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For homeowners and tenants caught in subprime mortgage crisis, reforms await Governor's signature — but are they enough?

Duties of brokers as fiduciaries are spelled out, making cases easier to prosecute



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As California continues to reel from the subprime mortgage crisis, a new law provides at least some protection for homeowners and tenants, and gives local government new enforcement powers to prevent foreclosure-related blight.

New protections effective immediately

On July 8, 2008, Governor Schwarzenegger signed Senate Bill 1137 (Peralta) into law. The statute was enacted as an urgency measure and is already in effect.

The new law requires lenders to contact homeowners at least 30 days before filing a notice of default to explore ways to avoid foreclosure, gives borrowers the right to request a subsequent meeting with their lender within 14 days, and requires lenders to provide homeowners with a toll-free telephone number to find a HUD-certified housing counseling agency. These protections apply to owner-occupied residences purchased between January 1, 2003, and December 31, 2007, when most problematic loans were made.

Tenants residing in foreclosed properties also benefit from the new law. They are entitled to receive a letter from the lender that informs them that the foreclosure process has begun, and that their landlord must provide them with at least a 60-day notice – an increase over the 30-day notice that lenders in California jurisdictions without rent control had previously been required to give. The new 60-day notice must be in English, Spanish, Chinese, Tagalog, Vietnamese and Korean, and the translations will be made available by the state. More than 80 percent of Californians with limited English proficiency speak one of the five languages required in the notice.

SB 1137 gives local governments a new way to prevent blight that often results from neglected foreclosed properties by authorizing civil fines of up to

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$1,000 per day for property owners who fail to maintain their buildings. Before fines are imposed, owners are entitled to receive a description of offensive conditions, and are allowed 14 days to begin repairs and 30 days to complete them.

SB 1137 will sunset on January 1, 2013.

AB 1830: Preventing future mortgage meltdowns

The Legislature has also enacted reforms to protect future borrowers, including a private right of action and attorneys fees for prevailing homeowners. As Plaintiff went to press, the legislature sent Assembly Bill 1830 (Lieu) to the Governor.

AB 1830 covers loans originated on or after July 1, 2009, and much of it is directed at mortgage brokers. The bill:

- Holds brokers to a fiduciary duty to the borrower, and states that any violation will be considered an infringement of the mortgage broker licensing law;
- Specifically bars brokers from steering borrowers toward loans that cost more than those for which the borrower qualifies, and from making false or misleading statements about higher priced loans;
- Eliminates financial incentives for exploiting borrowers by barring extra compensation for brokers who place homeowners in loans with prepayment penalties, which trap borrowers in predatory loans by requiring extra fees for early payoffs;
- Bans "flipping," or refinancing that provides fees to brokers and lenders but doesn't benefit borrowers;
- Bans negative amortization loans that allow borrowers to pay less than the full amount of interest owed, which lead to ever-increasing loan amounts that reset at dramatically higher monthly payments;
- Caps prepayment penalties at two percent of the principal balance prepaid during the first year of the loan, or one percent during the second year. Newly enacted federal law bans prepayment penalties after the first two years of a loan; and
- Allows enforcement by borrowers, licensing agencies, and the Attorney General; authorizes civil penalties of up to $10,000; and makes violators liable for a borrower's actual damages.

More reform is still needed

Although AB 1830 provides much-needed reform to prevent future mortgage meltdowns, it does not go far enough. The bill does nothing to prevent the "bait and switch" tactics that have been used by brokers who prey on homebuyers who do not speak English by promising terms in their native tongue that do not appear in the loan documents that are written in English. The Assembly had passed a bill (AB 512) that would have required a simple two-page translation of basic mortgage terms, but the Senate did not approve it.

Capping prepayment penalties is not enough – they should be banned. Prepayment penalties add an unnecessary financial burden to borrowers who want to refinance to a more affordable mortgage.

Another predatory lending practice ripe for elimination is the exclusion of escrow accounts to cover property taxes and insurance. This allows lenders to hide borrowing costs and leads to nasty financial surprises for unsuspecting borrowers. Lenders should also be required to ask mortgage applicants for proof of income, to ensure that borrowers can afford the cost of their loan.

Reforms to protect future borrowers will not help current homeowners avoid foreclosure and the newly enacted SB 1137 falls far short of providing meaningful relief. A dramatic solution is needed to stop California's current foreclosure crisis and prevent the devastating impact ever-increasing default rates will have on our state's economy.

Lawmakers should enact a temporary foreclosure moratorium to protect homeowners until a legislative solution can be fashioned. A legislative solution would allow blanket loan modifications to transform foreclosures into sustainable loans. Voluntary, case-by-case loan modifications have failed to help the great majority of California subprime borrowers from losing their homes.

Expand your practice

If Governor Schwarzenegger follows the lead of the legislature by approving AB 1830, plaintiffs' attorneys can obtain information about the new law and locate potential clients needing assistance by contacting the Housing and Economic Rights Advocates at www.heraca.org.

Another resource, Community Legal Services (CLS) in East Palo Alto, screens and refers victims of predatory lending practices and persons in foreclosure to attorneys through its five-county attorney referral service. CLS also offers trainings, mentors attorneys and provides trained law students to help attorneys who take on such cases. Attorneys can contact CLS by e-mailing Jon Frohmyer at jon@clsepa.org.

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