

# HOUSE BILL REPORT

## 2SHB 1362

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### As Passed Legislature

**Title:** An act relating to protecting and assisting homeowners from unnecessary foreclosures.

**Brief Description:** Protecting and assisting homeowners from unnecessary foreclosures.

**Sponsors:** House Committee on Ways & Means (originally sponsored by Representatives Orwall, Hope, Rolfes, Moeller, Liias, Probst, Green, Darneille, Frockt, Kirby, Miloscia, Roberts, Hunt, Dickerson, Upthegrove, Fitzgibbon, Kagi, Eddy, Hasegawa, Pettigrew, Ormsby, Sells, Kenney, Cody, Hudgins, Lytton, Moscoso, Ryu, Appleton, Reykdal, Van De Wege, Carlyle, Dunshee, Santos, McCoy, Tharinger, Haigh, Goodman, Jinkins, Jacks, Takko, Sullivan, Blake, Seaquist, Billig, Stanford, Ladenburg, Finn and Pedersen).

#### **Brief History:**

##### **Committee Activity:**

Judiciary: 1/26/11, 2/3/11, 2/17/11 [DPS];

Ways & Means: 2/23/11, 2/25/11 [DP2S(w/o sub JUDI)].

##### **Floor Activity:**

Passed House: 3/2/11, 83-13.

Senate Amended.

Passed Senate: 3/29/11, 36-11.

House Concurred.

Passed House: 4/1/11, 78-15.

Passed Legislature.

#### **Brief Summary of Second Substitute Bill**

- Amends the "meet and confer" requirement by repealing the expiration date, making it applicable to all deeds of trust for owner-occupied residential real property, and providing more time for the borrower to meet with the beneficiary.
- Establishes a foreclosure mediation process for borrowers referred to mediation by housing counselors or attorneys.
- Requires certain beneficiaries to remit to the Department of Commerce quarterly payments based on the number of owner-occupied residential real properties that have been issued notices of default.
- Makes certain actions Consumer Protection Act violations.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

- Makes other changes to the deeds of trust statutes.

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## HOUSE COMMITTEE ON JUDICIARY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Chandler, Eddy, Frockt, Kirby, Klippert, Nealey, Orwall, Rivers and Roberts.

**Staff:** Trudes Tango (786-7384).

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## HOUSE COMMITTEE ON WAYS & MEANS

**Majority Report:** The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Judiciary. Signed by 22 members: Representatives Hunter, Chair; Darneille, Vice Chair; Hasegawa, Vice Chair; Alexander, Ranking Minority Member; Bailey, Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Carlyle, Cody, Dickerson, Haigh, Haler, Hudgins, Hunt, Kagi, Kenney, Ormsby, Parker, Pettigrew, Seaquist, Springer, Sullivan and Wilcox.

**Minority Report:** Do not pass. Signed by 5 members: Representatives Orcutt, Assistant Ranking Minority Member; Chandler, Hinkle, Ross and Schmick.

**Staff:** Andy Toulon (786-7178).

### **Background:**

#### Foreclosure Process for Deeds of Trust.

Unlike a mortgage, a deed of trust may be nonjudicially foreclosed if the borrower defaults on the loan obligation. The Deeds of Trust Act establishes procedures for foreclosure and imposes certain requirements on beneficiaries and trustees.

To foreclose on a deed of trust, the beneficiary or trustee must send a notice of default to the borrower. After 30 days from when the notice of default is sent, the trustee may record a notice of sale in the county auditor's office. The foreclosure sale may not occur until after 90 days from the time the notice of foreclosure sale is recorded, and may not occur until at least 190 days from the date of default. Within that time frame, the borrower may, among other things, cure the default and discontinue the sale or bring a court action to enjoin the foreclosure.

#### Meet and Confer.

In 2008 the Legislature enacted legislation requiring a beneficiary to contact a borrower by letter and telephone before issuing a notice of default in order to assess the borrower's financial situation. The beneficiary must give the borrower information for housing counseling agencies and must inform the borrower that he or she can request a subsequent

meeting with the beneficiary to explore options to avoid foreclosure. This is referred to as the "meet and confer" requirement. The "meet and confer" requirement applies to deeds of trust made from January 1, 2003, to December 31, 2007, on owner-occupied residential property and expires on December 31, 2012.

#### Real Estate Excise Tax.

The real estate excise tax does not apply when property is transferred by deed in lieu of foreclosure to satisfy a deed of trust and no additional consideration (money or other thing of value) is given to the transferor. In some cases, a lender might provide a nominal amount of money to the borrower as an incentive for the borrower to transfer the property in a deed in lieu of foreclosure transaction and to assist the borrower in relocation costs ("cash for keys"). That money could be "consideration" and may be subject to the real estate excise tax.

#### **Summary of Second Substitute Bill:**

##### Meet and Confer.

The "meet and confer" requirement is amended to allow for an additional 60 days before the notice of default may be issued, if the borrower responds within 30 days of the initial contact. The beneficiary makes initial contact by sending a form letter, which must contain model language developed by the Department of Commerce (COM). The letter must urge the borrower to contact a housing counselor or attorney as soon as possible. If the borrower requests a meeting with the beneficiary, the meeting must be in person unless waived by the borrower. However, a person authorized to make decisions for the beneficiary may participate by phone. The "meet and confer" requirement is made applicable to all deeds of trust and the expiration date is repealed.

##### Housing Counselors.

A housing counselor who is contacted by a borrower has a duty to act in good faith to attempt to reach a resolution within the time frame of the meet and confer process. A resolution may include, but is not limited to a loan modification, an agreement to conduct a short sale, a deed in lieu of foreclosure, or some other plan. Housing counselors are not liable for civil damages resulting from acts or omissions in providing assistance to borrowers, unless the acts or omissions constitute gross negligence or willful or wanton misconduct.

##### Mediation.

A foreclosure mediation process is established that applies to borrowers of deeds of trust on owner-occupied residential property who have been referred to mediation by a housing counselor or attorney. The housing counselor or attorney may refer a borrower to mediation if appropriate based on the individual circumstances and a notice of sale has not yet been recorded. A referral to mediation does not preclude a trustee from issuing a notice of default. The mediation process does not apply to any financial institution that certifies to the COM that it was not a beneficiary in more than 250 foreclosure sales in a calendar year.

A housing counselor or attorney referring a borrower to mediation must send a notice form to the COM. Within 10 days of receiving the notice, the COM must select a mediator and notify the parties. The mediator must convene an in-person mediation session within 45 days after being selected, unless the parties agree in writing to extend the time. Provisions are established to address when the mediator must send the parties notice of the mediation

session, what documents and information the parties must provide to the mediator, and what factors the parties must consider during mediation. The parties must mediate in person, but a decision-maker on behalf of the beneficiary may participate by phone.

Parties in mediation have a duty to act in good faith. A violation of the duty to act in good faith may include the failure to timely participate in mediation without good cause, the failure of either party to provide certain information to the other party, the failure of a party to pay its portion of the mediator's fees, and other conduct set forth in the bill.

Within seven days of the conclusion of the mediation, the mediator must certify to the COM the outcome of mediation and whether the parties acted in good faith. A certification that the beneficiary violated the duty to act in good faith constitutes a defense to the foreclosure, but not to any future foreclosure action. A certification that the borrower violated the duty to act in good faith authorizes the beneficiary to proceed with the foreclosure.

If an agreement was not reached and the mediator's certification shows that the net present value of a modified loan exceeds the anticipated net recovery at foreclosure, the showing constitutes a basis for the borrower to enjoin the foreclosure.

The mediator's fees must not exceed \$400 for a three-hour session and must be paid for equally by the borrower and beneficiary. The COM must maintain a list of approved foreclosure mediators and may establish a training program for mediators. The COM must make annual reports to the Legislature on the results of the mediation program.

#### Funding.

Beginning October 1, 2011, and every quarter thereafter, beneficiaries must: (1) report to the COM the number of owner-occupied residential real properties for which the beneficiary has issued notices of default during the previous quarter; and (2) remit to the COM a lump sum payment of \$250 per property. No later than 30 days after the effective date of this provision, the beneficiaries must remit to the COM a lump sum payment of \$250 per owner-occupied residential real property for which the beneficiary has issued a notice of default during the three months prior to the effective date of this provision. This reporting and remitting requirement does not apply to financial institutions and loan servicers that have issued fewer than 250 notices of default in the preceding year, or to association beneficiaries.

The funds are to be deposited into the newly created Foreclosure Fairness Account, which is a non-appropriated account administered by the COM. The funds must be distributed as follows: no less than 80 percent to fund housing counselors; the greater of up to 6 percent, or \$655,000 per biennium, to the Consumer Protection Division of the Office of the Attorney General (AGO); up to 2 percent to the Office of Civil Legal Aid for purposes of contracting with legal aid programs for representation of homeowners in matters relating to foreclosure; the greater of up to 9 percent, or \$451,000 per biennium, to the COM to implement the Foreclosure Fairness Act; and up to 3 percent to the Department of Financial Institutions to conduct homeowner outreach and education programs. The amount specified to fund housing counselors may be less than 80 percent if necessary to meet the level of funding specified for the AGO and the COM.

#### Consumer Protection Act.

It is a Consumer Protection Act violation for any person or entity to: (1) violate the duty of good faith in the mediation requirement; (2) fail to initiate contact with the borrower and exercise due diligence under the "meet and confer" requirement; and (3) fail to comply with the reporting and remitting requirements to the COM.

Servicer's Duty.

A servicer's duty to maximize net present value under a pooling and servicing agreement is a duty that is owed to all parties in a deed of trust pool, not to a particular party, and the servicer acts in the best interests of all parties if it agrees to a modification where default on the loan is reasonably imminent and anticipated recovery under a modification is more than the anticipated recovery through foreclosure.

Real Estate Excise Tax.

For the purpose of the real estate excise tax, "total consideration" shall not include the amount of any relocation assistance provided to the transferor when a transfer is made by deed in lieu of foreclosure to satisfy a deed of trust.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for section 11, relating to creating an account, section 12, relating to requiring beneficiaries to remit funds, and section 16, relating to requiring the Department of Commerce to create forms and authorizing rule-making, which contain an emergency clause and take effect immediately.

**Staff Summary of Public Testimony (Judiciary):**

(In support) It is the American dream to own your own home. A person's house is the largest, most valuable asset. Over 75,000 families have lost homes to foreclosure and Washington is 10th in the nation in terms of the number of foreclosures. This year, over 30,000 families are at risk of losing their homes in Washington. The amount of foreclosures that will happen is about the size of a small city. This bill enhances the meet and confer requirements and encourages banks to meet with families before the foreclosure process starts. A recent study shows that the meet and confer process is not working and the system is broken. This bill expands housing counseling, which is an important resource for families, and as a last resort provides for mediation. The bill makes sure that parties are acting in good faith. The Consumer Protection Act provision is a way to provide some oversight to the system. There are many stories from homeowners in which banks lose the paperwork or do not respond to homeowners trying to work out modifications. In some cases, the homeowner cannot get resolution and the process drags on. Having a disinterested third party is a valuable tool, especially for homeowners who have limited knowledge of the process. It will be helpful to have the banks meet the borrower in a face-to-face meeting, which will increase the likelihood of getting sustainable modifications. There are over 20 states that have mediation programs and they are very effective. Many of those programs are "opt in" programs. Nevada's program is quick, effective, and efficient. Housing counselors can help homeowners exit out of the home gracefully. More counselors are needed and homeowners

need more tools to communicate with their lenders. Homeowners do not know who to talk to and how to navigate the process. There is incentive for some banks to foreclose. The Office of the Attorney General would look for trends to see if there is noncompliance with the Deeds of Trust Act. The Attorney General would not enforce the Deeds of Trust Act for a particular individual, but enforce the Consumer Protection Act for widespread noncompliance.

(With concerns) Many of the provisions raise constitutional issues around impairment of contracts. It will significantly increase litigation. The mediation section is based on Nevada's statute, but Nevada's mediation is run by the courts. The bill does not address the right to appeal a decision from the mediator. The consequences are very dire if a party is found to act in bad faith. One party should not be forced to make a decision on a loan modification. Smaller banks and credit unions must be exempted from the mediation requirements.

(Opposed) The banks and consumer advocates have a common goal, which is to make foreclosure a last resort. All parties in foreclosure are in a losing position. In most cases, banks go to great lengths to seek loan modifications, but sometimes foreclosure is the only solution left. Every case is different and every individual has distinct circumstances. It is difficult to fashion a broad solution. The banks agree to make the meet and confer provisions permanent and apply it to all deeds of trusts in the state. The real problem with the bill is the mediation program. The committee should look at other state models for solutions. The mediation program in the bill is not true mediation. It is a form of binding arbitration. The penalties for the lender are so heavy. Mediation is about choice, where the parties are free to agree or not. Mediation should be voluntary with some initial screening to determine whether it is appropriate. The timelines in the bill are very vague. The in-person meeting is a problem when banks have decision-makers who are in a different state. Dealing with the right person is the most important issue, not dealing with just anyone in person. Requiring a lender to modify the loan raises an impairment of contracts issue. Modification must be voluntary. Getting borrowers to housing counselors is the best way to get resolution instead of creating a whole new process. The mediator is required to make a good faith determination, but mediators do not typically make factual adjudications. The \$30 fee imposed at the county auditor is not a fee for service.

#### **Staff Summary of Public Testimony (Ways & Means):**

(In support) Our state is in a crisis with regard to foreclosure with 30,000 families at risk this year. The parties have all come to the table on this program. This bill strengthens "meet and confer" requirements, ensures access to housing counselors, and adds a new step of mediation. These changes will help meet homeowner needs.

The bill is very specific on the use of funds that come in as a result of the bill. There is strong agreement that the revenues that come in be protected for the use of housing counselors and other provisions of the bill to help people navigate the process of foreclosure.

Financial institutions have stepped up to offer to pay for the housing counselors and other requirements of the bill through a \$250 payment on each notice of default. It is estimated

that there will be a minimum of \$7.5 million per year for counseling and other efforts. The funding has been front loaded so there is no fiscal impact to the COM in the early days.

There are provisions in the bill that allow entities to demonstrate that they are authorized to participate in mediation by signing a declaration that they are the owner of a note. These declarations can be "robo-signed" and the language should be changed to remove a signed declaration as being sufficient proof that the party is able to enforce the promissory note or deed of trust. The true lender on mortgage backed securities is not always identified and intermediate banks trying to foreclose on properties may not actually have the right to participate in mediation. The bill should be changed to require an entity to prove they have the right to foreclose on a property.

(Neutral) There is a mediation program in Florida where the lender pays \$750 for the entire cost of mediation. It is important that there is consistent and effective administration of the program as programs in some other states have been implemented poorly.

(Opposed) None.

**Persons Testifying (Judiciary):** (In support) Representative Orwall, prime sponsor; Steve Breaux, Washington Public Interest Research Group; Sarajane Siegfriedt, King County Democrats; Andrew Kidder, Resolution Washington; Jonathon Johnson, National Association for the Advancement of Colored People; Charlotte Gilbert; Erin Rearden, Solid Ground; Bruce Neas, Columbia Legal Services; Verise Campbell, Nevada Foreclosure Mediation Program; Dan Backstrom; Nancy Shaffer; Sharon Kitchel Perdue, Service Employees International Union; Phil Harlan, Washington Realtors; James Parchment; Alex Kamaunu, Family Finance Resource Center; Michael Bird; Nancy Beck and Kulwinder Kaur, Statewide Poverty Action Network; Loren Shekell, Parkview Services; Simona Alvarez, Arturo Gonzalez, Eleazor Sevilla, and Silvia Hurtado, El Centro de la Raza; Mark Cote, Washington Homeownership Resource Center; Nick Federici, Washington Low Income Housing Alliance; Jim Sugarman, Office of the Attorney General; Rebecca Johnson, Washington State Labor Council; Rebeca Potasnik, Washington Asset Building Coalition; Denise Graham; Tom Borer; and Chris Van Dyk.

(With concerns) Al Ralston, Boeing Employees Credit Union; Michael Brooks, United Trustees Association; Nick Demerice, Department of Commerce; and David Spring.

(Opposed) Denny Eliason, Washington Bankers Association; Michelle Radosevich, Davis Wright; Zachary Urban, Colorado Coalition of Housing Counseling; James McMahan, Washington Association of County Officials; and Karen Gibbon, Washington State Bar Association Real Property Probate and Trust Section.

**Persons Testifying (Ways & Means):** (In support) Majken Ryherd, Statewide Poverty Action Network; Denny Eliason, Washington Bankers Association; Karen Pooley; and Barry Nilsen.

(Neutral) Serena K. Lee, American Arbitration Association.

**Persons Signed In To Testify But Not Testifying (Judiciary):** None.

**Persons Signed In To Testify But Not Testifying (Ways & Means):** None.