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BILL ANALYSIS

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House Bill 4453 (Substitute S-1 as passed by the Senate)
House Bill 4454 (Substitute S-1 as passed by the Senate)
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Sponsor: Representative Shanelle Jackson (H.B. 4453)
Representative Andy Coulouris (H.B. 4454)
Representative Bert Johnson (H.B. 4455)
House Committee: Banking and Financial Services
Senate Committee: Banking and Financial Institutions

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RATIONALE

Michigan and other states are facing what many are calling a foreclosure crisis. This is the result of various factors, including risky loan products and loose underwriting standards that fueled a housing boom in the early 2000s, the severe downgrading of mortgage-backed securities, and the collapse or bail-out of investment banks. In some cases, overly aggressive or fraudulent mortgage brokers and lenders extended mortgage loans to those who cannot afford to pay them back, particularly when an adjustable rate mortgage is reset. At the same time, job losses are at historic levels. In Michigan, which presently has the highest unemployment rate in the nation, there reportedly have been more than 19,300 foreclosures since January 1, 2009. The Center for Responsible Lending has projected 93,800 foreclosures in this State for the year.

Steps have been and are being taken at the State and national levels to address this situation. In Michigan, legislation was enacted in 2008 to reform the mortgage lending process and allow some homeowners to refinance their mortgages through the State Housing Development Authority. Federal measures include the FDIC loan modification program, which provides a model for lenders to use, and the new Home Affordable Modification program, which will reduce eligible homeowners' monthly mortgage payments. Although

financial institutions also are making voluntary efforts to renegotiate mortgage loans, less than 20% of people in default communicate with their lender or a counseling agency soon enough to mitigate the situation, according to the Detroit Office of Foreclosure Prevention and Response.

When lenders foreclose on residential mortgage loans in Michigan, they typically use foreclosure by advertisement (rather than bringing a foreclosure action in court). Foreclosure by advertisement is contractual in nature and governed in part by the terms of the mortgage document. To help prevent foreclosures, it has been suggested that this process should include mandatory procedures that would give homeowners an opportunity to meet with lenders and work out a loan modification.

CONTENT

The bills would amend Chapter 32 (Foreclosure of Mortgages by Advertisement) of the Revised Judicature Act to establish procedures under which a borrower would have to be given an opportunity to meet with a lender regarding modification of a mortgage loan on a principal residence before foreclosure proceedings could be commenced. The bills would do the following:

- **Prohibit a party from commencing foreclosure proceedings under Chapter 32 if the prescribed procedures had not been followed or the applicable time limits had not expired, or if the parties had agreed to modify the loan and the borrower were not in default.**
- **Require a foreclosing party, before proceeding with a sale under Chapter 32, to mail to the borrower a written notice containing specified information, including the name of a designated contact person who would have the authority to make modification agreements.**
- **Require the foreclosing party to include with the notice a list of approved housing counselors.**
- **Allow the borrower to bring an action to enjoin the foreclosure if the required notice were not served.**
- **Require the borrower to contact a housing counselor if he or she wished to work out a modification, and require the counselor to schedule a meeting with the designated contact person.**
- **Provide that foreclosure proceedings could not be begun until 90 days after the notice was sent, if the borrower requested a meeting.**
- **Require the borrower, the designated person, or the housing counselor to calculate a modified payment under the FDIC workout program if the meeting did not result in an agreement.**
- **Provide that the bills' requirements would not apply if the mortgage holder or servicer had qualified the loan for participation in the trial period necessary to obtain a loan modification agreement under the Federal Home Affordable Modification program.**
- **Require the Michigan State Housing Development Authority to prepare a list of approved housing counselors.**

(House Bill 4453 (S-1) would define "FDIC workout program" as the Federal Deposit Insurance Corporation (FDIC) mortgage loan modification program for delinquent residential first mortgages, effective on October 6, 2008, proposed by the FDIC to be used for modifications of residential mortgage loans under 12 USC 5220(b).)

All of the bills are tie-barred to each other and would take effect 30 days after they were enacted. The sections proposed by House Bills 4454 (S-1) and 4455 (S-1) would be repealed two years after the effective date of House Bill 4455 (S-1).

House Bill 4453 (S-1)

The bill would prohibit a party from commencing proceedings under Chapter 32 to foreclosure a mortgage of a principal residence if one or more of the following applied:

- The foreclosing party had not mailed notice to the borrower (the mortgagor), as required under House Bill 4454 (S-1).
- After notice was mailed to the borrower, the time for a housing counselor to notify the designated contact person of the borrower's request to work out a modification had not expired.
- Within 14 days after notice was mailed to the borrower, he or she had requested a meeting with the designated contact person and 90 days had not passed after the notice was mailed.
- The borrower had requested a meeting with the designated contact person and provided necessary documents if requested, and the designated person had not met or negotiated with the borrower.
- The borrower and mortgagee had agreed in writing to modify the mortgage loan and the borrower was not in default under the agreement.

This prohibition would apply only to proceedings under Chapter 32 in which the first notice of foreclosure under Section 3208 was published within two years after the bill's effective date. (Under Section 3208, notice that a mortgage will be foreclosed by a sale of the premises must be published for four successive weeks at least once a week in a newspaper published in the county where the premises are located, or if no newspaper is published in that county, in a newspaper published in an adjacent county.)

House Bill 4454 (S-1)

Notice to Borrower

The bill would require a foreclosing party to serve a written notice on a borrower before

proceeding with a sale under Chapter 32 of property claimed as a principal residence exempt from tax under Section 7cc of the General Property Tax Act (which exempts a principal residence from school operating taxes to the extent provided under the Revised School Code). The required notice would have to contain all of the following:

- The reasons that the mortgage loan was in default and the amount that was due and owing under the loan.
- The names, addresses, and telephone numbers of the mortgage holder, the mortgage servicer, and any agent designated by the mortgage holder or servicer.
- A designation of one of the people named in the previous provision as the person to contact who would have the authority to make modification agreements.
- That if the borrower requested a meeting with the designated contact person, foreclosure proceedings would not be commenced until 90 days after the date the notice was mailed to the borrower.
- That if the borrower and the designated person reached an agreement to modify the mortgage loan, the mortgage would not be foreclosed if the borrower abided by the terms of the agreement.
- That the borrower had the right to contact an attorney, and the telephone numbers of the State Bar of Michigan's Lawyer Referral Service and of a local legal aid office serving the area where the property was located.

(House Bill 4453 (H-1) would define "mortgage holder" as the owner of the indebtedness or of an interest in the indebtedness that is secured by the mortgage. "Mortgage servicer" would mean the servicing agent of the mortgage.)

In addition, the notice would have to indicate that a list of housing counselors prepared by the Michigan State Housing Development Authority (MSHDA) was enclosed with the notice. It also would have to indicate that, within 14 days after the notice was sent, the borrower could request a meeting with the designated contact person to attempt to work out a modification of the mortgage loan to avoid foreclosure, and could request a housing counselor to attend the meeting.

The person serving the notice would have to enclose with it a list prepared by MSHDA of the names, addresses, and telephone numbers of housing counselors approved by the Authority or by the U.S. Department of Housing and Urban Development (HUD). The person would have to serve the notice by first-class mail and by certified mail, return receipt requested, with delivery restricted to the borrower, to his or her last known address.

Within seven days after mailing the notice, the person also would have to publish a copy of it once in the same manner as required for publishing a notice of foreclosure sale under Section 3208.

If notice were required to be mailed to a borrower under these provisions, notice were not mailed, and proceedings were commenced against the borrower under Chapter 32, the borrower could bring an action to enjoin the foreclosure in the circuit court for the county where the mortgaged property was situated.

The provisions of the bill and House Bill 4455 (S-1) would not apply if the mortgage holder or mortgage servicer had qualified the loan secured by the mortgage for participation in the trial period necessary to obtain a loan modification agreement under the Home Affordable Mortgage program administered by the U.S. Department of the Treasury effective March 4, 2009.

Also, if a borrower and a designated contact person had previously agreed to modify the mortgage loan (as described below), the bills' provisions would not apply unless the borrower had complied with the terms of the modified loan for one year after the date of the modification.

In addition, the bills' provisions would not apply if the borrower were deceased.

Request for Modification; Meeting

Under House Bill 4454 (S-1), if a borrower wished to participate in negotiations to attempt to work out a modification of a mortgage loan, he or she would have to contact a housing counselor from the list prepared by MSHDA within 14 days after it was mailed to the borrower. Within 20 days after being contacted, the housing counselor would have to give written notice of the

request to the mortgage holder's or servicer's designated contact person.

The designated person then could request the borrower to provide any documents that were necessary to determine whether he or she was eligible for a modification, without an exception, under the FDIC workout program. The borrower would have to give the designated person copies of any requested documents.

A housing counselor contacted by a borrower would have to schedule a meeting between the borrower and the designated person to attempt to work out a modification of the loan. At the borrower's request, the counselor would attend the meeting. This meeting and any later meetings would have to be held at a time and place agreed to by the parties in the county where the property was situated or, if the parties agreed, in another county.

If the borrower and the designated contact person reached an agreement to modify the mortgage loan as a result of a meeting, the designated person, within seven business days after the agreement was reached, would have to prepare a writing stating the agreement and give it to the borrower. The borrower would have to adopt or reject the writing and return it to the designated person within seven business days after it was provided to the borrower.

House Bill 4455 (S-1)

Under the bill, if a borrower had contacted a housing counselor (as provided in House Bill 4454 (S-1)) but the process had not resulted in an agreement to modify the mortgage loan, the borrower, counselor, or designated person would have to calculate a modified payment amount under the FDIC workout program. The designated person would have to give the borrower a copy of any calculation that person made.

The Michigan State Housing Development Authority would have to develop the list of housing counselors approved by MSHDA or by HUD who could perform the duties of housing counselor under the bills.

MCL 600.3204 et al. (H.B. 4453)
Proposed MCL 600.3205a & 600.3205b (H.B. 4454)

Proposed MCL 600.3205c-600.3205e (H.B. 4455)

BACKGROUND

Foreclosure Process

Michigan law prescribes two methods of foreclosure: judicial foreclosure and foreclosure by advertisement, which are governed by Chapters 31 and 32 of the Revised Judicature Act, respectively. Both processes give the borrower an opportunity to recover, or "redeem", the property after a foreclosure sale, by paying the redemption amount and required fees, but the procedures and timelines are different.

Under Chapter 31, judicial foreclosure involves the filing of a foreclosure action in the circuit court. When a complaint is filed, the court determines the amount of the debt that is due and has the power to order a sale of the premises. The court may not order the sale within six months after the complaint is filed. The borrower then has six months after the sale to redeem the premises by paying the amount that was bid plus interest.

Under Chapter 32, a mortgage of real property may be foreclosed by advertisement upon default if the mortgage document contains a "power of sale". This process requires the mortgagee to post a notice conspicuously on the premises and publish it once a week for four successive weeks in a newspaper published in the county where the premises are located or, if there is no newspaper in that county, in a paper in an adjacent county. The notice must contain specified information, including the amount claimed to be due and the length of the redemption period. If the property is sold at a foreclosure sale, the mortgagor may redeem the property by paying the redemption amount and required fees within the applicable period.

The redemption period under Chapter 32 is one month, three months, or six months, depending on the size and type of the property, the percentage of the original debt still owed, and whether the property is abandoned. (In the case of residential property that does not exceed four units, is not more than three acres in size, and is not abandoned, the redemption period is six months if the amount claimed to be due is

more than two-thirds of the original debt.) If the specific one-, three-, or six-month redemption periods do not apply, the period is one year.

In addition, both Chapter 31 and Chapter 32 allow a court to issue a deficiency judgment against the mortgagor, for the amount of the debt not paid by the sale of the premises.

FDIC Workout Program

The FDIC loan modification program, which became effective on October 6, 2008, was developed for IndyMac Federal Bank and provides a framework for other financial institutions to use. The program targets distressed borrowers who are currently having financial difficulty with their scheduled mortgage payment, but have the capacity to make a loan payment. Modifications may be available for loans that are at least 60 days delinquent or where default is reasonably foreseeable; a foreclosure sale is not imminent; the borrower is currently not in bankruptcy or has not been discharged from Chapter 7 bankruptcy since the loan was originated; and the loan was not originated as a mortgage on a second home or investment property.

The FDIC's loan modification program is based primarily on the following two principals:

- Determining a payment the borrower can afford by multiplying the borrower's gross monthly income by the appropriate housing-to-income ratio, less taxes and insurance, to achieve a minimum payment reduction of 10%.
- Protecting investors' interests by requiring that the cost of the modification be less than the estimated cost of foreclosure.

Under the program, a housing-to-income ratio of 31% to 38% is considered affordable.

Home Affordable Modification Program

On March 4, 2009, the U.S. Department of the Treasury issued guidelines for the Making Home Affordable Program. This program includes a Home Affordable Refinancing program and a Home Affordable

Modification program. According to the Treasury Department, the guidelines "should serve as standard industry practice across the mortgage industry", and all lenders that receive financial assistance under the Financial Stability Plan are required to implement loan modification plans consistent with the guidelines. (Under the Financial Stability Plan, the U.S. Treasury will provide banks with financial assistance in order to make credit available. Components of the Plan include a Financial Stability Trust, which will make capital investments in major banks that meet a "stress test"; a Public-Private Investment Fund; and a Consumer and Business Lending Initiative.)

The loan modification program is limited to first-lien loans on owner-occupied property with an unpaid principal balance that does not exceed \$729,750 (although higher limits apply to property with two to four units). The mortgage loan must have originated before January 1, 2009, and a loan modification agreement may be entered into until December 31, 2012.

The program focuses on "at risk" homeowners, such as those experiencing serious hardships, decreases in income, or increases in expenses, or who show other indications of being at risk of default. Delinquency is not a requirement for eligibility. Borrowers with a high total debt level (housing and other debt, such as credit cards and auto loans, equal to 55% or more of income) qualify but only if they agree to enter HUD-certified consumer debt counseling.

Loan servicers must follow a specified sequence of steps to reduce monthly payments to not more than 31% of gross monthly income. The sequence requires first reducing the interest rate; then, if necessary, extending the term or amortization of the loan for up to 40 years; and then, if necessary, forbearing principal. The program shares the cost of reducing monthly payments and provides for fees and incentive payments to servicers and lenders/investors.

Successful completion of a trial modification period and entry into program agreements between the servicer and the Treasury Department's financial agent are prerequisites for any payments to the lender/investor, servicer, or borrower. The

trial period will last 90 days (three payments at modified terms) or longer if necessary to comply with investor contractual obligations. The borrower must be current at the end of the trial period to obtain a home affordable modification.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Residential mortgage foreclosures not only are devastating to the individuals and families who lose their homes, they also are costly to lenders and harmful to communities. Foreclosed homes contribute to downward pressure on property values and the deterioration of neighborhoods, perpetuating the cycle of financial distress. According to the Mortgage Bankers Association, in September 2008, Michigan was one of eight states that had rates of foreclosure above the national average. With an unemployment rate of 12%, and the expectation that payroll employment will continue to decline through 2010, Michigan might experience even more foreclosures than predicted.

Preventing unnecessary foreclosures can create a "win-win" solution for everyone. Banks, credit unions, and other lenders already are reaching out in creative ways to customers who are having or will have difficulty making their mortgage payments. Some banks, for example, are hiring housing counselors, contacting borrowers in person, and participating in community meetings. When lenders and borrowers renegotiate mortgage loans, homeowners can benefit from significantly reduced or frozen interest rates, repayment plans, principal forbearance, and longer terms. According to various sources, however, many homeowners either are not aware of their loss mitigation options or do not respond to correspondence from their lenders.

Since voluntary efforts to prevent home foreclosures are having limited success, it is necessary to enact mandatory procedures that would help bring the parties to the table. Lenders would have to give homeowners a detailed notice, by both first-class and certified mail, of their opportunity to request a meeting and attempt to reach

an agreement to modify their loan. Lenders also would have to provide a list of approved housing counselors and inform borrowers that they could have a counselor present at the meeting. After the notice was mailed, there would be a 90-day period during which the parties could work out a modification and the lender could not proceed with foreclosure.

According to testimony on behalf of the Michigan Advocacy Project, based on preforeclosure programs in other states, two factors are generally considered critical to a program's success: 1) a preforeclosure conference that includes a representative of the mortgage holder who must have the authority to modify the mortgage, and 2) a trained housing counselor who is familiar with the dynamics of the foreclosure process and the variety of loan modifications that will make the loan affordable. The legislation contains both of these elements.

Response: There is anecdotal evidence that distressed borrowers frequently disregard correspondence from their lenders, so it is critical that they be able to differentiate between standard mailings and a notice of their opportunity to work out a loan modification. It has been suggested that the required notice should clearly indicate that it contained important information from the State of Michigan, and the notice itself should be written by MSHDA.

Also, requiring lenders to publish the notice could encourage foreclosure rescue scams. Publication would enable unscrupulous firms and individuals to seek out and take advantage of distressed borrowers with false promises of helping to save their homes. Requiring the notice to be sent by first-class and certified mail would be adequate to ensure delivery, without causing unnecessary public humiliation to the homeowner.

In addition, there are situations in which a borrower will approach a lender about renegotiating the loan and the lender will choose instead to foreclose and then seek a deficiency judgment after selling the home for less than the amount necessary to cover the mortgage. The legislation should prevent lenders from obtaining a deficiency judgment if the parties entered into an agreement to modify the loan before foreclosure proceedings were commenced,

or if a modification agreement were not reached but the borrower were eligible for modification under the FDIC workout program.

Opposing Argument

The House-passed versions of these bills would allow a borrower to bring an action to convert a foreclosure by advertisement to a judicial foreclosure if the mortgage lender or servicer proceeded with foreclosure by advertisement in violation of the bills' requirements. In addition, under the House substitutes, foreclosure would proceed before a judge instead of by advertisement if the borrower and the mortgagee's representative did not agree to modify the loan but the borrower met the criteria for modification under the FDIC workout program. That program provides a clear framework for producing a sustainable loan modification that lowers a homeowner's monthly payments, while ensuring that modification is more beneficial to the lender than foreclosure would be. Although House Bill 4455 (S-1) would require the borrower, housing counselor, or designated contact person to calculate a payment under the FDIC workout program if a meeting did not produce a modification agreement, there is nothing to suggest that the lender would have to agree to that payment.

If borrowers were unfairly denied a loan modification, judicial foreclosure would give them the opportunity to make their case before a judge. The possibility of judicial foreclosure also would give lenders an incentive to participate in the preforeclosure process in good faith. Without allowing borrowers to have a judge intervene and ensure that they were treated fairly, this legislation would offer borrowers considerably less protection than originally proposed.

Response: Judicial foreclosure would add another step to the process, making it more protracted and expensive for both parties. While foreclosure is used as a last resort, it is necessary to have an efficient, effective foreclosure process that keeps costs from increasing, and property values from falling, more than is avoidable.

Opposing Argument

The vast majority of residential mortgage loans would not receive the protections offered by the bills, due to the exception for loans that lenders qualified for participation

in the trial period under the Home Affordable Modification program. The program's eligibility criteria are broad, and it encourages lenders to participate by matching reductions in monthly payments and paying fees and bonuses. Furthermore, qualification for participation in the trial period does not mean that a borrower will receive a loan modification, which depends on successful completion of the trial period.

Response: The number of borrowers and lenders that will qualify for and participate in the Home Affordable Modification program remains to be seen. The U.S. Treasury Department projects that the program will assist 3.0 to 4.0 million homeowners nationwide; the number in Michigan is unknown. While the program does contain incentives for lenders to participate, participation is mandatory only for banks receiving Financial Stability Plan assistance after the start of the program. The exception in the bills is necessary due to the potential for overlapping and inconsistent provisions in the State and Federal programs.

Opposing Argument

The bills actually could hurt borrowers, rather than help them, by offering false hope and giving lenders an excuse to speed up the foreclosure process. Under the bills, a lender could not proceed with foreclosure by advertisement for 90 days after sending the required notice, but the first two weeks essentially would be set aside for the borrower to contact a housing counselor. In addition to eating into the 90-day period, these two weeks would not give a borrower enough time to decide what to do, especially if the mail were delayed or the borrower already had moved out, which could happen if the water or heat were shut off. Then, after the first two-week period, the housing counselor would have 10 days to notify the lender of the borrower's request for a meeting. This would leave 66 days of the 90-day period. During this period, the lender simply would have to attend a meeting with the borrower, but would not be required actually to negotiate. Also, the lender could proceed with foreclosure if the borrower did not produce requested documents, which a homeowner in crisis might not have ready access to.

Typically, a lender will not start the foreclosure process until 120 days after a borrower defaults. Once the 90-day period

under the bills had elapsed, however, the lender would have little reason to delay if a loan modification agreement were not reached. A lender also could proceed months earlier if a borrower failed to request a meeting or provide requested documents.

Response: The length of time between default and foreclosure depends on various factors, including the lender's own policies, the borrower's payment history, and the borrower's circumstances. If a homeowner has lost his or her job and cannot make payments, for example, the lender is unlikely to delay foreclosure for 120 days.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills would have an indeterminate fiscal impact on the State. The bills could result in fewer home foreclosure proceedings or the postponement of foreclosures. If foreclosures were prevented by the process required by the bills, reductions in property values due to foreclosure could be avoided, with the result that local units of government would not lose as much property tax revenue in some cases. The impact would depend on the loan modification or refinancing options, the value of the home, and other factors.

The Michigan State Housing Development Authority would be required to develop and provide to mortgage lenders a list of approved housing counselors. This new responsibility would require minimal expenditures and would be supported with existing resources.

Fiscal Analyst: Elizabeth Pratt
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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.