

Date of Hearing: April 25, 2011

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

AB 935 (Blumenfield) – As Amended: April 14, 2011

SUBJECT: Foreclosures: foreclosure mitigation charges

SUMMARY: Would prohibit a notice of trustee's sale from being accepted for filing with a county recorder until the mortgage servicer pays a foreclosure mitigation charge of \$20,000. Specifically, this bill:

- 1) Requires the county recorder to forward the moneys to the Treasurer for deposit into the Foreclosure Mitigation Fund (FMF).
- 2) States that cost of the foreclosure charge may not be passed on to borrowers.
- 3) Provides that if the foreclosure sale is rescinded, then the county recorder shall return the moneys to the mortgage servicer except any interest that may have been earned while the moneys were held in trust.
- 4) Requires the moneys to be distributed to local agencies in the following way:
  - a) Twenty percent for K-12 and community college purposes;
  - b) Twenty percent for public safety purposes;
  - c) Twenty percent for redevelopment activities;
  - d) Twenty percent for mitigating the effects of foreclosures on the community, including, but not limited to, reimbursement of county recorder's costs in collecting the charge.
  - e) Twenty percent for loans for small business within the jurisdiction of the local agency.
- 5) Exempts from the requirements, a mortgage servicer that is servicing a loan for a mortgage lender with assets below ten billion dollars.
- 6) Exempts a mortgage loan servicer from paying the foreclosure fee for loans owned by any local or state government agency.
- 7) States it is the intent of this section to recoup some of the foreclosure costs currently being borne by the taxpayers of this state.

EXISTING LAW

- 1) Regulates the non-judicial foreclosure process pursuant to the power of sale contained within a mortgage contract, and provides that in order to commence the process, a trustee, mortgagee, or beneficiary must record a notice of default (NOD) and allow three months to

lapse before setting a notice of sale for the property. [Civil Code Section 2924, all further references are to the Civil Code].

- 2) Provides that the mortgagee, trustee or other person authorized to make the sale must give notice of sale, and requires notice of the sale to be made, as specified, at least 20 days prior to the date of sale. [Section 2924f].
- 3) Provides that a mortgage, trustee, beneficiary, or authorized agent may not file a NOD until 30 days after contact has been made with the borrower who is in default. [Section 2923.5a1].
- 4) Requires the mortgagee, trustee, beneficiary or authorized agent to contact a borrower in default in person or by telephone and inform them of their right to a subsequent meeting, and telephone number of the HUD to find a HUD- certified housing counselor. [Section 2923.5a2].
- 5) Allows a borrower to assign a HUD-certified counselor, attorney or other advisor to discuss with the entities options for the borrower to avoid foreclosure. [Section 2923f].
- 6) Provides that a NOD may be filed when the mortgagee, trustee, beneficiary or authorized agent has not contacted the borrower provided that the failure to contact the borrower occurred despite reasonable due diligence on the part of the entity and that "due diligence" means and requires the following:
  - a) The mortgagee, trustee, beneficiary or authorized agent sends a first class letter that includes the toll-free number available for the borrower to find a HUD-certified housing counseling agency; and,
  - b) Subsequent to the sending of the letter the mortgagee, trustee, beneficiary or authorized agent attempts to contact the borrower by telephone at least three times at different hours and on different days. [Section 2923g].
- 7) Requires the mortgagee, trustee, beneficiary or authorized agent to maintain a toll-free number for borrowers that will provide access to a live representative during business hours and requires the mortgagee, trustee, beneficiary or authorized agent to maintain a link on the main page of its Internet Web site containing the following information:
  - a) Options that may be available to borrowers who are unable to afford their mortgage payments and who wish to avoid foreclose, and instructions to borrowers advising them on steps to take to explore these options; and,
  - b) A list of documents borrowers should collect and be prepared to submit when discussing options to avoid foreclosure. [Section 2923g (5)].
- 8) Specifies that the notice and contact requirements do not apply in the following circumstances:
  - a) The borrower has surrendered the property as evidenced via a letter or delivery of keys to the property to the mortgagee, trustee, beneficiary or authorized agent ;

- b) The borrower has contacted a person or organization whose primary business is advising people who have decided to leave their homes on how to extend the foreclosure process and avoid the contractual obligations; or,
  - c) The borrower has filed for bankruptcy. [Section 2923h].
- 9) Makes a legislative findings and declarations that a loan servicer acts in the best interest of all parties if it agrees to, or implements a loan modification or workout plan in one of the following circumstances:
- a) The loan is in payment default, or payment default is reasonably foreseeable; or,
  - b) Anticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis. [Section 2923.6].
- 10) Provides that a notice of sale may not be given for 90 days in order for parties to pursue a loan modification. [Section 2923.52].
- 11) Specifies that a servicer can get an exemption from the 90-day foreclosure moratorium if they demonstrate proof of a comprehensive modification program. [Section 2923.53]
- 12) Requires that upon posting of a notice of sale, the mortgagee, trustee, beneficiary or authorized agent shall mail to the borrower a notice in English and Spanish, Chinese, Tagalog, Vietnamese, or Korean that states:
- "Foreclosure process has begun on this property, which may affect your right to continue to live in this property. Twenty days or more after the date of this notice, this property may be sold at foreclosure. If you are renting this property, the new property owner may either give you a new lease or rental agreement or provide you with a 60-day eviction notice. However, other laws may prohibit an eviction in this circumstance or provide you with a longer notice before eviction. You may wish to contact a lawyer or your local legal aid or housing counseling agency to discuss any rights you may have." [Section 2924.8].
- 13) Provides that a notice of sale postponement may occur at any time prior to the completion of a sale for any period of time not to exceed a total of 365 days from the date set in the notice of sale. [Section 2924g]
- 14) Specifies that if sale proceedings are postponed for a period totaling more than 365 days, the scheduling of any further proceedings shall be preceded by giving a new notice of sale. [Section 2924g]

FISCAL EFFECT: Unknown

COMMENTS:

Background:

The background of the current economic recession is well documented, and its effects, through the foreclosure crisis are easily demonstrated. The Banking and Finance Committee, as well as, other committees have conducted numerous hearings examining the foreclosure issue from multiple angles. According to ForeclosureRadar.com thus far in 2011, in California 74,581 NOD and 74,914 notice of trustee sales (NOT) have been filed. Furthermore, of the loans defaulting the majority tend have outstanding balances between 200-500K. Loans with vintages from 2005-2007 are those still at most risk of foreclosure, though the types of loans defaulting have changed. While many loans still exists of a subprime or non-traditional variety, the last year and a half has seen an increase in defaults on traditional fixed rate loans. Much of the strain in the prime-market, is a result of the greater economic downturn, specifically a double-digit unemployment rate.

Costs of Foreclosure.

The idea behind this bill is that foreclosures create unmitigated costs to local governments and society as a whole, and that mortgage loan servicers should pay for those costs because of a perceived, or real, lack of effort on the part of mortgage loan servicers to modify loans to sustainable levels.

What are the costs of foreclosures to California communities? Generally, one can easily guess at the broader unspecific costs of foreclosure. Likely, a home in foreclosure also equals a homeowner that is not spending money in the local economy, and may be delinquent in paying for local government fees and assessments.

Foreclosure costs are not just born by communities. Mortgage servicers and lenders also face substantial foreclosure losses. An April 2007 report by the Congressional Joint Economic Committee, "Sheltering Neighborhoods from the Subprime Foreclosure Storm" broke down the costs of foreclosure on various entities involved in the process:

- Homeowner: \$7,200
- Lender: \$50,000
- Local government: \$19,227
- Impact on neighbor's home value: \$1,508
- Estimated total cost of foreclosure: \$77,935

The study, *The Municipal Costs of Foreclosures: A Chicago Case Study*, Apgar & Duda, February 27, 2005 (Available at

[http://www.995hope.org/content/pdf/Apgar\\_Duda\\_Study\\_Full\\_Version.pdf](http://www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf))

is the most substantial analysis of municipal foreclosure costs available. This study found that depending on the nature of the foreclosure and the disposition of the property, the municipal costs can range from \$27 to almost \$35,000. Further costs pressures resulting from foreclosures have been covered in *The External Costs of Foreclosure: The Impact of single-Family Mortgage Foreclosures on Property Values*, Dan Immergluck and Geoff Smith 2006. (Available at

<http://www.findaforeclosurecounselor.org/network/neighborworksProgs/foreclosuresolutions/pdf>

[docs/hpd\\_4closehsgprice.pdf](#)). This study found that for every foreclosure within an eighth of mile of a home, results in a .9% decrease in the value of that property. Both studies outline the local government costs, as well as, the costs of foreclosure to public safety and educational institutions. However, these studies do not analyze California so the costs could be more or less. Furthermore, in the Chicago case study, the state of Illinois utilizes a judicial foreclosure system, whereas California generally uses nonjudicial foreclosure for residential property. Judicial foreclosure is typically more expensive.

Arguments in support.

A coalition of supporters writes in support (Following quotes are taken from multiple letters):

*Between 2009 and 2012, it is projected that almost two million California homes will suffer foreclosure. This crisis not only affects those who lose their homes, but our communities as a whole. Neighbors suffer from reduced property values; local governments lose property tax income; school enrollment declines and law enforcement sees increased calls and violent crimes...*

*...AB 935 addresses this problem by requiring mortgage servicers to pay a \$20,000 community reimbursement charge before foreclosing on a home. This charge goes entirely to local communities in order to offset the costs borne by our neighborhoods because of foreclosures. The monies are divided evenly between public safety, public education, local governments, redevelopment activities and small businesses. This bill will inject much needed funds into our neighborhoods and help to reverse the effects of the housing crisis...*

*...The state needs to have a bold policy to address the costs of foreclosures. Right now, California taxpayers are bearing the full expense of the foreclosure mess. Banks must be part of the solution to the problem they helped create.*

*The foreclosure fee (AB 935) addresses the costs of foreclosures by requiring mortgage servicers to pay just a portion of the costs with a \$20,000 community reimbursement fee before foreclosing on a home.*

*AB 935 provides an added financial incentive for mortgage servicers to modify loans as an alternative to foreclosure. However, if the servicer proceeds with a foreclosure, they pay the fee. Over the next two year, a foreclosure fee would generate an estimated \$12 billion. The revenue would go entirely to local communities in order offset the multiple costs borne by our neighborhoods because of foreclosures. The revenue is shared evenly between public safety, public education, local governments, redevelopment activities, and small businesses. This solution would inject desperately needed funds into our neighborhoods struggling to recover from foreclosures and its impacts.*

*California cannot afford to sit by and let bank foreclosures sap their communities and drain billions from public budgets. Mortgage servicers have been slow to modify home loans and need to pay their fair share of costs to restore communities.*

Arguments in opposition.

A coalition of opponents write:

*The TAX imposed by this measure will be passed on to either new borrowers purchasing residential property and/or will be paid by the actual holder of the mortgage note. The proposed TAX will further increase the costs associated with purchasing a home. This is particularly alarming given that interest rates are likely to rise, down payments are increasing, conforming loan limits are likely to be reduced and there is little private, secondary market capital interest in real estate lending...*

*Collectively, the government sponsored entities known as Fannie Mae and Freddie Mac, the Federal Housing Administration and the Veterans Affairs own or guarantee the majority of mortgage debt and they have recently been responsible for financing nearly 90 percent of all new loans. In most cases, the TAX proposed under this measure is payable by the federal government and therefore the taxpayers. Given that taxpayers already subsidize the federal government's involvement in mortgage lending, this will result in double taxation...*

*... While saddling other entities with this substantial new TAX, the measure does absolutely nothing to improve the borrower's underlying financial condition. For those unable to pay and where there are no other foreclosure avoidance solutions available to that borrower, foreclosure must still proceed, notwithstanding the TAX. In fact, if the author were successful at delaying or disincentivizing foreclosures, the result would be to exacerbate the very problem the author is purportedly attempting to fix. Delays in the foreclosure process undoubtedly will reduce income to local government from unpaid taxes, will encourage blight and will forestall economic recovery...*

Issues and questions for discussion.

This bill raises many questions and policy issues that require careful consideration. While, attempting to help homeowners is a laudable goal, the law of unintended consequences needs to be considered in the context of broader impacts and unanswered questions.

- 1) In support of this bill proponents have outlined the revenue that this foreclosure charge could bring in to the state to mitigate foreclosure costs to state and local government. At the same time, proponents have also pointed out that the fee is also designed to prevent foreclosure by forcing servicers to pay such a large monetary price to foreclose that they will be more likely to engage in loan modifications. This would appear to be conflicting goals, as either this is meant to generate revenue or prevent foreclosure, but not both. If foreclosures slow down or stop, then this proposal will not generate revenue.
- 2) This would apply to primary and non-primary residences. A servicer would be required to pay a fee under this bill, irrespective of whether the home is a vacation or rental property.
- 3) A mortgage loan servicer would have to pay the fee even in those cases where a borrower strategically defaults, or is simply unable to afford the mortgage even under more favorable terms and conditions. In the first case, the servicer faces the issue of a borrower who can otherwise afford a property, but determines due to negative equity considerations, that they

should walk away from the property. In the second case, you may have a borrower that even under the conditions of a loan modification, still may not be able to afford the loan and the home goes into foreclosure. In both cases, the servicer would be required to pay the 20,000 to file the sale notice. Additionally, if the premise is true, that the fee will encourage modifications, at what point should one judge that sufficient modification offers and attempts have been made? Does it matter that a servicer may have attempted modification? Under this bill, no matter how many offers of modification have been made, or even if the borrower defaults on an existing modification (re-default), the servicer would still have to pay the fee.

- 4) The costs of mortgage loan servicing are assumed by the holder of the loan, or in some cases by the borrower (late payment fees, etc). Mortgage loan servicers operate under various models. Some servicers only do mortgage loan servicing for the owners of the loan, and others are the servicing entities of large or small financial institutions that may service for their own portfolio, or service mortgages for other entities, such as secondary market participates. The costs associated with foreclosure are passed on ultimately to the owner of the loan. Fannie Mae, Freddie Mac and Ginnie Mae are the major secondary market purchasers of mortgages and hold 80% of the outstanding principle of mortgages that are serviced by commercial banks in their capacity as servicers. (For an explanation of these entities and their role in the mortgage market, staff suggest reading *Fannie Mae and Freddie Mac at Work in the Secondary Mortgage Market*, by Michael Padhi, senior economic analyst Federal Reserve Bank of Atlanta, accessible at [http://www.frbatlanta.org/pubs/financialupdate/financial\\_update-vol\\_14\\_no\\_1-fannie\\_mae\\_and\\_freddie\\_mac.cfm?redirected=true](http://www.frbatlanta.org/pubs/financialupdate/financial_update-vol_14_no_1-fannie_mae_and_freddie_mac.cfm?redirected=true)) Under the Troubled Asset Relief Program (TARP), Fannie and Freddie have already received an infusion of \$153 billion of taxpayer money, and some estimates believe that to fully cover Fannie and Freddie losses related to mortgages may cost the government an additional \$363 billion.

The point in this discussion is that the costs of the fee required in this bill will be passed on to the owner of the mortgage loan, and in some cases this could represent a large payment of taxpayer dollars.

This bill also states that the costs of the fee cannot be passed on to borrowers. It is not specific in regards to whether this is current or future borrowers. None the less, while the actual fee may not be directly passed on in the form of an itemized charge, future borrowers may potentially see the impact of this fee in the form of higher rates or increased closing costs.

- 5) Clearly, foreclosures have impacted the broader economic conditions in California, ranging from declines in tax revenue, the rise in unemployment and costs to local government. However, very little data exists that point to the specific costs of foreclosures in California. Much of the data justifying the size of the fee is based on a study (*The Municipal Costs of Foreclosures: A Chicago Case Study*, Apgar & Duda, February 27, 2005) concerning the impact of foreclosures in Chicago. It is unclear how the analysis of foreclosure in Chicago translates to the costs of foreclosure in California. The Apgar & Duda study found the costs ranged from \$27 to \$35,000 under various scenarios. Additionally, another factor that could contribute to the higher ranges for costs in Chicago is that Illinois is a judicial foreclosure state requiring court intervention and all of the fees and costs associated with it to complete a foreclosure. The Congressional Joint Economic Committee, also broke down the costs associated with foreclosure and in addition to Apgar & Duda found that foreclosure costs

lenders \$50,000.

- 6) This bill exempts entities servicing for a mortgage lender with assets below ten billion dollars. The exemption is drafted in such a way as to exempt those entities that are mortgage lenders, however not every entity that owns a mortgage loan with assets below \$10 billion is a mortgage lender.

Proposed amendment.

The author's staff has indicated the desire to amend the bill to limit its application to only those loans that exist at the time of enactment of the legislation in an attempt to mitigate potential costs to future mortgage borrowers. This amendment would mean that if a loan was originated after January 1, 2012 and then fell into foreclosure, a fee would not be required to process the trustee sale notice. This may address long term costs, but it does not account for how the ongoing costs of pre-2012 mortgages in foreclosure will be recouped or passed along to various entities in the mortgage finance system.

REGISTERED SUPPORT / OPPOSITION:

Support

Alliance of Californians for Community Empowerment (ACCE)  
Aspera Housing, Inc.  
California Coalition for Rural Housing  
California Council of Churches/California Church IMPACT  
California Federation of Teachers (AFT)  
California Nurses Association  
California Partnership  
California Professional Firefighters – Support If Amended  
California Reinvestment Coalition (CRC)  
California Teachers Association  
Center for Responsible Lending (CRL)  
Chrysalis Consulting Group, LLC  
Civic Center Barrio Housing Corporation  
Community Legal Services of East Palo Alto  
Congregations Building Community  
Consumer Attorneys of California  
Consumers Union  
Contra Costa Interfaith Supporting Community Organization (CCISCO)  
Council of Mexican Federations  
Dolores Huerta Foundation  
Fair Housing Law Project, a project of the Law Foundation of Silicon Valley  
Greenlining Institute  
Housing and Economic Rights Advocates  
InnerCity Struggle  
LA Voice  
MAAC Project of San Diego County  
National Asian American Coalition  
National Council of La Raza



National Housing Law Project  
Neighborhood Housing Services of Silicon Valley  
Oakland Chapter, NAACP  
One LA  
PACE  
Pacoima Beautiful  
Peninsula Interfaith Action (PIA)  
PICO California  
SEIU United Long Term Care Workers (ULTCW)  
SEIU/UHW  
Service Employees International Union (SEIU)  
Tenants Together  
The American Federation of State, County and Municipal Employees (AFSCME)  
The San Mateo County Central Labor Council  
Vallejo Neighborhood Housing Services, Inc.  
Vermont Slauson Economic Development Corporation

Opposition

California Association of Realtors  
California Bankers Association  
California Chamber of Commerce  
California Credit Union League  
California Financial Services Association  
California Land Title Association  
California Mortgage Bankers Association  
California Taxpayers Association  
Securities Industry and Financial Markets Association  
United Trustees Association

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081