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Real estate foreclosures: the effects of the 2015-16 reforms on the length of the proceedings

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Overview

In 2015-16, within a broader reform action aimed at improving the legal framework for the management of non-performing loans, significant changes were made to the rules governing real estate foreclosure proceedings in Italy, also with the objective of speeding up lending recovery. In this note, we use data on individual foreclosure proceedings to analyse the effects of this reform action on their duration. This is done by comparing the length of the main phases of the proceedings before and after the introduction of the new rules. Our results show that the reforms have shortened foreclosure proceedings in Italy: in particular, the median time needed to sell the assets has been reduced by around 40% (from 39.5 to 23.5 months), while the median length of the operations preceding the actual sale has decreased by 11% (from 28.5 to 25.5 months).

1. Introduction and main results

The availability of well-functioning legal tools and procedures for credit enforcement and for the management of corporate insolvency is key for effective NPL resolution. More efficient credit recovery proceedings would contribute to a reduction in the accumulation of NPLs in bank balance sheets during economic downturns and to an increase in recovery rates. In addition, faster proceedings may

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significantly increase the market value of NPLs,¹ thus supporting bank profitability and securitization activity.

In recent years, a wide reform action has been under way to improve the Italian legal framework in this respect. In 2015-16, with two distinct pieces of legislation, a wide array of measures were introduced with the aim of: a) shortening the length and improving the efficacy of credit recovery proceedings (both real estate foreclosure proceedings and bankruptcy proceedings); b) improving the regulation of contractual corporate restructuring tools (judicial compositions with creditors and debt restructuring agreements); and c) introducing an out-of-court mechanism for collateral enforcement.² More recently, in early 2019 a comprehensive reform of the insolvency framework was adopted, which amended all the main insolvency tools, including liquidation procedures and restructuring tools for corporate and personal bankruptcy. These new rules will come into force in full in August 2020.

This note focuses on the 2015-16 reforms of real estate foreclosure proceedings and analyses their impact on proceeding duration in Italy. It builds on a previous and more comprehensive study by the same authors, summarizing and updating its results.³

Real estate foreclosure proceedings play a key role in ensuring credit enforcement, as they are the judicial tools through which creditors, in case of debtor default, recover their credit by the forced sale of debtors' real property. The 2015-16 reforms introduced significant changes to the rules governing these proceedings, with the main objective of reducing their length. To this end, they amended the rules on the *pre-sale phase* of the proceedings (which includes the filing and servicing activities) and on the *sale phase* (that includes the activities related to the sale of the foreclosed asset). The *post-sale phase* (that includes the activities related to the distribution to creditors of the proceeds of the sale) was largely unaffected. More in detail, the 2015 reform set shorter time limits for several procedural activities included in the pre-sale phase. The rules governing the sale phase were instead changed both in 2015 and 2016; the aim was to provide greater flexibility to the price-setting mechanism, thus reducing the probability of having to rely on several auctions to sell the foreclosed assets.

The effects of this reform action are analysed by comparing the length of the pre-sale and sale phases of the proceedings under the old and the new rules. As most proceedings subject to the new rules are still under way, we base our analysis on an *ex ante* measure of length, namely the share of proceedings for which each phase was completed within a certain period of time.

¹ See L.G. Ciavoliello, F. Ciochetta, F.M. Conti, I. Guida, A. Rendina and G. Santini (2016), 'What's the value of NPLs?', Notes on Financial Stability and Supervision, Bank of Italy, Directorate General for Financial Supervision and Regulation.

² For a description of the content of the reforms, see M. Marcucci, A. Pischetta and V. Profeta (2015), 'The changes of the Italian insolvency and foreclosure regulation adopted in 2015', Notes on Financial Stability and Supervision, Bank of Italy, Directorate General for Financial Supervision and Regulation, and E. Brodi, S. Giacomelli, I. Guida, M. Marcucci, A. Pischetta, V. Profeta, and G. Santini (2016), 'New measures for speeding up credit recovery: an initial analysis of Decree Law 59/2016', Notes on Financial Stability and Supervision, Bank of Italy, Directorate General for Financial Supervision and Regulation.

³ S. Giacomelli, T. Orlando and G. Rodano (2018), 'Real estate foreclosures: their functioning and the effects of recent reforms', Questions di economia e finanza (Occasional Papers), Bank of Italy, Directorate General for Economics, Statistics and Research.

The main result is that the reform action reduced the length of the pre-sale and, especially, of the sale phase. More specifically:

- the share of proceedings for which the pre-sale phase was concluded within 12 months increased from 10% before the reform to 19% afterwards;
- the share of proceedings for which the sale phase was concluded within 18 months increased from 17% before the reform to 38% afterwards;
- the median length of the pre-sale phase is estimated to have been reduced from 28.5 to 25.5 months (becoming, as a consequence, about 11% shorter), while the sale phase shrank from 39.5 to 23.5 months (about 40% shorter).

2. Data and estimation methodology

We exploit a unique original dataset compiled using administrative data drawn from the Online Services Portal (*Portale dei Servizi Telematici*) of the Ministry of Justice.⁴ The dataset contains information on all the juridical events that occurred within each foreclosure proceeding initiated in first-instance courts between January 2010 and November 2018.

Based on such detailed information, the proceedings were divided into three main phases (pre-sale, sale and post-sale): the pre-sale phase includes the filing and servicing activities that take place before the court can order the sale of the foreclosed asset (e.g., filing of documentation by the claimant, appointment of the appraiser, submission of the appraisal); the sale phase includes the activities directly related to the sale of the foreclosed asset; the post-sale phase includes the activities related to the distribution to creditors of the revenues of the sales. The data allow us to identify the exact date of ‘milestone events’ signalling the beginning and the end of different phases of the proceedings. In particular, the pre-sale phase starts with the event ‘filing’ (*iscrizione a ruolo*) and ends with the beginning of the sale phase, which corresponds to the first instance of any of the events ‘court order of sale’ (*ordinanza di vendita*), ‘notice of sale’ (*avviso di vendita*) or ‘trustee’s sale’ (*delega per la vendita*). The sale phase ends with the first event that signals that the sale has actually taken place.⁵

To assess the effects of the reforms, we compare the phases of proceedings initiated before the entry into force of the new rules (pre-reform period) with those of proceedings initiated after the new rules were introduced (post-reform period). The simple comparison of the pre- and post-reform duration of concluded phases (i.e., all those phases for which the duration is directly observable) would lead to biased estimates. Indeed, an analysis run on proceedings closed in 2017 after the sale of the assets and the distribution of the proceeds to creditors sets the average duration of foreclosure proceedings at over 5 years, with the pre-sale phase taking a little less than 2 years, and

⁴ The data were made available by Associazione T.S.E.I. and the private company Datasinc s.r.l..

⁵ For instance, ‘issuance of the transfer decree’ (*emissione decreto trasferimento*) or ‘distribution plan’ (*piano di riparto*).

the sale phase being slightly longer than 2 years.⁶ This implies that a significant share of post-reform procedures had not been completed at the reference date (November 2018). Basing our estimates solely on proceedings with completed phases would result in evaluating the post-reform period only through the fastest proceedings, thereby providing an upwardly biased assessment of the impact of the reform.

To overcome this problem, we limit our analysis to the pre-sale and sale phases, which were the ones most directly impacted by the reform, and also those for which we have a reasonable post-reform sample (as only a minority of post-reform proceedings will have reached the post-sale stage). Therefore, we take an alternative duration measurement approach: for each quarter and each phase, we compute the share of proceedings for which that phase was completed within a given time horizon with respect to the population of proceedings for which that phase was initiated in the reference quarter.

Longer time horizons are associated with higher shares of proceedings with completed phases: consequently, the longer the time horizon, the larger the portion of the empirical distribution of phase durations that we are able to estimate. For each choice of the time horizon, a corresponding right tail of the available time window must be dropped. Hence, for instance, in computing the share of proceedings for which the sale phase was completed within 1 year, we are not able to use information from procedures initiated in the last year of our dataset (i.e., after November 2017). Thus, a tradeoff emerges between information loss from dropping more recent proceedings and the ability to calculate the distribution of phase durations.

In light of these considerations, in what follows we limit the reference time horizons to 12 months for the pre-sale phase and 18 months for the sale phase. This allows us to keep enough recent procedures to observe the initial effects of the second reform wave (2016), as well as to reconstruct the bottom half of the duration distributions for both the pre-sale and the sale phase in the pre- and post-reform periods. This enables us to provide estimates of the *median* duration of the two phases in both periods.

In addition to providing descriptive statistics, we also perform regression analyses in order to exploit further information about the proceedings, like the number of judge substitutions during each phase, the occurrence of other delaying events (e.g., oppositions, appeals, postponements) and the involvement of multi-parcel sales.

3. Results

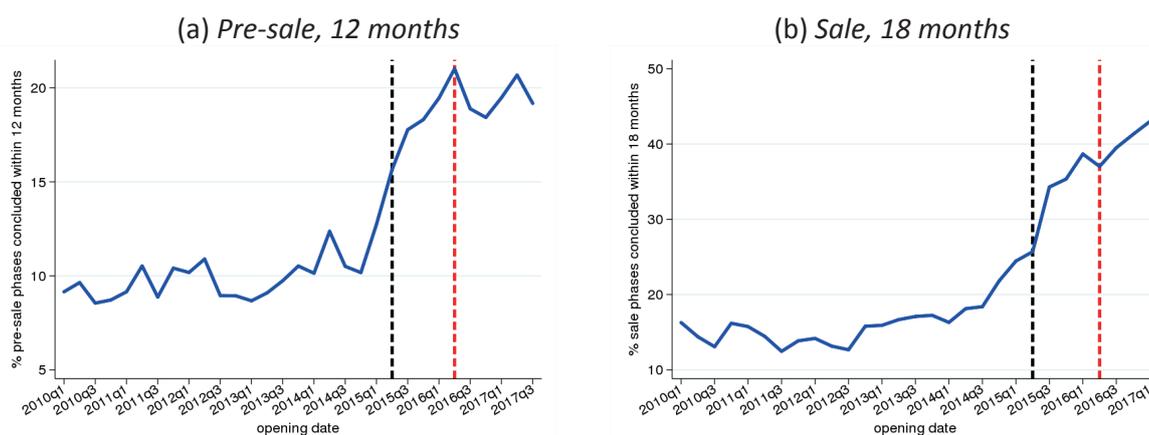
The main results of our analysis are summarized in Figure 1. The two panels report the share of pre-sale and sale phases concluded within 12 and 18 months respectively, by

⁶ There are also other proceedings that are either closed before the start of the sale phase (about 48% of all procedures closed in 2017) or after the start of the sale phase but before the asset is actually sold (15%). These proceedings are not included in our analysis.

the quarter in which the phase started. The vertical lines indicate the entry into force of the two reforms of 2015 and 2016. It is evident that the reform action reduced the length of both the pre-sale and sale phases. The share of proceedings for which the pre-sale phase was concluded within 12 months increased on average from 10% for procedures initiated before the 2015 reform (and therefore subject to the old rules), to 19% for those initiated after the 2015 reform. The results for the sale phase are even stronger. The share of proceedings for which the sale phase was concluded within 18 months was 17% under the old system, and it increased to 38% following the introduction of the new rules.

As can be seen from Figure 1, the duration of both the pre-sale and sale phases already shows some improvement for the proceedings initiated in the quarters immediately preceding the 2015 reform. A possible explanation may reside in some of the new provisions being applied, upon approval of the reform, also to procedures whose relevant phase had begun just before the reform was passed. Moreover, it can be seen that the duration of the pre-sale phase does not shrink further after the second reform wave of 2016, while further improvements can be observed in the duration of the sale phase.

Figure 1: Share of pre-sale and sale phases concluded within the given time horizons

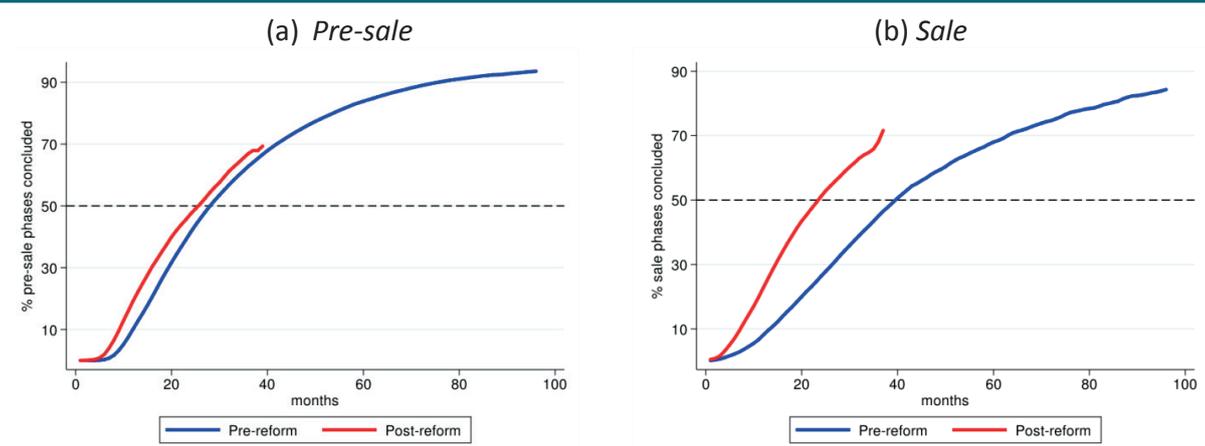


The left panel reports the share of proceedings whose pre-sale phase was completed within 12 months, by the quarter in which the phase started. The right panel reports the share of proceedings whose sale phase was completed within 18 months. The vertical black dashed line represents the date of the 2015 reform. The vertical red dashed line represents the date of the 2016 reform.

As explained in Section 2, by calculating the share of proceedings whose phases are concluded within different horizons, it is possible to estimate the median length of the different phases, before and after the reform, even if not all the phases have been concluded. The results of this exercise⁷ are reported in Figure 2. The median length of the pre-sale phase is estimated to have been reduced by about 11%, from 28.5 to 25.5 months (Figure 2a). The fall in the estimated median length of the sale phase is even larger: around 40%, from 39.5 to 23.5 months (Figure 2b).

⁷ For further methodological details, see S. Giacomelli, T. Orlando and G. Rodano (2018), 'Real estate foreclosures: their functioning and the effects of recent reforms', *Questioni di economia e finanza* (Occasional Papers), Bank of Italy, Directorate General for Economics, Statistics and Research.

Figure 2: Estimated median length of the *pre-sale* and *sale* phases (before and after the reform)



The left panel reports the share of proceedings whose pre-sale phase was completed within different time horizons as a function of the time horizon (in months) for proceedings subject to the rules in place before and after the reform. The right panel reports the same exercise with the share of proceedings whose sale phase was completed within different time horizons. The median duration of each phase, before and after the reform, corresponds to the intersection with the horizontal line.

These descriptive findings are confirmed by the results of a regression analysis. We estimate a linear model of the probability that the pre-sale phase is completed within 12 months, and the sale phase within 18 months, conditional on a post-reform dummy, controlling for court fixed effects, a polynomial time trend and proxies for the complexity of the proceeding.⁸

Table 1: The impact of the reform on the pre-sale phase (within 12 months)

	(1) Base	(2) Court efficiency	(3) Geographic heterogeneity	(4) Court size	(5) Real estate market
Post-reform	0.050*** (0.014)	0.019 (0.018)	0.015 (0.023)	0.052*** (0.018)	0.049*** (0.015)
Post-reform x Efficient		0.054* (0.031)	0.057* (0.031)		
Post-reform x South			0.006 (0.026)		
Post-reform x Big				-0.003 (0.031)	
Time-varying province-level real estate market indicators					X
Time-varying province-level economic activity indicators					X
N	357,679	357,679	357,679	357,679	336,844
Adj. R ²	0.224	0.226	0.226	0.224	0.219

Linear probability models. The dependent variable is a dummy equal to 1 if the pre-sale phase was concluded within 12 months from its starting date. *Post-reform* is a dummy variable equal to 1 if the pre-sale phase started after the 2015 reform. *Efficient* is a dummy variable equal to 1 if the proceedings were managed by an 'efficient' court, that is a court whose average value of the dependent variable calculated before the reform lies above the median. *Big* is a dummy variable equal to 1 if the proceedings were held in a big court, based on the median court caseload before the reform. *South* is a dummy equal to 1 if the court is located in a Southern region. In all specifications we control for proceeding-specific variables like number of judge substitutions (3 dummy variables: one substitution, two substitutions, more than two substitutions), presence of delaying events, multi-parcel proceedings. In all specifications we control for a 3rd order polynomial in time and for court fixed effects. In the specification in column 5 we also include time-varying province-level controls for real estate market (measured by the *real estate market intensity*, calculated as the share of total units in a province which are object of a transaction in a given year) and economic activity (measured by the yearly GDP growth rate at the province level). Standard errors in parentheses are clustered at the court level. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

⁸ In particular, we control for the number of judge substitutions during the given phase, the presence of delaying events (e.g., appeals or postponements) and whether the proceeding involved multi-parcel sales.

The results of the regression analysis are reported in Tables 1 and 2 for the pre-sale and sale phases respectively. This analysis confirms that the reform increased the probability of completing both phases and the effect was larger for the sale phase (see column 1 in both tables). Even controlling for court and proceedings characteristics, the share of proceedings for which the pre-sale phase was concluded within 12 months was 5.0 percentage points higher for post-reform proceedings. The effect of the reform was stronger for the sale phase: the share of proceedings concluded within 18 months was 8.6 percentage points higher after the reform.

The regression analysis also shows that the reform had a greater impact in courts that were more efficient in the pre-reform period for both phases: in column 2 of both tables, we interact the post-reform dummy with a dummy equal to 1 if the court was in the top half of the pre-reform distribution of the dependent variable, and we verify that the effect of the reform is mostly localized within courts belonging to this group.

Introducing a further interaction term (column 3) shows that such heterogeneity does not conceal an underlying geographical heterogeneity as far as the pre-sale phase is concerned, while the efficiency-differentiated effect on the duration of the sale phase indeed seems to dissipate once geographic heterogeneity (in form of a North/South divide) is considered. A similar exercise with a dummy that takes into account court size (column 4 in both tables) shows that the reform had a stronger effect in larger courts, but only for the sale phase.

Table 2: The impact of the reform on the sale phase (within 18 months)

	(1) Base	(2) Court efficiency	(3) Geographic heterogeneity	(4) Court size	(5) Real estate market
Post-reform	0.086*** (0.014)	0.041* (0.022)	0.085*** (0.029)	0.050** (0.023)	0.083*** (0.015)
Post-reform x Efficient		0.071** (0.029)	0.033 (0.034)		
Post-reform x South			-0.078** (0.030)		
Post-reform x Big				0.063** (0.030)	
Time-varying province-level real estate market indicators					X
Time-varying province-level economic activity indicators					X
N	156,355	156,355	156,355	156,355	148,569
Adj. R2	0.222	0.223	0.224	0.223	0.198

Linear probability models. The dependent variable is a dummy equal to 1 if the sale phase was concluded within 18 months from its starting date. *Post-reform* is a dummy variable equal to 1 if the sale phase started after the 2015 reform. *Efficient* is a dummy variable equal to 1 if the proceedings were managed by an 'efficient' court, that is a court whose average value of the dependent variable calculated before the reform lies above the median. *Big* is a dummy variable equal to 1 if the proceedings were held in a big court, based on the median court caseload before the reform. *South* is a dummy equal to 1 if the court is located in a Southern region. In all specifications we control for proceeding-specific variables like number of judge substitutions (3 dummy variables: one substitution, two substitutions, more than two substitutions), presence of delaying events, multi-parcel proceedings. In all specifications we control for a 3rd order polynomial in time and for court fixed effects. In the specification in column 5 we also include time-varying province-level controls for real estate market (measured by the *real estate market intensity*, calculated as the share of total units in a province which are object of a transaction in a given year) and economic activity (measured by the yearly GDP growth rate at the province level). Standard errors in parentheses are clustered at the court level. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

The results reported in column 5 of both tables refer to estimations obtained including time-varying indices of real estate market activity and of economic activity in general, measured at the province level. The robustness of our main coefficient to such inclusion indicates that the duration gains observed after the reform are not attributable to general improvements in market conditions, which may quicken the sale of foreclosed asset.

Furthermore, all our results are robust to the exclusion of proceedings initiated in the period preceding the entry into force of the reform (12 months for the pre-sale phase and 18 months for the sale phase). This enables us to account for the possibility that the reform unintentionally affected proceedings that had started just before the reform. The results are also robust to the clustering of standard errors at the regional level and to the inclusion of region-specific time trends.

4. Concluding remarks

The results of the analysis suggest that the 2015-16 reform wave has substantially reduced the length of foreclosure proceedings, in particular with regards to the sale phase. This may contribute to speeding up the recovery times for creditors in case of debtors' default. Most proceedings initiated after the reform are still under way, implying that the effects of shorter proceedings on creditor and debtor behaviour may become observable only over a longer time span.

The analysis also points out that the efficacy of the reform in shortening the length of foreclosure proceedings varies across courts, even when differences in the allocation of human resources and in caseloads are accounted for. In particular, the fact that the impact of the reform was relatively weaker in courts that showed worse performances before the reform itself suggests that the management of foreclosure proceedings can be improved by spreading the practices of the best-performing courts, beyond what the necessarily uniform regulatory requirements can impose.

Finally, it must be noted that there is still scope for further reducing the length of foreclosure proceedings, in particular for the pre-sale phase. The latter appears to have been only partially impacted by the recent reform wave. While on average shorter than before, the pre-sale phase is likely to persist as a relevant component of proceeding length (e.g., the pre-sale phase accounts for around 40% of the total duration of proceedings concluded in 2017). As much of the pre-sale phase is determined by the duration of procedures carried out by the judge and by court-appointed assessors, any regulations and practices aimed at speeding up the completion of these operations may further contribute to the reduction in the overall duration of foreclosure proceedings.