

## **Financial Institutions Law Update**

**06/19/2013**

### **Foreclosure Avoidance Mediation Program is Expanding to Include Judicial Foreclosures**

On June 4, 2013, Oregon Governor John Kitzhaber signed into law Senate Bill 558, which expands the Foreclosure Mediation Program created in 2012 to include judicial foreclosures. The original program applied only to nonjudicial foreclosures, and was created in response to the perception that borrowers were not being given an adequate opportunity to work out their delinquencies before losing their properties to nonjudicial foreclosure. Now, lenders will be required to participate in the program, regardless of the foreclosure method that they choose.

Prior to the new legislation, lenders had largely been able to avoid the mediation program by seeking judicial foreclosures instead. While judicial foreclosures require filing a lawsuit and are thus costlier and slower than nonjudicial foreclosures, those disadvantages were largely negated by the mediation requirements applicable at the time to only nonjudicial foreclosures. Judicial foreclosures also provided the clarity, certainty and finality of a judicial decree, thereby averting the all-too-common post-sale challenge to a nonjudicial foreclosure. Since the mediation program began in 2012, nonjudicial foreclosures in Oregon have all but disappeared, and the number of judicial foreclosures pending in Oregon's courts has skyrocketed. Expect to see a further surge of judicial foreclosure activity prior to August 4, 2013 — the date when the new law becomes effective and this avenue around the mediation program is closed — as lenders seek to avoid the costs and other problems associated with the mediation program.

The mediation program requires lenders who intend to foreclose on a residential trust deed to first enter into mediation with the borrower through a program established and administered by the Oregon Attorney General, with the intent to explore an alternative to foreclosure. Lenders are exempt from the program only if they have not commenced more than 175 residential foreclosures (judicial or nonjudicial) within the past year, or if the borrower opts out of the program. (Before the new law, that threshold number of foreclosures was 250, meaning that numerous lenders who were exempt under the former version of the program will now be swept into it.) Further, the legislation allows borrowers on a loan secured by a residential trust deed to initiate mediation with their lenders if a housing counselor certified that they are more than 30 days in default or have a qualifying financial hardship. Failure to comply with the mediation requirements is subject to civil penalties as an unlawful trade practice. Noncompliance in connection with a judicial foreclosure can also result in dismissal of the foreclosure action and an award of attorneys' fees and costs to the borrower.

The mediation program is in many ways problematic. It creates significant delay and cost in mitigating losses on delinquent loans that, in many cases, borrowers cannot realistically repay and lenders have already unsuccessfully sought to modify. The documents that lenders are required to produce under the Attorney General's rules — without any guarantee of confidentiality — could reveal sensitive proprietary information concerning a lender's methodologies for evaluating loans and securitization processes. But if lenders fail to comply, the mediator can refuse to issue the "certificate of compliance" that a lender must have in order to proceed with foreclosure. Worse, because the mediator is hand-picked by the Attorney General's office, there is a risk that he or she may be biased toward borrowers.

The Oregon legislature nevertheless has decided to force lenders to participate in the mediation program. But notwithstanding the legislature's good intentions, the new legislation may have unintended consequences for borrowers as well as lenders. It could cause lenders to think twice before issuing residential home loans in Oregon out of concern that their security interests will be difficult to recover. Rates will likely be higher for the loans that are made, as lenders seek to offset the higher cost of enforcing their security interests. In addition, the residential real estate market may continue to be dampened by the slow trickle of distressed properties entering the market, resulting in slower equity growth and lower sale prices for non-delinquent homeowners.

Now that lenders must accept the mediation program as a cost of doing business in Oregon, perhaps a new paradigm can be established that protects lenders' interests while shielding borrowers from the harsher realities of foreclosure. Mediators could encourage borrowers who have no hope of meeting a reasonable payment schedule to consent to a judgment of foreclosure and deed conveying their redemption rights in exchange for financial assistance in finding a new place to live that they can afford. The borrower could smoothly transition to a more stable living situation, and the lender could close its books on a non-performing asset and move on. The borrower's neighbors would benefit because the home could be sold and would not sit empty for months on end as the redemption period runs. It's not ideal, but perhaps it is a model that everyone can live with.

**For more information, please contact the Financial Institutions Practice Group at  
Lane Powell: [lppc@lanepowell.com](mailto:lppc@lanepowell.com)**

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