Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 380 (Substitute S-1 as reported)
Senate Bill 381 (as reported without amendment)
Senate Bill 382 (Substitute S-1 as reported)
Senate Bill 383 (Substitute S-1 as reported)
Sponsor: Senator Randy Richardville (S.B. 380)
Senator Mike Nofs (S.B. 381)
Senator Jim Marleau (S.B. 382)
Senator Darwin L. Booher (S.B. 383)
Committee: Banking and Financial Institutions

Date Completed: 6-11-13

RATIONALE

When the state and national economies went into a severe recession in 2008, Michigan and other states began to experience a mortgage loan foreclosure crisis. This resulted from various factors, including overly aggressive or fraudulent lending practices. As job losses reached historic levels and millions of borrowers fell behind on their mortgages, many financial institutions and other mortgage loan servicers failed to meet the needs of those borrowers. At the state and national levels, steps were taken, and continue to be taken, to address this situation. In Michigan, these measures include the enactment of legislation in 2009 to create a residential mortgage loan modification program. This program essentially provides for a 90-day moratorium before a mortgage lender may pursue foreclosure against a delinquent borrower, when proceeding under Chapter 32 of the Revised Judicature Act (which governs foreclosure by advertisement, rather than through the judicial system). During that time, the borrower must be given an opportunity to work out a modification with the lender.

Originally, the loan modification program was scheduled to be repealed on January 5, 2012, but the sunset date was delayed to June 30, 2013. Many people believe that the program should again be extended to coincide with Federal rules that are scheduled to take effect on January 10, 2014, and that Michigan law should reflect the new Federal rules.

A related issue involves the statutory redemption period after foreclosed property is sold at a sheriff's sale; during this period, the delinquent borrower can pay the loan in full to redeem the property. The length of the redemption period ranges from 30 days to one year depending on various circumstances, but is typically six months.

The Federal rules that are scheduled to take effect on January 10, 2014, offer a 120-day moratorium similar to Michigan's current 90-day moratorium discussed above. Some have suggested, therefore, that Michigan's redemption period should be reduced by up to 120 days, so the overall length of time between delinquency and the end of the redemption period would remain the same.

CONTENT

Senate Bills 380 (S-1), 381, and 382 (S-1) would amend Chapter 32 of the Revised Judicature Act to do the following:

- **Delay the sunset on the mortgage loan modification program for one year, until June 30, 2014.**
- **Revise a provision that prohibits foreclosure by advertisement under the program for proceedings in which the first notice is published**

before June 30, 2013, and change the date to January 10, 2014.

- -- **After January 9, 2014, prohibit foreclosure by advertisement of a principal residence if the party complied with Federal regulations regarding mortgage servicer policy and procedure, or a modification agreement had been made.**
- -- **Require mortgage servicers and small servicers to comply with Federal regulations regarding mortgage servicer policy and procedure, with regard to foreclosure proceedings in which the first notice was published after January 9, 2014.**

Senate Bill 383 (S-1) would amend the Chapter 32 to reduce the redemption period by 120 days for certain properties in which the first notice was published after January 9, 2014, if the servicer complied with Federal regulations regarding mortgage loan servicer policy and procedure; and reduce the redemption period by 60 days if the servicer complied with Federal regulations, the servicer had provided documents in support of a modification before the foreclosure sale, and the property had been listed on mutually agreed terms. The bill also would reduce the redemption period from three to two months for a mortgage of abandoned residential property that does not exceed four units, in which the amount claimed to be due on the mortgage is two-thirds or less of the original debt.

All of the bills are tie-barred.

Senate Bill 380 (S-1)

Section 3204 of the Act prescribes conditions that a party must satisfy to begin proceedings to foreclose on a mortgaged property by advertisement.

Under the residential mortgage loan modification program, the Act prohibits a party from beginning proceedings if a required notice has not been mailed to the borrower, if applicable time limits have not expired, or if the parties have agreed to modify the mortgage loan and the borrower is not in default. This provision applies only to proceedings in which the first notice of foreclosure has been published after July 5, 2009, and before June 30, 2013. The bill would change the ending date to January 10, 2014.

Also, under the bill, beginning January 10, 2014, a party that was subject to Section 3206 (proposed by Senate Bill 382) could not begin foreclosure by advertisement proceedings with regard to a principal residence if one or both of the following applied:

- -- That party complied with 12 CFR 1024.39 to 1024.41 (which prescribes policy and procedure requirements for mortgage servicers) if the party were subject to those Federal regulations because of Section 3206.
- -- The mortgagor and the appropriate person agreed to a loan modification, and the mortgagor was not in default under the modified terms.

Senate Bill 381

Originally, the loan modification program was scheduled to be repealed on January 5, 2012, and the sunset date later was delayed to June 30, 2013. The bill would delay the sunset on the program until June 30, 2014.

Specifically, Sections 3205a to 3205d provide for the mortgage modification program, and are scheduled to be repealed on June 30, 2013. The bill would change that date to June 30, 2014.

Also, under the bill, Sections 3205a to 3205d would not apply to proceedings in which the first notice was published after January 9, 2014.

Senate Bill 382 (S-1)

The bill would add Section 3206 to mandate that, for a proceeding in which the first notice was published after January 9, 2014, a mortgage servicer comply with 12 CFR 1024.39 to 1024.41 with respect to the mortgage. The bill states that this would apply to small servicers even as to the provisions of the Federal regulations that do not apply to small servicers.

("Servicer" would mean that term as defined in the Federal regulation; i.e., generally the person responsible for the servicing of a mortgage loan. "Small servicer" would mean a servicer that qualifies as a small servicer under the Federal regulations, i.e., either services 5,000 or fewer mortgage loans, for which the servicer (or an affiliate) is the creditor or assignee; or is a housing finance agency as defined in 24 CFR 266.5.

The applicable Federal regulations, 12 CFR 1024.39 to 1024.41, are described below in **BACKGROUND**.)

Senate Bill 383 (S-1)

Chapter 32 prescribes redemption periods in which a mortgagor may redeem various types of foreclosed real property. For a mortgage of commercial or industrial property, multifamily residential property in excess of four units, and residential property not exceeding four units in which the amount due is more than two-thirds of the original debt, the redemption period is six months from the date of the sale. Chapter 32 also prescribes a one-year redemption period for properties not subject to the specified periods.

The bill would require the redemption period in these circumstances to be reduced by 60 days if all of the following circumstances were met:

-- Section 3206 applied to the foreclosure of the mortgage.
-- The party foreclosing the mortgage complied with Section 3206.
-- The mortgagor provided financial documents in support of a modification before the foreclosure sale.
-- The property had been listed for sale on terms that were mutually agreed to by the mortgagor and the purchaser under the foreclosure sale.

The redemption period would be reduced by 120 days if the mortgagor did not provide documents in support of a modification before the foreclosure sale, or the property had not been listed on mutually agreed-to terms, but Section 3206 applied and the mortgagor complied.

In addition, the redemption period for a mortgage of residential property not exceeding four units, if the property is abandoned, is three months. The bill would change the redemption period to two months.

The bill would not change the remaining redemption periods under Chapter 32. (For a mortgage used for agricultural purposes, the redemption period is one year. For a mortgage of abandoned property, the redemption period is 30 days or the time required to provide notice under Section 3241a (which requires a mortgagee to inspect a property, provide notice that the mortgagee considers the premises abandoned, and allow 15 days for the mortgagor to dispute an abandonment claim). For a mortgage of abandoned residential property of four units or less, in which the amount claimed is more than two-thirds of the original debt, the redemption period is one month.)

MCL 600.3204 (S.B. 380)
600.3205e (S.B. 381)
Proposed MCL 600.3206 (S.B. 382)
MCL 600.3240 (S.B. 383)

BACKGROUND

Mortgage Loan Modification Program

Public Acts 29, 30, and 31 of 2009 established the residential mortgage loan modification program in Chapter 32 of the Revised Judicature Act, with the original sunset date of January 5, 2012. Public Acts 301 and 302 of 2011 postponed the sunset to December 31, 2012, and made various changes to the program. Public Act 521 of 2012 again delayed the sunset to June 30, 2013.

The statute prescribes procedures under which a borrower must be given an opportunity to work out a modification of his or her mortgage loan on a principal residence before foreclosure proceedings may be commenced under Chapter 32. These procedures call for the borrower to be given notice containing specified information, including the following:

-- The borrower may request a meeting with someone designated by the foreclosing party to attempt to work out a modification of the mortgage loan to avoid foreclosure.
-- Foreclosure proceedings will not commence until 90 days after notice is mailed if the borrower requests a meeting.
-- If the parties reach a modification agreement, foreclosure proceedings will

not be commenced if the borrower abides by the agreement.

-- If the parties do not reach an agreement but the borrower meets certain criteria for modification, the foreclosure will proceed before a judge instead of by advertisement.

The notice also must include a list of approved housing counselors developed by the Michigan State Housing Development Authority. To schedule a meeting with the person designated by the foreclosing party, the borrower may contact that person either directly or through a housing counselor.

As a rule, the modification criteria require the foreclosing party's designee to use a loan modification program or process that targets a ratio of the borrower's housing-related debt to the borrower's gross income of 38% or less, on an aggregate basis, applying features specified in the law. If the borrower is eligible for modification according to these calculations, the mortgage holder or servicer typically may not proceed under Chapter 32 but may proceed under Chapter 31, which provides for foreclosure in the circuit court. If the borrower is not eligible for modification, the mortgage holder or servicer may foreclose under Chapter 32.

<u>Federal Rules</u>

In response to the economic crisis that began late in 2007, the U.S. Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly known as the Dodd-Frank Act. This law created a new agency, the Consumer Financial Protection Bureau (CFPB), in order to consolidate most Federal consumer financial protection authority. The CFPB is responsible for supervision and enforcement with respect to the laws governing providers of consumer financial products and services. In January 2013, the CFPB announced rules pertaining to mortgage loan servicing that will be effective on January 10, 2014.

In particular, 12 CFR 1024.39 to 1024.41 include requirements pertaining to policy and procedure for early intervention, continuity of contact, and loss mitigation, as described below.

<u>CFR 1024.39: Early Intervention Requirements</u>: If a borrower is late making a payment, the servicer must orally notify, or make good faith efforts to orally notify, the borrower not later than 30 days after the due date. The servicer also must provide written notice within 40 days of the due date, and the notice must contain contact information, loss mitigation options, an explanation of the foreclosure process, and information on housing finance authorities and homeownership counselors.

<u>CRF 1024.40: Continuity of Contact</u>: Not later than five days after providing, or making a good faith attempt to provide, oral notice of a delinquency, a servicer must assign personnel to assist the borrower with loss mitigation options. If a mortgage is transferred to a new servicer, the new servicer must assign personnel within reasonable time of the transfer.

A servicer must establish policies and procedures reasonably designed to ensure that assigned personnel can accurately provide the following information when applicable:

-- Loss mitigation options and application status.
-- Actions the borrower must take to pursue mitigation options.
-- The circumstances in which the servicer may make a referral to foreclosure.
-- Any servicer-established loss mitigation deadlines.

A servicer's policies and procedures will satisfy these requirements if the assigned personnel do not engage in a practice or pattern of failing to perform these tasks.

A servicer also must provide access to a complete record of the borrower's payment history in the servicer's records, and all documents that the borrower has submitted for loss mitigation options.

<u>CFR 1024.41: Loss Mitigation Procedures</u>: Any servicer that makes loss mitigation options available to borrowers must comply with the all of the following:

-- Exercise reasonable diligence in obtaining information to complete a borrower's incomplete loss mitigation application.

-- When a borrower submits an incomplete application earlier than five days before the deadline, send notice to the borrower stating that it is incomplete, what information is needed, and the deadline for submittal.
-- Within 30 days of receiving a complete application submitted before the deadline, evaluate the borrower for all potential loss mitigation options, and provide notice to the borrower stating whether the servicer will offer an option.
-- If the servicer denies an application, state the specific reasons for denial, and notify the borrower of appeal options, requirements, and deadlines.

A servicer may establish a deadline for complete loss mitigation application submission, but that deadline must not be earlier than 90 days before the scheduled foreclosure sale.

A servicer also may establish a deadline for a borrower to accept or reject a loss mitigation option, but the deadline must be no earlier than 14 days after the servicer notified the borrower of the option. A servicer must allow a borrower to accept or reject an option while simultaneously making an appeal of the servicer's determination.

A servicer must not conduct a foreclosure sale if the borrower submitted a complete application within the assigned deadline, unless: 1) the servicer provided notice that the borrower is not eligible for a loss mitigation option, the borrower has not requested an appeal, or the window for requesting an appeal has closed; 2) the servicer denies the borrower's appeal; 3) the borrower rejects the servicer's option offer; or 4) the borrower fails to perform under an agreement on an option.

A servicer must allow a borrower to appeal an option determination for at least 14 days after providing notice of the determination to the borrower. Appeals must be reviewed by personnel other than those responsible for evaluating the borrower's application. Within 30 days of an appeal, the servicer must provide notice stating the servicer's determination, and any options the servicer will offer.

A servicer is required to comply with these procedures only for a single complete loss mitigation application.

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

Since the Consumer Financial Protection Bureau rules for mortgage loan modifications were developed based on gathered information on industry best practices, bringing Michigan law into conformity with these rules would likely increase accessibility to and the effectiveness of loan modification programs, which could result in fewer foreclosures.

According to the Michigan Foreclosure Task Force, this State experienced 416,000 foreclosure filings between 2005 and 2010. Between 2006 and 2010, the State lost approximately $63 billion in residential housing value. Approximately 70,000 foreclosures took place from March 2012 to March 2013, the third-highest number of foreclosures in the nation for that period.

Residential foreclosures not only are devastating to the individuals and families who lose their homes, they also are costly to lenders and harmful to communities. When foreclosed homes remain unoccupied and unmaintained, they contribute to downward pressure on property values, create opportunities for criminal activity, and lead to the deterioration of neighborhoods. According to the Task Force, the number of vacant homes in Michigan increased by 211,107 (47.1%) between the 2000 census and the 2010 census.

Preventing unnecessary foreclosures is beneficial to both lenders and borrowers. The best way to do so is to require lenders to meet with borrowers, especially before the parties' relationship becomes adversarial. As the foreclosure crisis escalated, many at-risk borrowers were unable to get through to their lenders to discuss foreclosure alternatives, and others never tried to make contact. Since the mortgage loan modification program was implemented, it has helped thousands of Michigan borrowers become current on their loans and avoid losing their homes.

According to a July 2012 survey of housing counselors and legal service attorneys by the Task Force, 60% cited an increase in the previous 12 months in the proportion of their clients who were able to prevent foreclosure through negotiations with their lenders.

Many residents are still struggling to pay their mortgages, often through no fault of their own. By extending the existing program until June 30, 2014, the bills would continue to protect consumers until the final rules issued by the CFPB become effective on January 10, 2014.

Supporting Argument

By reducing the redemption period in situations involving servicers subject to the Federal regulations, Senate Bill 383 (S-1) essentially would shift the foreclosure time frame. Since the preforeclosure moratorium would be extended to 120 days, the postforeclosure statutory redemption period should be reduced accordingly. Mortgage servicers that comply with modification program rules and foreclosure law should not be forced to wait an additional six months after foreclosure to take possession of property.

Very few homeowners take advantage of the redemption period. According to the Michigan Bankers Association, the average number of redemptions is about 1%. It would be unfair to entitle a delinquent borrower to one year or more of possession of property to the detriment of the servicer (assuming a six-month redemption period). Under the provisions in Senate Bill 383 (S-1), the entire foreclosure process, from delinquency to the end of the redemption period, still could take over six months to complete. This would provide fairness to servicers and enough time for borrowers to seek alternatives to foreclosure.

The bill also would provide flexibility for borrowers seeking short sales. ("short sale" is an industry term that describes a situation in which the price of a sale does not satisfy the amount owed on the mortgage loan, the seller is unable to make up the deficiency, and the servicer must approve the sale.) Homeowners seeking short sale approval would face only a 60-day, rather than a 120-day, reduction in the redemption period, allowing more time to pursue a short sale.

Response: The Federal rules do not extend the preforeclosure time frame; they actually serve to codify common industry practice. According to the Task Force, many servicers wait 90 to 120 days after delinquency to start the foreclosure process. Since this was already common practice, the moratorium does not necessarily provide homeowners with any additional time to combat foreclosure.

Also, to consider a reduction in the redemption period merely a shift in the foreclosure time frame misses the distinct and separate purposes of preforclosure and postforeclosure policies. The pending Federal rules and current State rules for a moratorium during the pre-foreclosure process are aimed at preventing fraudulent foreclosures from happening, and allowing homeowners to avoid foreclosure, cure the default, modify the loan, and avoid a poor credit rating. The State's postforeclosure statutory redemption period is meant to give homeowners a realistic period of time in which to seek alternative financing to keep the home, mitigate loss through a short sale, seek alternative living arrangements, and challenge a wrongful foreclosure. According to a representative from the Michigan Advocacy Project, no other state has replaced existing postforeclosure protections with the preforeclosure protections in the pending Federal rules.

According to the Ingham County Register of Deeds, the preforeclosure process requirements were adopted in response to an increase in fraudulent foreclosures. Some servicers had foreclosed on homeowners who were not delinquent or had renegotiated the terms of the loan. According to the Register of Deeds and various media outlets, during the housing crisis, servicers illegally foreclosed on over 700 active military personnel. According to the FBI's 2010 Mortgage Fraud Report, Michigan ranked in the top 11 states for suspected mortgage fraud activity. Homeowners should not face the burden of a reduced redemption period due to policies aimed at combatting fraudulent foreclosures.

The fact that redemption rates are at about 1% reflects the fact that most homeowners currently owe more on their homes than the homes are worth, and that as a result, these homeowners cannot currently get proper financing or sell the home. The argument that the redemption period should be reduced because of this statistic is based on the premise that the market will not recover. If and when the market does recover, and more homeowners are able to redeem, homeowners would be at a disadvantage because the redemption period would be much shorter.

Supporting Argument

Keeping homes in the foreclosure process longer than necessary costs servicers, borrowers, and communities. When their costs increase, servicers can be forced to impose higher costs on all customers through increased service charges. Servicers can be responsible for property taxes, insurance, maintenance, association fees, and court costs for eviction, among other costs, without having actual possession of the property. Requiring servicers to undergo a longer process from borrower delinquency to property possession will increase these costs.

During the redemption period, property value can plummet. Some homeowners neglect or intentionally damage homes during the foreclosure process, potentially causing a huge decrease in the value of the home and its neighborhood. Sometimes, for example, fixtures are stolen or destroyed, and copper wires and pipes are sometimes stripped out of the walls, potentially resulting in condemnable property. Shortening the redemption period could prevent this type of damage to a home, which could help maintain the value of the home and its neighborhood

Response: Shortening the redemption period would do little to deter outgoing homeowners who are intent on damaging property. A homeowner can do just as much damage with a two-month redemption period as within a six-month period.

Other states have allowed banks to take possession of a home, by court order, if it is significantly damaged during foreclosure. Michigan could adopt similar legislation to remedy this problem. A blanket reduction in the redemption period would not solve this problem; rather, it would burden the responsible homeowners who would be denied sufficient opportunity to redeem their homes.

Supporting Argument

A long redemption period can lead to abandoned property, which can then contribute to neighborhood crime and blight. As mentioned above, the number of vacant houses in Michigan increased by 47.1% between 2000 and 2010. A shorter redemption period could help neighborhoods by allowing a servicer to take possession of foreclosed property and sell it to a new owner more quickly, which would reduce the number of abandoned properties.

Response: Chapter 32 already prescribes a redemption period of only one month for abandoned property with up to four units, if the amount claimed is more than two-thirds of the original debt, and only three months if the amount claimed is two-thirds or less. The purported problem has already been addressed in statute, and further reductions in the redemption period are unnecessary.

Further, according to the Task Force, between 2005 and 2010, out of 416,116 foreclosed residential units, only 227,060 were ultimately sold to new purchasers by the foreclosing party. This means that nearly 200,000 bank-owned homes remained on the market. Based on these numbers, it is difficult to conclude that a shorter redemption period would enable servicers to sell houses more rapidly.

Opposing Argument

Reducing the redemption period could benefit servicers that fail to comply with the foreclosure law, to the detriment of responsible homeowners. In order to foreclose by advertisement, a servicer must meet specific requirements. If a servicer fails to comply, the foreclosure is improper, and the homeowner can challenge it. Homeowners deserve the full redemption period to find irregularities in the process and save their homes. A short redemption period could expire before the homeowner even had access to the sheriff's deed, servicer documents, and other relevant information needed to combat a fraudulent foreclosure.

Also, according to multiple sources, short sales typically take approximately six months or longer to complete. Although Senate Bill 383 (S-1) would provide for a reduction of 60 days (rather than 120) in the redemption period in the case of some short sales, this would provide a four-month redemption period, which is an insufficient amount of time. Reportedly, short sale negotiations typically start after other options, like modification, fall short. Many times, these negotiations begin around the same time as the sheriff's sale. It is unlikely that a short sale could be processed within the reduced time frame given in the bill.

In addition, underbids can be a problem for many homeowners facing foreclosure. (An underbid occurs when a servicer bids less than it is owed on the mortgage at the foreclosure sale, which results in the deficiency being unsecured.) Underbids are a problem when servicers underestimate property value through bad appraisals, sell the property for an unreasonably low price, and hold the buyer liable for the resulting deficiency.

If a foreclosing servicer underbids on a foreclosure, the homeowner can redeem the home by paying the amount of the servicer's bid, sell the home for the bid amount without lender approval (as the sale would no longer be considered a short sale), or obtain alternative financing for the bid amount. However, under a shortened redemption period, a homeowner could be unaware of an underbid on the foreclosure sale until the redemption period had passed, especially in a county where public records are not posted in a timely manner.

Legislative Analyst: Glenn Steffens

FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

Fiscal Analyst: Josh Sefton

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