment patterns; aggressively maintain contact; offer forbearance	Educate borrowers that quick action offers best results
(5) Payments Severely Delinquent	Negotiating workout, managing crisis or initiating home sale	Develop & Maintain contact with borrower, offer budgeting assistance, review workout options	Restore payment flow. Minimize costs.	Work with borrower and lender to offer workouts; transfer loan to specialized unit.	Assist borrower in contact with servicer to develop loan workout or alternative to foreclosure
(6) Foreclosure Filing	Finding resources, employment or home sale	Aggressive workout options; assess property collateral value	Rapidly and efficiently recoup assets and minimize losses.	Manage legal, broker and appraisal functions.	Mitigate impacts on borrower, property, and neighborhood
(7) Foreclosure Complete	Relocating to rental housing; rebuilding credit	Maintain property, optimally upgrade for resale	Maximize sale price to cover unpaid loan balance, foreclosure and REO costs	--	Increased turnover, vacant homes, law enforcement and legal administration
(8) REO Managed³	--	Quickly re-sale property to minimize vacant period and lender costs	--	--	Quickly re-sale property to minimize vacant period and public costs

³ In states with a long foreclosure process, foreclosure complete and REO management process may take place simultaneously.

5.0 Intervention Strategies

Figure 3 illustrates the potential outcomes of nonprofit intervention programs for each participant in the foreclosure process at each stage—from current to REO.

Figure 3: Potential Outcomes of Foreclosure Intervention Programs by Participant:

Payments Current

Potential Intervention(s): Workshops, Preventive telephone or face-to-face counseling, Outreach

Borrower:	budgeting to insure regular payments
Lender:	receive expected payment of principal and interest
Servicer:	collect payments; receive servicing fees
Investor:	receive coupon payments (often through trustee)
Community:	benefit from owner-occupied homes; resident have access to credit

Payments Initially Delinquent

Potential Intervention(s): Hotline, Refer to counseling (telephone or face-to-face), Outreach

Borrower:	re-arrange budget; remedy income shortfall; manage consumer debt
Lender:	avoid delayed revenue streams; reduce costs of providing customer services
Servicer:	avoid delayed/lost revenue; minimize administration costs
Investor:	avoid delayed/lost revenue
Community:	avoid migration of loan to foreclosure

Payments Severely Delinquent

Potential Intervention(s): Aggressive outreach campaigns, Hotlines, Intensive counseling, Outreach

Borrower:	intensive budgeting; accessing financial assistance, emergency or refinance loans
Lender:	reduce probability of migration to foreclosure; preserve collateral value
Servicer:	reduce lost servicing revenue; reduce costs of collections
Investor:	avoid payments foregone; preserve quality of security
Community:	maintain quality property conditions; avoid neglect due to foreclosure

Foreclosure Filing

Potential Intervention(s): Programs with servicers, Loan/Payment Assistance funds, Property services

Borrower:	recognize seriousness of problems; seek out resources; consider sale or workout
Lender:	accurately assess payoffs from workout or aggressive foreclosure proceeding
Servicer:	reduce costs of contacting borrower; reduced broker and legal functions
Investor:	maximize potential for recouping assets
Community:	maintain property conditions; reduce probability home will be vacant

Foreclosure Complete

Potential Intervention(s): REO/Property disposition programs

Borrower:	find quality housing; re-structure finances; rebuild credit
Lender:	avoid long vacant period; manage property services, utilities and taxes
Servicer:	maximize sale price; minimize legal and administrative costs
Investor:	minimize losses; spend on property improvements up to breakeven point
Community:	quickly turn property over to quality occupant; minimize oversight and clean-up costs by municipality; recoup back taxes and other liens; avoid abandonment

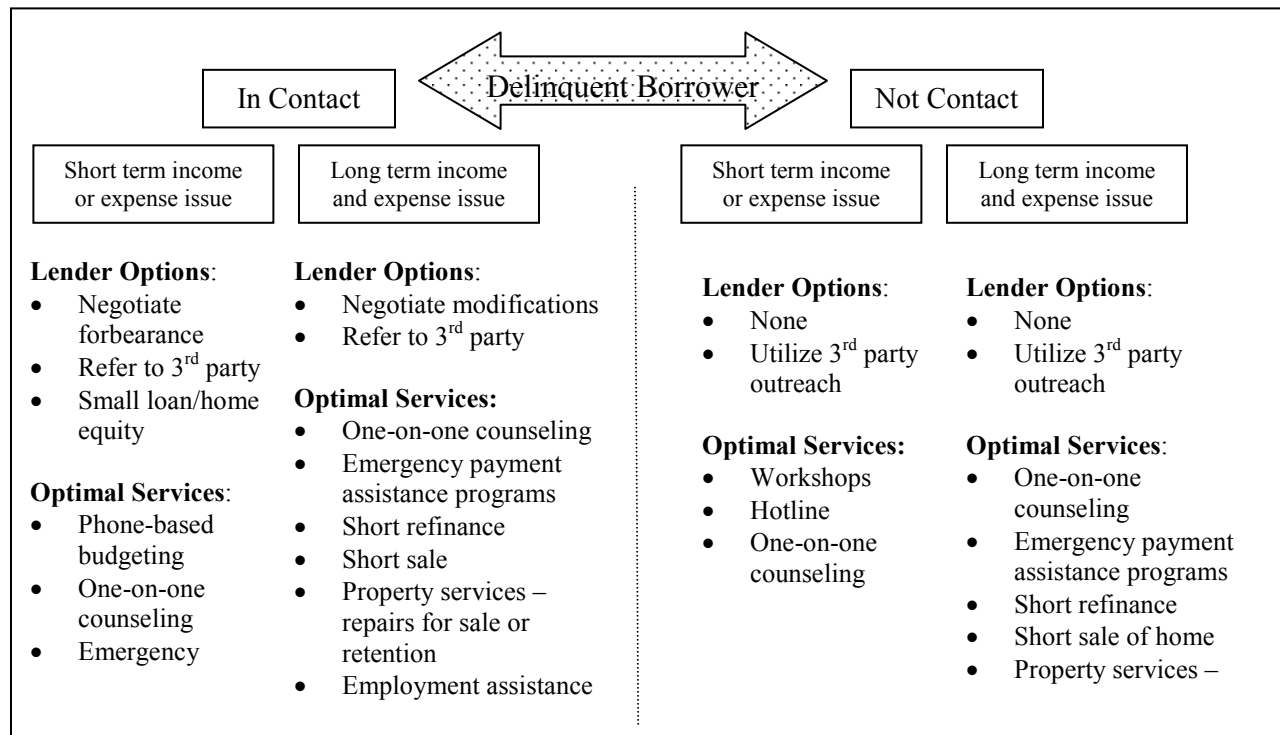
6.0 Optimal Interventions by Borrower Situation

One simple way to triage borrowers is by their contact status with their lender and the depth of their financial problems, as shown in Figure 4. Borrowers in communication with their lender or their lender’s third-party servicer can learn about options such as forbearance and loan modifications. Borrowers who are not in contact obviously will not have these alternatives. The value of nonprofit providers in such cases is to facilitate communications between the borrower and the servicer. This might be achieved through a default hotline, workshops, one-on-one counseling or door-to-door outreach. As the mortgage servicing industry becomes increasingly centralized, the presence of a local entity that can make the connection with borrowers at risk of foreclosure provides a highly valuable function to the industry.

For borrowers in contact, nonprofits play a valuable role as a third-party counselor who can help them make informed choices. Typically this is in the form of telephone counseling, or in some cases face-to-face counseling.

The next important distinction is between borrowers with a short-term or temporary situation and those who have experienced a situation that will result in long-term financial problems. Borrowers with a temporary loss of income or increased expenses will be more likely to become current on their loan with budgeting or short-term financial assistance. Borrowers who experience an illness, death, or divorce that reduces their income more permanently may require a specialized loan from a nonprofit to help them through a transitional period. They may also require assistance in selling their home in order to exit their property without the cost of foreclosure.

Figure 4: Matching Services to Customer Type



7.0 Modeling the Value of Savings Due to Nonprofit Interventions

The role of nonprofits in reducing the costs of foreclosure has been discussed in several studies. Moreno's 1995 study of a foreclosure prevention program in Minnesota suggests \$16,000 in saved costs for financial institutions due to intensive interventions by nonprofit programs. But, at each stage of a mortgage, borrowers, lenders, loan servicers, investors, and communities all derive value from the interventions of nonprofit programs. In some cases, this will be in the form of reduced costs, in other cases nonprofit programs can increase the effectiveness of existing activities and stretch limited resources to serve greater populations.

Estimating the effectiveness of nonprofit interventions is difficult. First, foreclosure intervention is often complicated and not easily generalized across borrowers. Mindful of this challenge, this analysis uses a typology of (1) the at-risk borrower, (2) the delinquent borrower, (3) the borrower in foreclosure (*lis pendens*), and (4) the property after foreclosure, in REO (real estate owned by lender). Also, this analysis focuses on the potential value of default interventions for consumers, lenders, servicers, investors and neighborhoods. For each group, the role of the nonprofit is described, and the potential value related to cost savings is estimated.

Second, there is little evidence on the effectiveness of programs. Anecdotal evidence and non-experimental data suggests borrowers who receive assistance are less likely to foreclose than average, but these studies suffer from selection bias. Borrowers entering into programs are likely to be the most highly motivated and would have figured out other alternatives to foreclosure in the absence of a nonprofit program (Quercia, Cowen, Moreno, 2004). Evaluating interventions is a costly and lengthy process. This analysis simply assumes the intervention could be proven to be effective, even if not such evidence exists.

Third, the true costs to the many parties from the public and private sector of an additional foreclosure is difficult to measure. Studies typically estimate the *average costs* of a particular service or activity, when in fact the *marginal costs* of an *additional* foreclosure may be much less (or more) depending on the circumstances. This analysis uses imprecise estimates of costs, largely to provide a general sense of the relative order of magnitude of potential savings related to interventions

7.1 Model 1: At-risk Borrower (not delinquent)

A borrower at-risk of default due to unexpected events (death, divorce, illness, job loss), financial mismanagement (overspending; debt management) or to onerous loan terms and fraud each require unique interventions. However, at this early stage, there is a high probability solutions to foreclosure can be developed. Most of value is to consumers at this stage, with an emphasis on prevention. The focus of intervention is on education, budget assistance, and skill building, as opposed to counseling or advocacy (unless fraud is involved). The costs of providing services at this stage tend to be relatively small, but delivering services in a fast and convenient manner is important in order to engage borrowers before their situation deteriorates. The value to lenders at this stage is predicated on the borrower not moving to the next stage of delinquency, which is not something easily measured.

The estimated value of an intervention is the reduction of the probability of a borrower becoming seriously delinquent. Assume a borrower has a 10% chance of being delinquent, typical for high-

risk subprime borrowers with refinance mortgages (a frequent type of client in foreclosure programs). If the nonprofit program could be proven, controlling for other factors, to reduce the probability of foreclosure to 5%, then the expected losses for lenders is reduced. The severity of losses is small at this stage, however. The value to borrowers includes the preservation of their credit rating, reduced future borrowing costs, avoidance of late fees, and reduced stress and anxiety.

The cost of providing workshops or outreach is low, estimated at \$50 to \$100 by Neighborhood Housing Services of (NHS) Chicago. The cost of phone-based preventative counseling is approximately \$100, based on information from several consumer credit counseling agencies. Assuming borrowers lose \$35 in late fees and face \$600 in increased borrowing costs, and lenders face delays in one payment, the estimated value of intervention at this stage is in the range of \$635.

Figure 5
Model 1: At-risk Borrower (not delinquent) **Total: \$635**

	Problem(s)	Strategy	Assumptions	Nonprofit Role	Estimated Value of Savings
Borrower	(1) Financial management; (2) Income instability; (3) Victim of fraud	(1) Education; (2) Employment services; (3) Legal aid	(1) Information changes behavior; (2) Employment options exist; (3) Legal actions alter mortgage terms	Outreach; Counseling and Education Referral source	\$635
Lender (or issuer)					... ⁴
Servicer (maybe third party or issuer lender)	Slow payments (no contact yet)	Enhanced contact	Contact facilitates workouts in later stages		... ⁴
Investor (residual owner)					
Neighborhood					
Municipality					

⁴ Assuming \$35 flat late payment fee and average consumer debt balance of \$7,500 at 10% rate versus 18% rate. The financial cost of delayed \$80 in interest and \$300 in principal payment (for 30 year \$100,000 loan at 8% rate) for one month is negligible. The average administrative cost of servicing a loan is \$6.58 for one month according to the MBA's 2002 Cost of Servicing Study. In 2000, the MBA estimated direct costs of default average \$20 per month for the servicer, most due to collections or legal actions. To the extent borrowers eventually pay late fees, lenders and servicers have little net cost at this stage.

7.2 Model 2: Delinquent Borrower (payment past due, but not in foreclosure)

The value of interventions for consumers discussed in the previous stage continues to be relevant as borrowers move into delinquent status. However, lenders and servicers have an increased potential for losses from borrowers the longer a payment is past due. The emphasis shifts from preventative education to crisis intervention using counseling or advocacy services. To the extent counseling helps borrowers make better choices and alters behaviors, it may successfully lead to the resolution of payment problems.⁵

The costs of actually delivering services tend to be moderate at this stage. Phone-based counseling offers speed and convenience, which are very important at this stage. Face-to-face counseling is useful for borrowers seeking out a physical office for help, but is generally less convenient and more costly than telephone-based counseling. Given the typical resource constraints on nonprofit counselors, telephone-based counseling can usually provide services to more borrowers than individual face-to-face counseling. According to practitioners in the housing counseling industry, face-to-face services costs an average of \$300 or more, while phone-based counseling can still be delivered for \$100 to \$200, depending on the number and length of sessions required.

The value of services at this stage is largely predicated on borrower not advancing to foreclosure. This is again difficult to estimate. Some share of borrowers will self-cure, without any intervention. Others will not, and without help are on a path to foreclosure. The estimated value of intervention is based on a reduction in the probability of a completed foreclosure due to an intervention.

If borrower has a 13% chance of going to foreclosure, and interventions reduce that in half to a 6.5% probability, then the expected losses for lender and borrower are reduced.⁶ Assuming a total cost for a completed foreclosure of \$58,800, this is an expected value of \$3,822 ($0.065 * 58,800$) for lenders.⁷ As the length of delinquency increases, the servicer's costs accumulate up to \$60.

If borrowers lose \$15,000 in home equity and increased future borrowing costs due to a completed foreclosure, their expected cost savings from a successful intervention is \$975 ($0.065 * 58,800$).⁸ In addition to economic costs, borrowers may benefit from reduced stress and anxiety if they are able to retain their home due to successful interventions—something beyond economic measures but perhaps even more important.

⁵ There is no experimental evidence of the impacts of services for these borrowers. However, studies suggest a potentially causal impact of pre-purchase counseling on loan performance and credit counseling on borrowing behavior (see Hornburg, 2004). Studies by Moreno (1995) suggest post-purchase programs have an impact using non-experimental data, but lacked a valid comparison group.

⁶ Citigroup Global Markets, "Delinquency Transitions in Subprime Loans—Analysis, Model, Implications" March 17, 2004.

⁷ \$58,800 cost of foreclosure to lender cited in Cutts and Green, 2004. Figure 8 (page 17) provides an estimate for FHA loans conducted in the 1990s based on an \$100,000 home value, 90% LTV and 7% fixed-rate mortgage.

⁸ See figure 8 (page 17). \$13,063 in lost equity, plus \$600 in increased borrowing costs for three years.

Figure 6					Total: \$5,492
Model 2: Delinquent Borrower (not yet in foreclosure)					
	Problems	Strategy	Assumption	Nonprofit Role	Est. Value of Savings
Consumer	(1) Cannot meet obligations; (2) Anxiety and fear	Counseling Facilitate dialogue with servicer	Borrower will act on advice	Outreach; Service provider; Referral source Advisor to lender/servicer	\$635+\$975 = \$1,610 reduced stress
Lender (or issuer)	Delayed principal and interest	Push for intensive servicing	Borrowers will catch up	Making contact with borrowers Assessing servicer	\$3,822
Servicer (maybe third party or issuer lender)	(1) Late payments; (2) Making contact with borrower; (3) Verifying if borrower is providing truthful information	Information (collecting and providing): phone calls, home visits, special mailings; videos/CDs	Able to accurately assess borrower situation; use forbearance if short-term income or expense issue; borrower will cure with reduced payments	Making contact; Third-party objective/trusted source of counseling; Verification of information for servicer	up to \$60
Investor (residual owner)	None (yet)	May mandate acceptable work outs		
Neighborhood	None				
Municipality	Delayed revenue (potential delinquent tax payments)				

7.3 Model 3: Borrower in Foreclosure

At this stage, a borrower with short-term income or expense problems has the potential to recover. Other borrowers are better off pursuing an alternative to foreclosure such as a short sale or deed-in-lieu, especially if they have long-term problems with little chance of maintaining the home. Interventions have a dual emphasis at this stage of preserving the home while also preparing for foreclosure or alternatives to foreclosure. Education and prevention are no longer appropriate; at this stage counseling or advocacy is very directive.

The costs of delivering services increase. Clients need more intensive services, in addition to the phone-based or face-to-face counseling listed in prior stages. To the extent properties need inspections or repairs, staff must physically inspect homes. In cases where a borrower needs financial assistance in the form of a loan or grant, costs may rise dramatically. NHS of Chicago estimates a borrower in foreclosure might require over \$500 in counseling and advocacy costs, and over \$5,000 in costs related to grants, loans and property repairs. Convenience and speed of delivery is less important at this stage, depending on state laws.

The value of intervention at this stage shifts to lenders and investors as losses become more probable. Faster repayment plans, reduced workout costs, better performing loan modifications, faster pay-offs and improved re-sale values are all potential impacts of interventions. The borrower’s ability to retain their home or to exit ownership without completing a foreclosure is valuable, although the damage to their credit is not easily reversible at this stage. Estimating cost savings at this stage is more challenging because of the diversity of services provided and a lack of empirical evidence. Assuming, however, borrowers at this stage have a 50% chance of completing a foreclosure, and interventions reduce that probability to 25%, the value for lenders is \$14,700 (based on a \$58,800 cost of foreclosure), before administrative costs. To the extent investors share in these losses, they will bare some portion of this cost and value potential savings, so long as the costs of interventions are less than the predicted reduction in losses.

Borrowers facing a \$15,000 loss from foreclosure could gain \$7,500 from intervention. In cases where lenders work out a short sale or deed-in-lieu of foreclosure, losses will remain, but at lower levels. Cutts and Green cite the difference between a completed foreclosure and these alternatives at \$14,800.

Figure 7					Total: \$22,500
Model 3: Borrower in Foreclosure					
	Problem	Strategy	Assumption	Nonprofit Role	Est. Value of Savings
Consumer	(1) Fees and past due balance exceeds resources; (2) Anxiety and fear prevent action (3) Distressed property condition	Counseling and related interventions	Borrower will act on advice	Outreach; Service provider; Referral source; Support for home sale; Property repair services; Emergency loan or grant provider	\$7,500
Lender (or issuer)	Delayed principal and interest	Intensive servicing Loan modification	Borrowers will catch up; Borrowers will not repeat behavior	Making contact with borrowers	\$14,800-15,000 (less administrative costs) May be shared with investor
Servicer (may be third party or issuer lender)	Late payments; Making contact with borrower; Verification of information provided by borrower	Repeated phone calls, home visits, special mailings; videos/CDs	Assess borrower situation; employ forbearance if short-term income or expense issue	Making contact; Third-party objective/trusted source of counseling; , mediation between borrower and lender Verification of information for servicer	
Investor (residual owner)	Potential write down of asset; reduced income	Reduce loss severity	Investor owns first loss position (residual)	Facilitate borrower to reduce losses	Portion of lender losses
Neighborhood	Contagion effect	Reduce fear of property decline	Residents value neighborhood	Provide property services and loans	
Municipality	Delayed revenue (tax and other lien payments)	Decrease time property is vacant	Intervention can prevent or reduce negative outcomes	Tap city resources and inform officials of foreclosure issues	

7.4 Model 4: Foreclosed Property

After a foreclosure is completed, borrowers have absorbed the costs of losing their home and ruining their credit. The value of intervention at this point is primarily for lenders and investors who hold a first-loss position created by reducing the severity of losses at auction, as well as the costs of holding and managing REO properties.

Again, there is no empirical evidence of the impact of nonprofit intervention at this stage, but anecdotal reports by lenders suggest nonprofits add value by assessing properties, recommending improvements and speeding the disposition process. If lenders face holding costs of \$300 per month and intervention reduces holding time by 4 months, \$1,200 in savings is produced. If intervention can help boost resale values by 10%, then the average REO property which would have sold for \$80,000 might sell for \$88,000, a gain of \$8,000 before administrative costs. Importantly, nonprofits might also help lenders preserve their reputation in a community where they hold a large REO inventory.

The costs of foreclosure to a municipality can be significant (Apgar, Duda, Gorey, 2005). In the simplest foreclosure cases, costs to local government can be as little as \$400. But if a property is vacant for an extended period and abandoned, costs can balloon to \$35,000 for policing and community services costs. The effect on local neighborhoods is difficult to estimate, but include depressed home values and increased criminal activity. For nearby homeowners, indirect costs of a foreclosed property is estimated at over \$16,000 per nearby property in Chicago, or \$220,000 for a neighborhood in aggregate. If enhanced property disposition interventions can avoid vacancies and negative neighborhood impacts, the cost savings is significant (Apgar, Duda, Gorey, 2005).

Figure 8					Total: \$263,000
Model 4: Foreclosed Property					
	Problem	Strategy	Assumption	Nonprofit Role	Est. Value of Savings
Consumer	Finding new housing	Rental search assistance	Borrower not suitable for homeownership	Referrals and counseling.	N/A
Lender (or issuer)	(1) Costs of maintaining property (2) Need to sell property at minimal loss	Enhanced disposition: property improvements; streamlined sale; new buyer preparation	Lender lacks neighborhood information Property not in demand	Facilitate lender's knowledge of market to reduce losses; Take possession for rehabilitation and resale to qualified, owner-occupants	\$1,200-\$8,000 (less administration costs)
Investor (residual owner)	Potential write down of asset; reduced income	Reduce loss severity	Investor owns first loss position (residual)		Portion of lender losses
Neighborhood	Contagion effect	Reduce fear of property decline	Vacant properties impact crime & property values	Provide property services and home improvement loans	\$220,000
Municipality	Tax revenue Public safety and fire suppression costs	Secure property; Avoid or reduce vacancy period	Vacant units attract crime & public costs.	Accelerate disposition; enforce vacant property maintenance, avoid repeated defaults	\$400-\$35,000

8.0 Conclusions

This paper provides a stylized discussion of the potential economic value of nonprofit foreclosure intervention programs. Interventions by nonprofit programs must be carefully designed and targeted for maximum effect. This demands understanding the default process from the perspective of consumer behavior as well as the financial industry. An array of interventions are available, from those delivered early in the process designed to prevent future problems, to those employed after a foreclosure to mitigate broader community harm. Borrowers, lenders, servicers, investors and local governments all face costs at various stages of the foreclosure process, although not all face the same magnitude at each stage. Understanding the degree of potential losses at each stage for each party helps nonprofit intervention programs understand the motivation of their potential partners.

After a delivery system has been crafted, services need to be deployed in an efficient manner. Frequently this begins with centralized phone-based services, and then expands to include more intensive, and costly, place-based services. Two major distinctions are required when assessing program delivery systems, the level of contact borrowers in distress maintain with their lender and/or servicer, and the significance of the trigger event which caused the borrower to fall behind. A borrower with a short-term financial problem who is communicating with their lender has a relatively good chance of curing their delinquency. Borrowers that experience a trigger event resulting in a permanent income change and who are essentially hiding from their lender face larger challenges. To the extent nonprofits can develop strategies for dealing with such borrowers and demonstrate success in doing so, they will prove highly valuable.

Estimating the actual costs and economic value of savings derived from interventions is fraught with problems. Admittedly the illustrations discussed here are a mix of average costs estimates based on a series of assumptions. Values rightly need to be considered net of administrative costs and tied more closely to the timing and impact of the intervention. There is very little data available on costs or impacts, in large part due to a lack of any empirical evaluations of the industry. Savvy nonprofits should consider employing such evaluations in the future in order to bolster their case.

With these caveats in mind, the value of early intervention is mostly for the borrower, and estimated at approximately \$600. Of course, in addition there is value in preventing future problems, which potentially can be more costly. For borrowers in early delinquency, lenders and servicers also may benefit from costs avoided if an intervention can cure a problem loan and help to reduce future opportunities for delinquency. The value of interventions at this stage may exceed \$5,400. For loans in foreclosure, the stakes are higher for all parties involved. Borrowers can avoid losses of equity and damage to their credit record, while lenders and investors avoid costly completed foreclosures. The value of intervention may exceed \$22,500, based on one set of assumptions. Finally, once a loan is in REO, the negative effects on the community are substantial. Lenders might benefit in the order of \$8,000 from expedited property disposition, but local neighbors who avoid the blighting effect of a vacant home benefit even more. Vacant and abandoned homes present large costs for local governments. Together the direct and indirect costs of foreclosure might exceed \$260,000 at this stage.

Clearly, there is economic value to nonprofit default intervention activities. Organizations should re-assess their roles, and the appropriate levels of support from public and private sources to strengthen and support this important work. By better understanding the value of intervention and what drives successful outcomes, new or improved intervention strategies could be developed that provide for the most value. All parties to foreclosure will no doubt benefit from such action.

Figure 8:	
Costs Saved Avoiding A Typical FHA Foreclosure	
Average House Price	\$100,000
Months Since Mortgage Origination	36
Outstanding Mortgage	\$87,014
Months from 90 Day Delinquency to Disposition	5
Equity Lost	(\$13,063)
Attorney, Title, Transfer Fees in Disposition *	(\$3,200)
Broker Commission (6%) for Disposition/Sale	(\$6,000)
Deferred Maintenance/Rehab Incurred Before Sale*	(\$8,000)
Lost Interest During Delinquent/Default Period	(\$2,452)
Property Taxes, Hazard Insurance	(\$1,050)
Total Costs	(\$33,765)
* Based on <i>Providing Alternatives to Mortgage Foreclosure: A Report to Congress, US Department of Housing and Urban Development, March 1996</i>	
See: www.jchs.harvard.edu/publications/finance/collins_w99-7.pdf	

Works Cited and Additional Resources

- Apgar William C. and Mark Duda. 2005. Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom. A report prepared for the Homeownership Preservation Foundation www.hpfonline.org
- Apgar, Bill, Mark Duda and Rochelle Nawrocki Gorey. 2005. The Municipal Cost of Foreclosures: A Chicago Case Study" Unpublished report prepared for the Homeownership Preservation Foundation.
- Apgar, William and Mark Duda, with Bruce Gottschall, Rochelle Nawrocki Gorey Angie Marks. 2004. Preserving Homeownership: Community-Development Implications of the New Mortgage Market. Neighborhood Housing Services of Chicago. www.nhschicago.org
- Capone, Charles A. 1996. Providing Alternatives to Mortgage Foreclosure: A Report to Congress. Washington, DC: U.S. Department of Housing and Urban Development. <http://www.huduser.org/publications/hsgfin/mortgage.html>
- Collins Michael, and Rochelle Nawrocki Gorey. 2005. Analyzing Elements of Leading Default-Intervention Programs. Unpublished manuscript. www.policylabconsulting.com
- Collins, Michael 2003. "Chicago's Homeownership Preservation Challenge: Foreclosures," presentation to the Federal Reserve Bank of Chicago, February. www.policylabconsulting.com
- Collins, Michael, Eric Belsky and Karl E. Case 2003. "Exploring the Welfare Effects of Subprime Mortgage Lending," a paper presented at the Building Assets, Building Credit Symposium, Harvard University, Cambridge, Massachusetts. www.jchs.harvard.edu
- Cordell, L. 2001. "Innovative Servicing Technology: Smart Enough to Sustain Homeownership Gains?," Research Institute for Housing America: 2001 Conference on Housing Opportunity: Will Technology Expand Housing Opportunity. www.housingamerica.org/downloads/web4.ppt
- Cutts, Amy Crews and Richard K. Green. 2004. "Innovative Servicing Technology: Smart Enough to Keep People in their Homes," Freddie Mac Working Paper #04-03 http://freddiemac.com/news/pdf/fmwp_0403_servicing.pdf
- Duncan, Doug. 2000. Cost Effective Practices. MBA National Servicing Conference San Diego, California June 22. http://www.mortgagebankers.org/present/2000/duncan_0622.ppt#16
- Hornburg Steven P. 2004 Strengthening the Case for Homeownership Counseling: Moving Beyond A Little Bit of Knowledge. Joint Center for Housing Studies of Harvard University. W04-12 www.jchs.harvard.edu
- Gorham, Lucy; Roberto G. Quercia; and William M. Rohe. 2003. Effective Practices in Post-Purchase Foreclosure Prevention and Sustainable Homeownership Programs. Prepared for the Fannie Mae Foundation. Center for Urban and Regional Studies, The University of North Carolina at Chapel Hill. <http://curs.unc.edu/Roheeffectivepracticesfinalreport.pdf>
- Immergluck, Dan and Geoff Smith. 2005. The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime. Promises & Pitfalls: As Consumer Finance Options Multiply, Who Is Being Served and at What Cost? A Federal Reserve System Community Affairs Research Conference Washington, D.C. April 7-8. http://www.chicagofed.org/cedric/files/2005_conf_paper_session1_immergluck.pdf
- Moreno, Ana. 1995. Cost Effectiveness of Mortgage Foreclosure Prevention. Prepared for the Family Housing Fund, Minneapolis, MN. http://www.fhfund.org/educational_materials_reports.asp
- Moreno, Ana. 1998. Mortgage Foreclosure Prevention: Program and Trends. Prepared for the Family Housing Fund, Minneapolis, MN. http://www.fhfund.org/educational_materials_reports.asp
- Quercia, Roberto G., Spencer M. Cowan, and Ana Moreno. 2004. The Cost-Effectiveness of Community-Based Foreclosure Prevention. Joint Center for Housing Studies of Harvard University. BABC 04-18 www.jchs.harvard.edu