4.2 Reducing harm from foreclosed properties

This set of policies is intended to limit the spillover effects from foreclosed properties by enforcing codes on vacant properties and supporting funds for acquisition-rehabilitation-resale programs. These strategies are designed to mitigate the impacts that foreclosed homes may have on the community by becoming blighted, a public nuisance, or otherwise contributing to unsafe, unhealthy, and unlawful activity. Additionally, these efforts can reduce the burden felt by tenants living in owner occupied properties, who often have their utilities shut off and are asked to leave despite existing tenant protections. Specific strategies include:

- *Enforcing codes to mitigate the harm of vacant foreclosed homes.* Both the City and County of Sacramento have adopted ordinances to prevent vacant properties from becoming blighted. These ordinances set minimum standards for the exterior maintenance of vacant properties and allow for fines to be imposed on owners who neglect to maintain their properties. Increased foreclosure activity has resulted in a greater number of vacant REO properties. The city and county should be prepared to enforce the ordinances so that these foreclosed homes do not cause blight in the communities. In Buffalo, NY, a city prosecutor has brought lenders to court to hold them accountable for the maintenance of their vacant REO properties. The City of Lawrence (Massachusetts) is seeking to require lenders to register foreclosed properties with the City in order for the City to ensure the properties are maintained.[29]

- *Supporting fund for nonprofits to acquire, rehabilitate and resell foreclosed properties.* As a result of the foreclosure crisis, many cities are exploring strategies to handle the volume of vacant properties. Vacant properties can be costly for city governments to secure and maintain. Some cities have been working to get these properties into the hands of nonprofit housing developers to rehabilitate and resell properties to low- and moderate-income and minority, first-time homebuyers. Such strategies typically require raising private investments and accessing federal grants. The San Diego City-County Task Force is trying to create a land bank where nonprofit organizations would buy empty houses in bulk from a lender and reserve them for low-wage workers. The City of Brockton, MA is working with a charitable foundation and a state agency to acquire bank owned properties and turn them into family housing.[30] Congress is currently considering a special CDBG allocation targeted for these purposes. Additional best practices are available from the National Vacant Properties Campaign.[31]

- *Educating tenants and banks about tenant rights.* Many tenants do not know what their rights are if their home is foreclosed upon. Many banks that take back properties through foreclosure are either unaware of the rights of tenants, or choose to disregard those rights in the hopes of reselling properties, preferably unoccupied. The City and County of Sacramento could conduct outreach to educate tenants and foreclosing banks about their respective rights and responsibilities. The City of Boston has begun such efforts.[32]

[29] Janna Tetreault and Ann Verrilli, "Addressing the Foreclosure Crisis: State and Federal Initiatives in Massachusetts." Citizens' Housing and Planning Association. March 2008, p. 16.
[30] Id. at p. 17.
[31] www.vacantproperties.org.
[32] Id. at p. 16.

4.3 Preventing risky loans from being made in the future

This set of policies aims to reduce the number of loans that put families at risk of foreclosure through regulation and consumer education. Specifically, they include:

- *Recommending or requiring consumer education and counseling.* As proven in several studies, housing counseling programs can help prevent foreclosures. Many municipalities and public agencies, including SHRA in its mortgage assistance and development assistance programs, promote or require pre-purchase homeownership education for their mortgage assistance or affordable housing programs. AB1830 by Assemblymember Ted Lieu would require home loan counseling for certain borrowers on certain loans.

- *Supporting regulations on loan products.* The Home Ownership and Equity Protection Act (HOEPA) of 1994 includes provisions regarding refinance and equity loans with high rates and fees, such as requiring disclosures and banning certain product features. The Federal Reserve Board currently has an open comment period out on a proposal to enhance the HOEPA regulations. California is one of 30 states to have passed a law to augment HOEPA.

- *Eliminating "bad actors".* When fraudulent activity occurs, it is important for legal action to be pursued so that individuals or institutions will not be able to take advantage of others. The county district attorney or a city attorney could pursue legal action in cases of fraud or deception. Recently, the cities of Cleveland and Baltimore filed lawsuits against the lenders with the most foreclosures for their municipal costs of the foreclosure crisis.

5.0 Conclusions

Ranked fifth nationally by foreclosure rate, Sacramento has been particularly hard hit by the current foreclosure crisis as its housing market progressed rapidly through a boom and bust cycle. In 2007, nearly 18,000 households defaulted, and more than 7,000 of them lost their homes through foreclosure. It is estimated that the foreclosures that occurred in 2007 have already cost homeowners, neighbors and local government billions of dollars. As the housing market continues to decline and more ARM resets occur, it is anticipated that thousands more families will enter into the foreclosure process over as long as the next two years. The ongoing crisis threatens to create a number of negative social and economic impacts for Sacramento's families and neighborhoods that could take years from which to recover.

The city, county and SHRA have an opportunity to play a key role in addressing Sacramento's foreclosure crisis by focusing on three types of policies – those that help borrowers in default, those that reduce the harm from foreclosed properties and those that prevent risky loans from being made in the future. Such policies can mitigate the harm of foreclosures in Sacramento, thus protecting the health and vitality of families, neighborhoods and the local economy.

FEDERAL AND STATE LEGISLATION ON THE SUBPRIME MORTGAGE FORECLOSURE CRISIS

Foreclosure Prevention Act of 2008 HR 3221 (formerly Reid S. 2636)

Compromise legislation announced April 2 provides funding for local and state governments and tax incentives for home purchasers and builders to deal with different aspects of the foreclosure crisis. (Co-sponsors of the original legislation included Senators Boxer and Feinstein.) Following are the bill's current provisions, prior to the Senate's floor debate and final action, which is expected the week of April 7:

- $10 billion one-time increase in tax-exempt private activity bond cap to enable local and state housing finance agencies to refinance subprime loans (not previously allowed), provide assistance to first-time homebuyers, and develop multifamily housing. The increase would be allocated among states on the basis of population.

  Subprime mortgages are defined as adjustable rate single family loans originated between December 31, 2001 and January 1, 2008 that the bond issuer determines would cause financial hardship if not refinanced. The California Debt Limit Allocation Committee (CDLAC) does not know whether any other restrictions will apply, such as the default status of the homeowner.

  Impact: if this provision passes, SHRA could apply to CDLAC for authorization to issue tax-exempt mortgage revenue bonds to refinance subprime loans. (We still have the problem of the mortgage holder's willingness to allow a refinance at the home's current value, rather than the loan's outstanding balance.)

- $4 billion in CDBG funds for purchase, rehabilitation and re-sale or rental of abandoned or foreclosed homes. Funds may be used for loans, grants or other financing mechanisms to nonprofit housing and community development organizations. HUD will prepare an allocation formula based on state and local foreclosure and default rates and numbers. Homes purchased must be at or below a recent appraisal. Households may be assisted up to 120 percent of area median income.

- $100 million in foreclosure counseling to Neighborhood Reinvestment Corporation (local NRC agencies are NeighborWorks and Sacramento Mutual Housing Association).

- $7,000 tax credit to purchasers of newly built homes or properties in default or foreclosure.

- $6 billion for in tax rebates for home builders, allowing them to claim current losses against taxes paid in prior years.

- Increase in the standard income tax deductions for property taxes by $500 for single filers and $1,000 for families.

- Increase in the Federal Housing Administration's (FHA) loan limit to 110 percent of an area's median home price and an increase in FHA's downpayment requirement to 3.5 percent (from 3 percent).

- Foreclosure protections for active-duty soldiers.

- Simplified disclosure on mortgage documents (Truth in Lending Act amendments)

Hope for Homeowners Act (Dodd)

On March 13, 2008, Senator Christopher Dodd, chair of the Senate Committee on Banking, Housing and Urban Affairs, released his proposal to help refinance at-risk borrowers into viable mortgages by allowing the Federal Housing Administration (FHA) to insure refinanced mortgages that have been substantially reduced by mortgage holders and lenders. Sharing some similarities with Representative Barney Frank's "FHA Housing Stabilization and Homeownership Retention Act" (see below), the proposal is receiving intense review and is subject to change. Highlights of the proposed legislation follow:

- Administration: the program will be overseen by a Board made up of the Secretaries of HUD and the Treasury and the chairman of the FDIC.

- Eligible borrowers: owner-occupants of principal residences. The Board will establish standards for repayment ability.

- New loan amount: the size of the new FHA-insured loan will be determined by the lesser of: 1) the borrower's repayment ability, based on FHA requirements and taking into account total debt-to-income ratios (residual income), or 2) the amount of the existing loan minus a discount established through an auction process established by the Board. The auction process will allow for bulk refinances of eligible loans at a discount. The federal government will not take possession of the mortgages.

- Loan terms: FHA will not insure more than 90 percent of the home's current value. The loan will be a fixed rate, 30-year loan.

- Equity sharing: upon sale, refinance, or other disposition, the borrower will share equity with FHA according to a phase-in plan over five years.

- Subordinate liens: all existing subordinate liens must be extinguished prior to participation in the program.

- Funding: $20 billion in credit subsidy, expected to insure new affordable loans that refinance approximately $400 billion in troubled mortgages.

- New Fannie Mae and Freddie Mac requirements: The two government enterprises would have a new goal that would require them to purchase eligible loans at a discount and write down those mortgages according to the borrower's repayment ability. They would be authorized to raise additional capital commensurate with the additional risk.

Home Ownership Preservation and Protection Act (Dodd) S. 2452

Introduced December 12, 2007; referred to Senate Banking, Housing and Urban Affairs Committee. 18 co-sponsors, including Senators Boxer and Feinstein

- Basic consumer protections: creates a duty for mortgage brokers to consider the best interests of their clients, as is now required of depository lending institutions, and provides for a duty of good faith and fair dealing toward borrowers for all lenders.

- Steering: prohibits steering prime borrowers into more expensive subprime loans.

- Income verifications: requires lenders to conduct meaningful analysis of borrower's ability to repay the loan (prohibits "no doc" or no stated income loans).

- Fees: prohibits prepayment penalties and "yield spread premiums." The latter encourages mortgage brokers to place borrowers into excessively expensive loans by providing a higher fee to the broker.

- Benefits: requires that home loans provide a net tangible benefit to the borrower.

- Enforcement: allows state attorneys general to enforce the law, and provides that the law does not override state laws.

- Liability: unlike current law, allows the borrower to go directly to the current mortgage holder for a cure in the case of a violation, rather than putting the burden on the borrower to find the party responsible.

Helping Families Save Their Homes in Bankruptcy Act (Durbin) S. 2136

Introduced October 3, 2007. Referred to Senate Judiciary Committee. Senators Feinstein and Boxer are co-sponsors.

- Amends federal bankruptcy law to permit homeowners in Chapter 13 proceedings to restructure the mortgage on their primary residence if strict income and expense criteria are met.

- Allows borrowers a 30-year repayment period at a fixed rate of interest.

- Permits bankruptcy judges to waive prepayment penalties and requires notice during the bankruptcy case of any lender fees and charges that may be added to the mortgage debt.

- Exempts up to $75,000 of the value of a principal residence from being used to pay creditors if the homeowner is 55 or older.

FHA Housing Stabilization and Homeownership Retention Act of 2008 (Frank)

On March 13, 2008, Representative Barney Frank, chair of the House Financial Services Committee, released his proposal to help refinance at-risk borrowers into viable mortgages by allowing the Federal Housing Administration (FHA) to insure refinanced mortgages that have been substantially reduced by mortgage holders and lenders. The proposal would also authorize a loan and grant program to states for the acquisition and rehabilitation of foreclosed properties. The proposal is receiving intense review and is subject to change. Highlights of the proposed legislation follow:

- Eligible borrowers: owner-occupants of principal residences who lack the capacity to pay their existing mortgages (as shown by a total mortgage debt-to-income (DTI) ratio of greater than 40 percent).

- Existing loan reduction: the existing senior mortgage holder would have to write down the existing loan to 85 percent of the property's current value to meet FHA's 90 percent loan-to-value requirement plus five percent for an FHA loan loss reserve. Existing mortgage holders would have to waive all prepayment, default and delinquency fees and penalties.

- New FHA loan: the new mortgage is a fixed rate loan based on the current appraised value of the home and the borrower's documented repayment ability. (A borrower cannot be denied based solely on a FICO credit score or on any delinquency or default under an existing mortgage.) The borrower's total debt-to-income ratio should not exceed 40 percent, with an exception allowed up to 50 percent DTI ratio if six months of timely mortgage payments had been made.

- Government "exit premiums" (equity recapture): The government will take a second lien on the property, due on sale, refinance, or other disposition. Out of any net profits the borrower will pay the greater of: 1) three percent of the original loan amount, or 2) a declining percentage of any profits beginning with 100 percent in year one and reduced 20 percent each year thereafter. At year five, only the three percent exit premium applies.

Loans and Grants to States for Foreclosure Relief

- The bill provides for $10 billion in loans and grants to states for the purchase and rehabilitation of vacant foreclosed homes. The amount received by states is based on its percentage of foreclosures, adjusted for the state's median home price.

- States can allocate funds to government entities, nonprofits and for-profits for the acquisition and rehabilitation of owner-occupied foreclosed housing. Funds for foreclosed rental housing (defined as 20 units or less and predominately vacant) are restricted to government entities and nonprofits.

- Loans are zero interest with two-year terms for homeownership and five-year terms for rentals. Grants (up to 25 percent of a state's allocation) may be used for a variety of holding costs, administrative costs, and downpayment and closing cost assistance.

- Homes purchased for resale must be sold to families with incomes not exceeding 140 percent of the area's median income. Rental properties must serve families having incomes not exceeding 100 percent of area median income. States are required to give preference to entities serving the lowest income households for the longest periods.

Emergency Home Ownership and Mortgage Equity Protection Act (Miller)
HR 3609

Introduced September 20, 2007. Reported out of Judiciary Committee December 12 on vote of 17-15. Current bankruptcy law allows court-supervised loan modifications under a chapter 13 payment plan for commercial real estate (including yachts), but not for homeowners.

- Amends federal bankruptcy law to allow court-supervised loan modifications for the principal residence of a homeowner under a chapter 13 payment plan. This provision is limited to homeowners with insufficient income to pay their mortgage and who have received notice that foreclosure is imminent.

- Requires that principal balance of loan not be reduced below the value of property, that the term be 30-years, and interest be set at a commercially reasonable market rate.

- Applies only to subprime and non-traditional loans (i.e., interest-only and payment option adjustable rate mortgages)

- Prohibits lender from adding fees or charges while the case is pending unless notice is given to both the debtor and the bankruptcy trustee.

- Eliminates pre-petition bankruptcy counseling if a lender has initiated foreclosure on the homeowner's principal residence.

Federal Reserve Proposed Standards for Home Loan Originators

On December 18, 2007, the Federal Reserve proposed new rules expected to regulate the types of reckless lending practices responsible for the subprime mortgage crisis. Its new standards for home loan originators unfortunately do not, in the opinion of consumer and housing finance organizations. The following comments are from an *analysis by the Center for Responsible Lending. Comments on the proposed rules are due March 18, 2008. Five major predatory practices are highlighted.*

- Prepayment penalties: Referred to as "exit taxes" on subprime loans, prepayment penalties trap borrowers in subprime loans. The proposed rule only slightly limits prepayment penalties on adjustable rate mortgages and otherwise allows them to remain effective for five years, with no limit on their size.

- Yield-spread premiums: mortgage brokers receive higher fees for originating higher interest subprime loans (when many borrowers, estimated at 20 to 40 percent, would qualify for less expensive financing). These practices remain unregulated in the Federal Reserve's proposals, with the exception of the requirement that yield spread premiums must be disclosed in writing.

- Ability to repay: a large part of the subprime mortgage crisis is due to lenders making loans to families without ensuring that they have the ability to repay. The proposed rule applies this ability-to-repay standard to subprime lenders, but makes the rule unenforceable by requiring the borrower to document that the lender was engaged in a "pattern or practice" of such lending. In past Congressional testimony, the Federal Reserve acknowledged that the rule was meaningless. "As a practical matter, because individual consumers cannot easily obtain evidence about other loan transactions, it would be very difficult for them to prove that a creditor has engaged in a 'pattern or practice' of making loans without regard to homeowners' income and repayment ability."

- Verification of income: the proposed rule would require income documentation for subprime borrowers, but did not require it for "non-traditional loans," those allowing deferred payment of principal or interest (such as payment option adjustable-rate mortgages).

- Escrow of taxes and insurance: many subprime loans were marketed with artificially low monthly payments by excluding taxes and insurance. The Federal Reserve would now require that they be escrowed, but allows a one year opt-out.

STATE LEGISLATION

Use of Redevelopment Tax Increment Funds (Mullin and Nunez) AB 2594

- The California Redevelopment Association is proposing changes to redevelopment law to allow the use of both housing setaside and capital ("80 percent") funds to prevent subprime mortgage foreclosures and support low/moderate income homeownership of foreclosed properties.

- Eligible activities include refinancing; the purchase, rehabilitation and resale of foreclosed properties; and credit counseling. The legislation proposes modifications of the term of affordability covenants, certain underwriting standards, and accounting for production.

- The CRA provisions should be added to the legislation shortly.

Proposed legislation

The following bills in the state legislature all deal with regulating the mortgage business to avoid some of the conditions contributing to the subprime lending crisis. There are not any funding bills to provide resources to local government.

Subprime Lending Reform Act (Lieu) AB 1830

Introduced on January 23, 2008, the bill has been referred to the Assembly Banking and Judiciary Committees. The bill has 36 co-sponsors and appears to be the lead legislation on subprime mortgage reform.

The bill redefines a "covered loan" as a "high cost loan", and establishes "subprime loans" and "nontraditional loans" as subject to regulation. High cost and subprime loans are both defined by differences between their interest rates and the yields on Treasury securities or conventional mortgages. Nontraditional loans are those that allow borrowers to defer principal and/or interest payments. The summary below pertains to all three loan types, although there are slight differences with high cost loans.

- Requires the lender's reasonable belief that borrower is able to make the required loan payments along with property taxes and insurance. Interest payments must be based on a fully indexed rate. Adds a "rebuttable assumption" that the borrower's total monthly debts should not exceed 45 percent of monthly gross income.

- Requires income verification as well as debt-to-income ratios and residual income information to determine borrower's ability to repay the loan (prohibits "no-doc" loans).

- Does not allow a loan to contain negative amortization (where the payment schedule causes the principal balance to increase).

- Prohibits prepayment fees or penalties.

- Establishes that any refinancing must result in a net tangible benefit to the borrower. The lender also cannot encourage a default on an existing loan in order to refinance it with a subprime or nontraditional loan.

- Prohibits steering – directing a borrower to a more costly loan than they qualify for.

- Prohibits "yield spread premiums" or other incentive compensation that is based on the high subprime interest rate.

- Does not allow an increase in the interest rate as a result of a default; loans also cannot contain a call provision that permits the lender, in its sole discretion, to accelerate the indebtedness except in the case of foreclosure, sale, or fraud.

- Requires the establishment and collection of a monthly escrow for property taxes and hazard insurance; the impound account must remains in existence for five years and until the borrower has sufficient equity to eliminate private mortgage insurance.

- Establishes a Consumer Caution Notice to be disclosed to the borrower and signed prior to loan closing.

Mortgage Lending (Lieu) AB 69

Introduced December 4, 2006; passed by Assembly and referred to Senate Banking, Finance, and Insurance Committee.

- The bill requires mortgage lenders to report on their loan loss mitigation efforts for subprime and alternative mortgage products serviced by those entities. The data includes the volume of loans in default and foreclosure and the disposition of loan modifications, including deeds in lieu, short sales, forbearances, refinancings, reduction of interest rates, extension of loan terms, and reduction of principal balances.

- Subprime loans would be reported by loan type: hybrid adjustable rate mortgages (ARMs), fully amortized adjustable and fixed rate loans, loans with interest only features, payment option ARMs, and loans with negative amortization.

- The bill is intended to follow up on the work of the Department of Corporations and its voluntary collection of loss mitigation data with a requirement on mortgage lenders to provide the data on an ongoing basis. Other than gaining transparency in loan loss mitigation, the data should help policy makers determine the obstacles to loan modifications.

- Information would be posted on the web sites of the Department of Corporations and the Department of Financial Institutions.

Mortgage Debt Forgiveness (Machado) SB 1055

Introduced January 7, 2008, referred to the Senate Revenue and Taxation Committee.

- Allows borrowers whose lenders agree to forgive some or all of their mortgage debt to exclude that forgiven debt from their income for state tax purposes. (Conforms California tax law to the federal Mortgage Debt Relief Act of 2007)

Home Financing Programs (Correa) SB 1065

Introduced February 8, 2008, referred to the Senate Transportation and Housing Committee.

- Authorizes local governments to offer refinancing of home mortgages and reverse home mortgages as part of their home financing programs. Existing law prohibits refinancing unless substantial rehabilitation is undertaken as part of the loan, a condition eliminated in this bill.

- Establishes income limits for participation in local government home financing programs.

Foreclosure Consultants (Bass and Lieu) AB 180

Passed by Assembly, sent to Senate Judiciary Committee

- Increases the regulation of foreclosure consultants who offer to rescue borrowers and requires them to register with the Department of Justice. Among other provisions, it would prohibit foreclosure consultants from contracting with an owner to obtain the remaining proceeds from a foreclosure sale of his residence. It permits an owner to cancel a contract up to five days after execution.

Assigning Liability for Wrongful Practices (AB 2359)

Assembly member Dave Jones is proposing legislation ensuring that lenders and purchasers of mortgage backed securities cannot cut of their liability for failure to comply with their legal obligations in mortgage lending. The proposed bill also prohibits mandatory arbitration in dispute resolution, a practice found in subprime lending that requires borrowers to waive their rights to defend against foreclosure in a court of law, making it difficult to seek meaningful redress.

Notification for Delinquencies and Fines for Deteriorated Properties

Senate Bill 926 (Perata), which was defeated by one vote, will be returning in this legislative session. It provided for enhanced notification of borrowers in default, established tenant protections for defaulted rental property, required documentation of loan modifications, and allowed local governments to fine deteriorated properties.

Foreclosure Counseling

The California Reinvestment Coalition (CRC) has raised $5.1 million from nine financial institutions and two foundations to increase the number of mortgage counselors in the state. Proposals from nonprofit counseling agencies should result in an average grant of $100,000. Sacramento's HUD-approved counseling agencies are applying for the grants.

The National Foreclosure Mitigation Counseling Program, administered by Neighborworks America, received $180 million from Congress for homeowner foreclosure counseling. The California Housing Financing Agency and Rural Communities Assistance Corporation received $8 million from that appropriation for reallocation to approved counseling agencies in California.