Chapter 8

The 2008 Real Estate Crisis and Effects

Chapter 8 Goals:

- Be aware of the 2008 mortgage and real estate crisis
- Understand how subprime lending and the expansion of adjustable rate mortgages contributed to the collpase of the real estate market
- List the regulations that were created in response to the subprime lending market
- Learn about Federal Stimulus Acts
- Recognize what a foreclosure is
- Learn the foreclosure process
- How a property can be redeemed after foreclosure

Chapter 8: The 2008 Real Estate Crisis and Effects

Key Terms

American Recovery and Reinvestment Act (ARRA) Annual Percentage Rate (APR) Antideficiency Protection Act bankruptcy California Residential Mortgage Lending Act certificate of discharge creative financing deed in lieu of foreclosure Dodd-Frank Bill Economic Stimulus Act of 2008 Federal Housing Finance Agency (FHFA) Financial Institutions Reform Recovery and Enforcement Act foreclosure Foreclosure Prevention Act Fraud Enforcement and Recovery Act of 2009 Good Faith Estimate (GFE)	growing equity mortgage program Home Affordable Foreclosure Alternative Program (HAFA) Home Affordable Modification Program (HAMP) Home Affordable Refinance Program (HARP) home equity sales contract Home Equity Sales Contract Act Housing and Economic Recovery Act (HERA) judicial foreclosure lien modification mortgage loan disclosure statement mortgage debt securitization Nationwide Mortgage Licensing System (NMLS) non-judicial foreclosure notice of default notice of sale	option ARM mortgage predatory lending power of sale Real Estate Settlement Procedures Act (RESPA) reinstatement right of redemption right of rescission Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) second mortgage securitization subprime lending trustee in bankruptcy trustee sale trustee sale postponement Truth in Lending Act (TILA) Truth in Lending Disclosure Statement usury uniform settlement statement unlawful detainer

The 2008 Real Estate Crisis

Local, state, federal, and world economic markets are interconnected. The success or failure of one market has the ability to affect the landscape of another, particularly when it is one as large as the real estate market.

This was made clear in 2008 when the real estate market collapsed. Among the main factors that contributed to the collapse were:

- Increase in subprime lending
- Expansion of adjustable rate mortgages (ARMs)
- Government interference in the market

Subprime Lending

Subprime lending refers to providing loans for "at risk" borrowers who may not be able to repay the loan. For example: borrowers with bad credit or those without the necessary income to make mortgage payments.

Prior to the early 2000s, subprime lending was restricted to very few applicants. In an attempt to increase profits, however, bigger banks began approving subprime borrowers with low introductory rates and with little to no down payment required. They approved borrowers even while understanding that a significant percentage of them would default.

Before 1998, almost all loans were 30-year fixed rate mortgages. Lenders originated these loans for the purpose of collecting interest throughout the loan term. In late 1998, however, a new "originate to sell" mentality took hold. Lenders knew that they could make more money by charging points and fees to originate loans than they could by collecting interest on loans.

Consequently, lenders started originating risky loans with the intention of selling them to other investors or lenders. This practice is known as **mortgage debt securitization**. Lenders stopped caring about the quality of the loans they originated – or borrowers' ability to pay them back– because they could always sell them. Many economists and bankers made arguments centered on the fact that borrowers and lenders did not have enough financial skin in the performance of any single loan to care whether it was good or bad because they could always walk away from them.

Big banks sold these "bad" mortgage notes to smaller lenders before the interest rate readjusted. Believing that property values would continue to rise, these less experienced lenders bought them.

Risky Loan Options

In the early 2000s, lenders developed new loan programs in an attempt to lure consumers into purchasing real estate and taking out mortgages. These "creative financing" alternatives to standard loan programs were often risky.

For example, lenders significantly expanded adjustable rate mortgages (ARMs) into the primary residence mortgage market. Although such programs were not new, they had been historically sold to experienced businessmen and investors and had never been used on a grand scale before.

As discussed in Chapter 7, introductory ARM interest rates are lower, but they can adjust at any time throughout the life of the loan based on credit indexes and current market conditions. Consequently, borrowers with ARMs have always had a higher risk of default than those with fixed-rate mortgages due to the volatility of the payments.

The low introductory interest rate lured a massive influx of borrowers into taking out loans in the early 2000s and ARMs quickly became a larger percentage of overall loan originations.

ARMs gave borrowers the false impression that a home purchase was cheaper than it was. Many borrowers believed that as interest rates increased, they could simply refinance at a lower rate. However, this is only true if property values continue to rise. When property values stopped rising in 2006, lenders increased interest rates. Consequently, borrowers' monthly payments increased and it became more difficult for them to pay on time.

Banks also started offering an **option ARM mortgage** that gave borrowers four monthly payment options:

- Minimum
- Interest-only
- Principal and interest
- Negative amortization

Many borrowers were lured into taking out such a mortgage, as they believed they could continue making the minimum payments indefinitely. However, when the mortgage's introductory "honeymoon" period expired, borrowers were forced to make the full principal + interest monthly payments and many could no longer afford their homes.

Another program offered by lenders was the **growing equity mortgage program**. This was created for borrowers who expected to make more money in the near future. The first period of the program would begin with a low payment and as the borrower began to earn more monthly income, the payments increased. If a borrower did not end up making more money, however, they would unable to make the increasing mortgage payments.

Government Interference in the Market

In 1989, the government enacted the **Financial Institutions Reform Recovery and Enforcement Act**. The purpose of the Act was to create a more equitable footing between savings and loan associations and larger, more established lenders. To do this the act gave more power and influence to Fannie Mae and Freddie Mac to provide more mortgages to low income and moderate income borrowers. Although this strategy was meant to help the market, it adversely affected the natural cycle of supply and demand.

It adversely affected the mortgage market because Fannie Mae and Freddie Mac was given the right to guarantee mortgages of certain lenders, even if the quality of the mortgages produced was lower. This created an unfair marketplace, where Fannie Mae and Freddie Mac were picking winners and losers by guaranteeing some mortgages, while not doing the same with other lenders. This caused banks whose mortgages were guaranteed to produce lower quality mortgages, knowing that ultimately, they would be repaid regardless of whether the mortgage went into default or not.

The government also guaranteed loans through the financial institutions Freddie Mac and Fannie Mae. (These will be discussed further in Chapter 9.)

As lenders knew that the government would buy back – or bail out – their loans, they could originate "bad" loans without any real repercussions. In other words, the government provided a safety net that allowed lenders to engage in high risk lending behavior.

The Fall Out

By 2006, the real estate market was being shaped by short-term risky business practices over safe, long-term growth. Before long, the bubble burst.

Beginning in 2006, an increasing number of subprime borrowers began defaulting on their mortgages. Loans that were initiated on the premise of a minimum or no down payment soon led to an influx of borrowers who were "upside down" on their mortgage. This meant that a borrower's loan amount was higher than the value of his or her property. Many borrowers were forced to forfeit or abandon their properties.

As their interest rates and monthly mortgage payments increased, many borrowers with ARMs also fell into default.

These defaults soon led to a wave of foreclosures. The sudden increase of properties on the market created a higher supply than demand. This caused property values to fall drastically.

Investors grew wary of any investments. Lenders subsequently tightened their underwriting standards, which further stalled economic development. Industries that depended upon the real estate market suffered, if they did not collapse themselves. Unemployment rose. Consumer spending – in the real estate market and the economy overall – dropped.

All of these factors led to a significant contraction in the economy. This ultimately rippled outward to cause billions of dollars in losses across the globe and a worldwide economic collapse.

Government Response

In order to stabilize the market and prevent further losses, the government intervened. Its goal was to stabilize the mortgage market, reduce the foreclosure rate, and give the market the impression that the government was there to help.

Many government initiatives targeted the housing and mortgage market. The government and economists believed that improving the health of the real estate market – including property values, available credit, and lowered interest rates – would improve the health of the overall economy.

Economic Stimulus Act of 2008

In 2008, Congress passed the **Economic Stimulus Act of 2008**. The purpose of the Act was to stimulate economic growth by incentivizing business investment and consumer spending.

The Act provided tax rebates to low and middle-income taxpayers. Individuals could qualify for a rebate of at least $300; married couples could qualify for at least $600.

The Act also changed the limit of conforming loans and loans guaranteed by the government.

Housing and Economic Recovery Act (HERA)

The **Housing and Economic Recovery Act (HERA)** was passed in July of 2008 under the direction of President George W. Bush. It was geared towards better regulating financial and real estate markets.

One of HERA's main provisions was to require mortgage brokers to report residential and commercial business activities to the Department of Real Estate. To do so, they must complete the Mortgage Loan Activity Notification form (Form RE 866) using their name and license number.

This provision is enforced at the state level.

Another provision was to meet the new standards of the **Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)**. The SAFE Act was created to regulate the practices of mortgage loan originators (MLOs) and ensure that mortgage program guidelines are being followed.

The SAFE Act required mortgage loan originators to:

- Register on the Nationwide Mortgage Licensing System by January 1, 2011. The **Nationwide Mortgage Licensing System (NMLS)** is a database of mortgage lenders, mortgage loan originators, and mortgage brokers.
- Finish all requirements for MLO licensure, including federal and state examinations.
- Be issued an MLO endorsement on their individual real estate license.

American Recovery and Reinvestment Act (ARRA)

President Barack Obama signed the **American Recovery and Reinvestment Act (ARRA)** in 2009. ARRA furthered HERA's original provisions.

Among the new provisions offered in ARRA were:

- *Providing grants to low-income individuals and families.* These grants allowed states to trade low-income housing tax credits for new grants to construct and/or rehabilitate low-income housing.
- *Allocating $6 billion to the Neighborhood Stabilization program.* This provided grants to state and local municipalities to homeowners who lived in foreclosure-ridden neighborhoods. The purpose of the program was to help consumers repair and purchase foreclosed properties. By taking foreclosed properties off the market and reducing available inventory, the market's supply and demand could be stabilized.
- *Replacement of the Federal Housing Finance Board with the Federal Housing Finance Agency.* This made the **Federal Housing Finance Agency (FHFA)** the new regulator of Federal Home Loan Banks.

Dodd-Frank Bill

President Obama signed the **Dodd-Frank Bill** – also known as the Financial Stability Act of 2010 – into law on July 21, 2010. The purpose of the bill was to provide oversight to the financial market and bring stability to the unstable real estate market.

The Bill created a Financial Research office, as well as the Financial Stability Oversight Council.

Home Affordable Modification Program (HAMP)

The **Home Affordable Modification Program (HAMP)** gives homeowners the opportunity to modify the terms of their existing mortgage in order to avoid foreclosure.

To qualify, a borrower must currently occupy his or her home, have loans below $729,750, and be able to demonstrate financial hardship. This includes a loss of income, divorce, medical bills, illness, or an unemployed spouse.

Home Affordable Refinance Program (HARP)

The **Home Affordable Refinance Program (HARP)** allows borrowers with a Fannie Mae or Freddie Mac loan to refinance in order to have a lower monthly mortgage payment.

Unlike HAMP, which assists borrowers who are in danger of foreclosure, HARP assists borrowers who are current on mortgage payments but are unable to refinance due to decreased property values.

Current estimates calculate that between three and four million borrowers qualify for an interest rate reduction and potentially other modifications to their mortgage.

Home Affordable Foreclosure Alternatives Program (HAFA)

The **Home Affordable Foreclosure Alternative Program (HAFA)** was created to help borrowers whose loans were not owned by Fannie Mae or Freddie Mac avoid foreclosure.

HAFA was also aimed at reducing neighborhood foreclosures that would drive down overall property values.

Second Mortgage/Lien Modification Program

The Second Mortgage/Lien Modification Program helps borrowers who are experiencing financial hardship to modify the terms on their second mortgage.

Antideficiency Protection Act

The **Antideficiency Protection Act** (SB931) clarified protection laws for borrowers who owed more on their mortgages than the value of their properties.

Prior to its passage, defaulting borrowers who had a larger loan amount than the value of their properties were responsible for paying lenders the difference after foreclosure. However, the Act stipulated that a lender can only foreclose on the property and cannot seek a judgment against a defaulting borrower (Cal. Code Civ. Proc. Section 580 D).

According to Section 580(e) of the Act:

"No judgment shall be rendered for any deficiency under a note secured by a first deed of trust or first mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for less than the remaining amount of the holder."

This gave borrowers the option to walk away from a bad investment without the fear of owing money after foreclosure.

The Act only applies to a borrower's original mortgage, not home equity loans.

Furthermore, the Act reaffirms California's One Action Rule, which stipulates that a lender can only pursue one form of action in recovering their debt (California Civil Code, Section 726).

In the event that a defaulting borrower becomes current with his or her mortgage, the borrower can reinstate the mortgage. A **reinstatement** refers to when a borrower brings a mortgage current before a foreclosure takes place.

Foreclosure

Foreclosure is the process of terminating a property owner's right to possess and use a particular property. This typically occurs when a borrower cannot or chooses not to uphold mortgage payments, property taxes, or H.O.A. fees for a sustained period of time.

Foreclosure is synonymous with the mortgage term power of sale. **Power of sale** refers to a mortgage or lien holder's power to force a sale of a defaulting borrower's property in order to recoup unpaid debt due.

Foreclosure Process

There are three steps in the foreclosure process:

- Notice of default
- Notice of sale
- Trustee sale

Notice of Default

A lender may implement the foreclosure process as quickly as 90 days after a borrower fails to make a payment. In periods of high foreclosure rates, however, a lender will generally take longer than 90 days to avoid adding another foreclosure to the market.

A **notice of default** is a notification supplied by a lender to a borrower that indicates that the borrower is behind on mortgage payments and is in violation of his or her loan obligations.

A notice of default is typically issued after the fourth missed payment. It states how much the borrower owes, including the balance, interest, fees, penalties, and any other costs required to bring the loan current.

A lender must provide a borrower with a notice of default within 10 days of recording the default. The notice must be sent through certified mail.

A lender must also send the notice to the State Controller's office.

The primary lien holder is responsible for providing a notice of default to parties with an interest in the property, including the borrower and junior lien holders.

SUMMARY OF KEY INFORMATION

The attached notice of default was sent to ______________________________, in
(Name of the Trustor)

relation to ____.
(description of the property that secures the mortgage or deed of trust in default)

This property may be sold to satisfy your obligation and any other obligation

secured by the deed of trust or mortgage that is in default. ________________
(Trustor)

has, as described in the notice of default, breached the mortgage or deed of trust on the property described above.

IMPORTANT NOTICE: IF YOUR PROPERTY IS IN FORECLOSURE BECAUSE YOU ARE BEHIND IN YOUR PAYMENTS, IT MAY BE SOLD WITHOUT ANY COURT ACTION, and you may have the legal right to bring your account in good standing by paying all of your past due payments plus permitted costs and expenses within the time permitted by law for reinstatement of your account, which is normally five business days prior to the date set for the sale of your property. No sale date may be set until approximately 90 days from the date the attached notice of default may be recorded (which date of recordation appears on the notice).

This amount is ____________ as of ________________ and will increase
(date)

until your account becomes current.

While your property is in foreclosure, you still must pay other obligations (such as insurance and taxes) required by your note and deed of trust or mortgage. If you fail to make future payments on the loan, pay taxes on the property, provide insurance on the property, or pay other obligations as required in the note and deed of trust or mortgage, the beneficiary or mortgagee may insist that you do so in order to reinstate your account in good standing. In addition, the beneficiary or mortgagee may require as a condition to reinstatement that you provide reliable written evidence that you paid all senior liens, property taxes, and hazard insurance premiums.

Upon your written request, the beneficiary or mortgagee will give you a written itemization of the entire amount you must pay. You may not have to pay the entire unpaid portion of your account, even though full payment was demanded, but you must pay all amounts in default at the time payment is made. However, you and your beneficiary or mortgagee may mutually agree in writing prior to the time the notice of sale is posted (which may not be earlier than three months after this notice of default is recorded) to, among other things, (1) provide additional time in which to cure the default by transfer of the property or otherwise; or (2) establish a schedule of payments in order to cure your default; or both (1) and (2).

Following the expiration of the time period referred to in the first paragraph of this notice, unless the obligation being foreclosed upon or a separate written agreement between you and your creditor permits a longer period, you have only the legal right to stop the sale of your property by paying the entire amount demanded by your creditor.

To find out the amount you must pay, or to arrange for payment to stop the foreclosure, or if your property is in foreclosure for any other reason, contact:

____

(Name of beneficiary or mortgagee)

____

(Mailing address)

____

(Telephone)

If you have any questions, you should contact a lawyer or the governmental agency which may have insured your loan.

Notwithstanding the fact that your property is in foreclosure, you may offer your property for sale, provided the sale is concluded prior to the conclusion of the foreclosure.

Remember, YOU MAY LOSE LEGAL RIGHTS IF YOU DO NOT TAKE PROMPT ACTION.

If you would like additional copies of this summary, you may obtain them by calling________________________.
(Telephone Number)

Notice of Sale

A **notice of sale** is an acceleration of a notice of default. At this point, a borrower must pay back the lender for defaulted debt obligations in order to keep his or her property.

A notice includes a borrower's name and property address, as well as a statement that the property will be sold in auction and the auction date.

A notice of sale must be sent to a borrower through certified mail. A lender must also post the notice on the borrower's property and a public place (such as a DMV) for 30 consecutive days.

A notice can be removed if a borrower brings his or her loan current or reaches a loan modification. A borrower must either apply for a loan modification or pay back the owed balance to avoid further foreclosure proceedings.

Trustee Sale

When a borrower defaults on payments to a lender, and the lender has followed the aforementioned steps, the lender has the right to sell the property in a trustee sale. A **trustee sale** is a public auction in which a defaulted borrower's property is sold.

If a foreclosed property lies within two or more counties, a trustee sale may occur in either one of the counties.

When a buyer purchases a property through a trustee sale, he or she is awarded immediate possessory rights. In other words, a borrower has no right of redemption.

Types of Foreclosure

There are two kinds of foreclosure proceedings: judicial and nonjudicial foreclosure.

Judicial Foreclosure

A **judicial foreclosure** occurs when a borrower falls behind on loan payments secured by a mortgage. This kind of foreclosure requires court approval to be executed, which is why judicial foreclosures typically take longer to execute.

Under a judicial foreclosure, a court will order a defaulting borrower's property to be sold at a public auction.

Because the process of administering a foreclosure is costly and time-consuming, a court will always require the winning bidder to make a deposit of $5,000 for the purchase.

If a winning bidder then produces the full funds to purchase the property within 10 days of the sale, he or she will be awarded a certificate of sale by the Real Estate Commissioner or the local sheriff. This certificate is subsequently recorded with the county recorder's office.

If a winning bidder cannot produce the funds to purchase the property within 10 days, the bidder will forfeit his or her deposit and the property will likely be auctioned again.

However, even with a certificate of sale, a bidder/buyer of a foreclosed property technically does not own the property until the original property owner's redemption period has expired. The **right of redemption** refers to a foreclosed property owner's right to reclaim his or her property by coming current with a debt within a specified period.

If the right of redemption period expires and the original homeowner has not come current on his or her debt, the homeowner must vacate the property. If the original homeowner does not vacate, the new buyer can file an **unlawful detainer**. This gives a court the right to evict the original homeowner.

The first lien holder on a foreclosed property – typically the bank – is first entitled to the proceeds from a trustee sale. Once that lender's losses are made whole, any remaining money will awarded to junior lien holders (second or third mortgage holders).

Once a lender's losses have been satisfied after the sale of a property, the lender will sign a **certificate of discharge**. Once recorded, this certificate removes the lender's lien from the property.

If a foreclosed property is not sold, a court may order the property to be auctioned later or put it on the open market as an R.E.O. A R.E.O. is the acronym for real estate owned, meaning the property is owned by a lender.

Non-Judicial Foreclosure

A **non-judicial foreclosure** occurs when a borrower falls behind on loan payments secured by a trust deed.

A non-judicial foreclosure is negotiated between a lender, a borrower, and a third party (typically an escrow company). The escrow company is responsible for implementing the foreclosure process against a defaulting borrower.

The non-judicial foreclosure process is typically much faster and easier than the judicial foreclosure process.

There is no right of redemption in a non-judicial foreclosure (when there is a trust deed). This minimizes a lender's risk to lend money.

Foreclosure Prevention Act

After an influx of foreclosures hit California in 2008, California passed the **Foreclosure Prevention Act**. The Act extended the period of time a lender had to wait in between filing a notice of default and a notice of sale.

Previously, lenders had to wait 90 days after filing a notice of default before filing a notice of sale. The Act extended that period to 180 days. This gave borrowers more time to come current on their debts before facing foreclosure.

Trustee Sale Postponement

In times where there are high foreclosure rates – such as after the 2008 real estate collapse – a trustee (i.e. escrow company), under the guidance of a beneficiary (i.e. lender), may potentially withhold the foreclosure process. This is done to avoid dumping excess real estate inventory onto the market, which only serves to decrease the value of a beneficiary's asset.

California Civil Code, Section 2924g states:

"The sale shall commence at the time and location specified in the notice of sale. Any postponement shall be announced at the time and location specified in the notice of sale for commencement of the sale..."

"If the sale of more than one parcel of real property has been scheduled for the same time and location by the same trustee, (1) any postponement of any of the sales shall be announced at the time published in the notice of sale, (2) the first sale shall commence at the time published in the notice of sale or immediately after the announcement of any postponement, and (3) each subsequent sale shall take place as soon as possible after the preceding sale has been completed."

A lender can postpone a trustee sale under the following circumstances:

- Upon the order of a court of competent jurisdiction
- If stayed by operation of law
- By a written or oral agreement between a lender and a borrower
- At the discretion of a trustee (i.e. escrow company)
- If a trustee sale's proceedings are postponed for a period or periods totaling more than 365 days. In this case, a new notice of sale must be given before scheduling any further sale proceedings

Deed in Lieu of Foreclosure

A **deed in lieu of foreclosure** – also known as a mortgage release – is a foreclosure alternative that allows a defaulting borrower to voluntarily transfer a property title to a lender. Put another way, a borrower eliminates his or her debt by forfeiting his or her property ownership rights.

A foreclosure prevents a borrower from buying another property for at least 5 years. A deed in lieu of foreclosure allows a borrower to avoid having a foreclosure attached to his or her credit.

It also helps a lender avoid the expensive and time-consuming foreclosure process while maintaining the value of the property being used as collateral for a loan.

A deed in lieu of foreclosure should be used if:

- A borrower is behind on mortgage payments
- A borrower cannot qualify for a refinance loan or loan modification
- A borrower faces long-term financial hardship
- The value of a property is less than the mortgage debt
- A borrower cannot sell his or her home

Mortgage release programs vary by lender. Some programs allow a borrower to remain on a property for a specified period of time (usually one to three months) without making mortgage payments. Others give a borrower the option to rent the property for up to one year.

Foreclosure Abuse

With the influx of foreclosures after the real estate market crash, there was a rise in deceptive foreclosure prevention services. Supposed "loan modification experts" solicited borrowers who fell behind on mortgage payments with the promise that they could reduce the borrower's mortgage debt, forgive past due mortgage payments, and provide a better interest rate. While many companies did dispense legitimate services, a sizable percentage collected upfront fees without providing any service.

In order to deter fraudulent companies and reduce foreclosure abuse, the California legislature passed SB94 on January 1, 2013. This legislation prevented any company who provided mortgage relief services from charging an advance fee for loan modification services before services were fully given. This included attorneys, real estate firms, and real estate agents.

SB94 targeted companies who:

- Stop or postpone foreclosure sales
- Assist borrowers in applying for loan modification programs
- Assist in performing forensic loan audits

Any company or individual who violates the terms established by SB94 may be prosecuted and/or subject to civil and criminal penalties.

Bankruptcy

Article I, Section 8, of the United States Constitution authorizes the restructuring of debt to avoid further financial collapse.

A 1934 Supreme Court decision stated that bankruptcy "gives to the honest but unfortunate debtor... a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."

Bankruptcy is a court-administered process that allows a defaulting borrower to restructure his or her debt. Bankruptcy discharges all or a portion of a debtor's debt, thereby reducing or eliminating the debtor's personal financial liabilities.

When a borrower files for bankruptcy, a court issues an order for relief that directs lenders to stop all collection activities. This allows a borrower to delay and/or prevent the foreclosure process and retain a property.

However, bankruptcy damages a borrower's credit for a long period of time and is seen as a last resort.

Both individuals and businesses can declare bankruptcy.

Most bankruptcy decisions are made in a formal meeting at the United States Trustee's Office. This meeting allows a debtor to negotiate debt with his or her lenders and discuss the discharging of a debt.

There are six common bankruptcy types, including:

- **Chapter 7**: A court liquidates a debtor's assets to pay lenders and other individuals owed money by the debtor. In this case, a **trustee in bankruptcy** (court representative) holds title to a debtor's assets and handles selling them.
- **Chapter 9**: Adjusts the debts of a municipality. This allows a municipality to reorganize its assets and liabilities in order to financially salvage a town, village, county, or school district.
- **Chapter 11**: Reorganizes a debtor's debt through a court approved repayment plan.
- **Chapter 12**: Adjust the debts of a farmer or a fisherman whose regular annual income depends on nature. This form of bankruptcy allows the debtor to repay debts over a period of time, typically three years.

- **Chapter 13**: When both a debtor and a lender make a request to force a debtor to liquidate and distribute his or her assets. This only applies to someone who earns a regular income.
- **Chapter 15**: Deals with bankruptcy cases that cross borders. This type of bankruptcy is used when a debt or subject property is subject to the laws of both the United States and a foreign entity.

Mortgage Abuse and Fraud

The Federal Trade Commission (FTC) is responsible for outlining consumer protection measures to protect consumers from fraud and identity theft.

Fraud Enforcement and Recovery Act of 2009

The **Fraud Enforcement and Recovery Act of 2009** gives federal authorities the right to prosecute individuals and corporations who fail to follow federal financial regulations. This includes the right to investigate company practices.

The Act sets aside a $650 million total budget for prosecutors to pursue fraud cases. It also provides an estimated $140 million to the FBI and $100 million to the U.S. Attorney's Office to track mortgage fraud, as well as over $80 million for the Justice Department's criminal, civil and tax offices.

Inquiries, complaints, and allegations of mortgage fraud can be made to the Loan Modification Scam Prevention Network. More information can be found on www.preventloanscams.org.

Home Equity Sales Contracts

When faced with losing one's home and the uncertainty of foreclosure proceedings, many homeowners become susceptible to fraud and make bad decisions.

After the 2008 real estate crash, many defaulting homeowners tried to sell their homes through a **home equity sales contract**. Under such a contract, a homeowner who faced foreclosure would sell his or her property and its equity to another party. This not only entitled the buying party to the physical property, but also swindled the homeowner out of any equity he or she had built.

To combat this ever-growing problem, the government passed the **Home Equity Sales Contract Act**. The Act was aimed at helping consumers avoid the dangers associated with home equity sales contracts.

It required all home equity sales contracts to contain the following provisions:

- A homeowner with equity has the right to cancel a home equity sale
- A homeowner with equity has the right to revoke a home equity sales contract up to five business days after the sale
- The contract must use a size 10 font

Because many people have been taken advantage of using home equity sales contracts, the law typically sides with the equity seller in such legal disputes.

If an equity buyer in a home equity sales contract fails to adhere to these standards, he or she can be fined up to $10,000 and held responsible for damages, including legal costs. A buyer can also be sentenced to up to one year in jail. If a judge determines that an equity buyer took advantage of an equity seller, the transaction can also be rescinded within two years of the sale.

California Residential Mortgage Lending Act

The **California Residential Mortgage Lending Act** was enacted in 1994 to regulate the activities of mortgage bankers and establish new practices for the mortgage industry.

The Act applies to companies that assist, service, and/or provide loans to borrowers of residential real estate for properties between one to four units.

The following groups are exempt:

- Licensed California real estate brokers
- Institutional lenders
- Individuals who provide mortgage loans

Federal Disclosure Requirements

Truth in Lending Act (TILA)

The **Truth in Lending Act (TILA)** is a federal law passed in 1968 that created a uniform system for calculating and disclosing loan interest rates. Initially regulated by the Federal Reserve Board, the Act's provisions are now enforced by the Consumer Financial Protection Bureau.

Prior to the Act, the way lenders calculated and advertised their loan rates were unique to each lender. This was confusing for consumers and left them unable to accurately compare loan products from different lenders.

TILA does not impose certain interest rates or loan fees on lenders. Rather, it created a standardized system that allows consumers to shop more smartly.

Lenders must provide borrowers with documentation about the specific loan they are receiving. For example, if a borrower is applying for an adjustable rate mortgage, the lender must provide him or her with a copy of the Federal Reserve's Consumer Handbook on Adjustable-Rate Mortgages.

One of the documents that lenders must provide to borrowers is a **Truth in Lending Disclosure Statement**. Mortgage disclosures must be provided within three days of a borrower's submission of an application. This statement provides borrowers with a simplified version of the mortgage terms, including:

- Annual Percentage Rate (APR)
- Loan amount
- Monthly mortgage payments
- Late charges
- Prepayment penalties
- Insurance payments

One of the Truth in Lending Act's main provisions requires lenders to use an **annual percentage rate (APR)** as the standard mortgage description term for mortgage products. APR is the cost of credit expressed as a yearly rate in a percentage. It factors in the down payment, monthly payment, and the terms and conditions of a mortgage product.

Certain transactions are exempt from TILA, including:

- Buying a property with more than one unit as this is considered a business investment, rather than a personal one
- Access to credit for improving or renovating a property with over four units. Getting credit for buying, improving or maintaining a non-owner occupied rental property is considered a business purpose.

Right of Rescission

TILA also protects a borrower's right of rescission. The **right of rescission** gives a borrower the right to cancel a home equity loan or line of credit with a new lender, or to cancel a refinance transaction with another lender, within three days of closing.

The right of rescission does not apply to property purchases.

The three-day period begins when a contract is signed and a copy is given to a borrower; it ends on midnight of the third day.

If a borrower begins the rescission process within the three-day period, a lender is required to issue a refund. This includes any lender and processing fees. Certain costs – such as inspections – cannot be refunded.

Usury refers to when a mortgage interest rate is above the legal limit. This typically occurs with private lenders who are not bound by the same standards as government-backed loans. If this occurs, a borrower has the right to rescind the mortgage.

A borrower may also rescind a mortgage if he or she was not given a Truth in Lending report indicating his or her right of rescission.

Federal Truth-In-Lending Disclosure Statement

Lender/Broker: Loan Number: TIL Date:

Borrower(s): Property Address:

☐ Initial Disclosure estimated at time of application ☐ Final Disclosure based on contract terms

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	Amount Financed	Total of Payments
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you assuming the annual percentage rate does not change.	The amount of credit provided to you or on your behalf as of loan closing.	The amount you will have paid after you have made all payments as scheduled assuming the annual percentage rate does not change.
%	$	$	$

Your Payment Schedule Will Be:

Number of Payments	* Amount of Payments	Monthly Payments Are Due Beginning	Number of Payments	* Amount of Payments	Monthly Payments Are Due Beginning

* Includes mortgage insurance premiums, excludes taxes, hazard insurance and flood insurance.

☐ **Demand Feature:** This loan transaction has a demand feature.

☐ **Required Deposit:** The annual percentage rate does not take into account your required deposit.

☐ **Variable Rate Feature:** Your loan contains a Variable Rate Feature. Disclosures about the Variable Rate Feature have been provided to you separately.

Security Interest: You are giving security interest in:
☐ the goods or property being purchased. ☐ real property you already own.

Filing or Recording Fees: $

Late Charge: If a payment is more than days late, you will be charged $ / %

Prepayment: If you pay off your loan early, you
☐ may ☐ will not have to pay a penalty.
☐ may ☐ will not be entitled to a refund of part of the finance charge.

Insurance: Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

Type	Premium	Signature	
Credit Life		I want credit life insurance.	Signature:
Credit Disability		I want credit disability insurance.	Signature:
Credit Life and Disability		I want credit life and disability insurance.	Signature:

This loan transaction requires the following insurance:

☐ Hazard Insurance ☐ Flood Insurance ☐ Credit Insurance ☐ Credit Life Insurance ☐ MMI ☐ PMI

Borrower(s) may obtain hazard and flood insurance through any person of his/her choice, provided said carrier meets the requirements of the Lender. If Borrower desires Property Insurance to be obtained through the Lender's designated agency, the cost will be set forth in a separate insurance statement furnished by the Lender.

☐ If you purchase insurance from creditor, you will pay $ for a one-year term.

Assumption: Someone buying your house:
☐ may ☐ may, subject to conditions, ☐ may not assume the remainder of your loan on the original terms.

See your contract documents for additional information regarding nonpayment, default, right to accelerate the maturity of the obligation, prepayment rebates and penalties, and the Lender's policy regarding assumption of the obligation.

You are not required to complete this agreement merely because you have received these disclosures or signed a loan application.

☐ All dates and numerical disclosures except late payment disclosures are estimates. means an estimate.

"The undersigned hereby acknowledge receiving and reading a completed copy of this disclosure along with copies of the documents provided. The delivery and signing of this disclosure does not constitute an obligation on the part of the lender to make, or the Borrower(s) to accept, the loan as identified."

Read, acknowledged and accepted this day of , By:

Borrower Date Co-borrower Date

REGZ – TIL 11/09 ~ Encompass360™

Real Estate Settlement Procedures Act (RESPA)

Because each mortgage typically contains hundreds of pages of difficult to understand paperwork, the federal government passed the Real Estate Settlement Procedures Act in 1974.

The **Real Estate Settlement Procedures Act (RESPA)** is a federal consumer protection law that requires lenders that provide federally backed mortgage loans to provide disclosures for the sale or transfer of residential real estate for properties of one to four units. These disclosures include all pertinent loan information and mortgage costs during the loan process.

For example, say a mortgage broker advertises a mortgage interest rate of 5%, which is 2% less than most other lenders. However, the broker requires a borrower to only use his or her escrow company, which charges a higher rate than other escrow companies. The broker misleads borrowers into thinking that his or her services are less expensive due to the cheaper upfront interest rate, when the "package deal" with the escrow company ultimately makes the broker more expensive than other lenders. This is illegal under RESPA.

RESPA applies to federal backed loans, including:

- Loans backed by the FDIC
- Mortgage loans financed through a federal agency (i.e. FHA, VA)
- Loans sold to Fannie Mae, Freddie Mac, or another government-backed financial entity

Loans must be first mortgages, including purchases, refinancing, property improvement loans, and equity lines of credit. RESPA does not apply to second mortgages, loan assumptions, construction/home improvement loans, or land sales.

Under RESPA, lenders must provide potential borrowers with the following information within three days of them submitting a completed loan application:

- *Mortgage Servicing Disclosure:* indicates whether a lender will continue to service a loan, or transfer it to another lender.
- *Special Information Booklet:* provides the rights of borrowers and the various settlement services. This booklet is provided by the Department of Housing and Urban Development (HUD).
- *Good Faith Estimate (GFE)*

A **good faith estimate (GFE)** provides an estimation of a borrower's loan settlement costs, or the costs a borrower will pay at the closing of a mortgage loan. This document allows borrowers to easily compare various lenders' mortgage loan costs and terms in order to select the best one.

OMB Approval No. 2502-0265

Good Faith Estimate (GFE)

Name of Originator	Borrower
Originator Address	Property Address
Originator Phone Number	
Originator Email	Date of GFE

Purpose

This GFE gives you an estimate of your settlement charges and loan terms if you are approved for this loan. For more information, see HUD's *Special Information Booklet* on settlement charges, your *Truth-in-Lending Disclosures*, and other consumer information at www.hud.gov/respa. If you decide you would like to proceed with this loan, contact us.

Shopping for your loan

Only you can shop for the best loan for you. Compare this GFE with other loan offers, so you can find the best loan. Use the shopping chart on page 3 to compare all the offers you receive.

Important dates

1. The interest rate for this GFE is available through ☐. After this time, the interest rate, some of your loan Origination Charges, and the monthly payment shown below can change until you lock your interest rate.
2. This estimate for all other settlement charges is available through ☐.
3. After you lock your interest rate, you must go to settlement within ☐ days (your rate lock period) to receive the locked interest rate.
4. You must lock the interest rate at least ☐ days before settlement.

Summary of your loan

Your initial loan amount is	$
Your loan term is	years
Your initial interest rate is	%
Your initial monthly amount owed for principal, interest, and any mortgage insurance is	$ per month
Can your interest rate rise?	☐ No ☐ Yes, it can rise to a maximum of %. The first change will be in .
Even if you make payments on time, can your loan balance rise?	☐ No ☐ Yes, it can rise to a maximum of $
Even if you make payments on time, can your monthly amount owed for principal, interest, and any mortgage insurance rise?	☐ No ☐ Yes, the first increase can be in and the monthly amount owed can rise to $. The maximum it can ever rise to is $.
Does your loan have a prepayment penalty?	☐ No ☐ Yes, your maximum prepayment penalty is $.
Does your loan have a balloon payment?	☐ No ☐ Yes, you have a balloon payment of $ due in years.

Escrow account information

Some lenders require an escrow account to hold funds for paying property taxes or other property-related charges in addition to your monthly amount owed of $☐.
Do we require you to have an escrow account for your loan?
☐ No, you do not have an escrow account. You must pay these charges directly when due.
☐ Yes, you have an escrow account. It may or may not cover all of these charges. Ask us.

Summary of your settlement charges

A	Your Adjusted Origination Charges *(See page 2.)*	$
B	Your Charges for All Other Settlement Services *(See page 2.)*	$
A + B	Total Estimated Settlement Charges	$

Understanding your estimated settlement charges

Your Adjusted Origination Charges

1. Our origination charge
This charge is for getting this loan for you.

2. Your credit or charge (points) for the specific interest rate chosen

- ☐ The credit or charge for the interest rate of ☐ % is included in "Our origination charge." (See item 1 above.)
- ☐ You receive a credit of $ ☐ for this interest rate of ☐ %. This credit **reduces** your settlement charges.
- ☐ You pay a charge of $ ☐ for this interest rate of ☐ %. This charge (points) **increases** your total settlement charges.

The tradeoff table on page 3 shows that you can change your total settlement charges by choosing a different interest rate for this loan.

A Your Adjusted Origination Charges $

Your Charges for All Other Settlement Services

Some of these charges can change at settlement. See the top of page 3 for more information.

3. Required services that we select
These charges are for services we require to complete your settlement. We will choose the providers of these services.

Service	*Charge*

4. Title services and lender's title insurance
This charge includes the services of a title or settlement agent, for example, and title insurance to protect the lender, if required.

5. Owner's title insurance
You may purchase an owner's title insurance policy to protect your interest in the property.

6. Required services that you can shop for
These charges are for other services that are required to complete your settlement. We can identify providers of these services or you can shop for them yourself. Our estimates for providing these services are below.

Service	*Charge*

7. Government recording charges
These charges are for state and local fees to record your loan and title documents.

8. Transfer taxes
These charges are for state and local fees on mortgages and home sales.

9. Initial deposit for your escrow account
This charge is held in an escrow account to pay future recurring charges on your property and includes ☐ all property taxes, ☐ all insurance, and ☐ other ☐.

10. Daily interest charges
This charge is for the daily interest on your loan from the day of your settlement until the first day of the next month or the first day of your normal mortgage payment cycle. This amount is $ ☐ per day for ☐ days (if your settlement is ☐).

11. Homeowner's insurance
This charge is for the insurance you must buy for the property to protect from a loss, such as fire.

Policy	*Charge*

B Your Charges for All Other Settlement Services $

A + B Total Estimated Settlement Charges $

Instructions

Understanding which charges can change at settlement

This GFE estimates your settlement charges. At your settlement, you will receive a HUD-1, a form that lists your actual costs. Compare the charges on the HUD-1 with the charges on this GFE. Charges can change if you select your own provider and do not use the companies we identify. (See below for details.)

These charges **cannot increase** at settlement:	The total of these charges **can increase up to 10%** at settlement:	These charges **can change** at settlement:
▪ Our origination charge ▪ Your credit or charge (points) for the specific interest rate chosen *(after you lock in your interest rate)* ▪ Your adjusted origination charges *(after you lock in your interest rate)* ▪ Transfer taxes	▪ Required services that we select ▪ Title services and lender's title insurance *(if we select them or you use companies we identify)* ▪ Owner's title insurance *(if you use companies we identify)* ▪ Required services that you can shop for *(if you use companies we identify)* ▪ Government recording charges	▪ Required services that you can shop for *(if you do not use companies we identify)* ▪ Title services and lender's title insurance *(if you do not use companies we identify)* ▪ Owner's title insurance *(if you do not use companies we identify)* ▪ Initial deposit for your escrow account ▪ Daily interest charges ▪ Homeowner's insurance

Using the tradeoff table

In this GFE, we offered you this loan with a particular interest rate and estimated settlement charges. However:

- If you want to choose this same loan with **lower settlement charges,** then you will have a **higher interest rate.**
- If you want to choose this same loan with a **lower interest rate,** then you will have **higher settlement charges.**

If you would like to choose an available option, you must ask us for a new GFE.

Loan originators have the option to complete this table. Please ask for additional information if the table is not completed.

	The loan in this GFE	The same loan with lower settlement charges	The same loan with a lower interest rate
Your initial loan amount	$	$	$
Your initial interest rate[1]	%	%	%
Your initial monthly amount owed	$	$	$
Change in the monthly amount owed from this GFE	No change	You will pay $ **more** every month	You will pay $ **less** every month
Change in the amount you will pay at settlement with this interest rate	No change	Your settlement charges will be **reduced** by $	Your settlement charges will **increase** by $
How much your total estimated settlement charges will be	$	$	$

[1] *For an adjustable rate loan, the comparisons above are for the initial interest rate before adjustments are made.*

Using the shopping chart

Use this chart to compare GFEs from different loan originators. Fill in the information by using a different column for each GFE you receive. By comparing loan offers, you can shop for the best loan.

	This loan	Loan 2	Loan 3	Loan 4
Loan originator name				
Initial loan amount				
Loan term				
Initial interest rate				
Initial monthly amount owed				
Rate lock period				
Can interest rate rise?				
Can loan balance rise?				
Can monthly amount owed rise?				
Prepayment penalty?				
Balloon payment?				
Total Estimated Settlement Charges				

If your loan is sold in the future

Some lenders may sell your loan after settlement. Any fees lenders receive in the future cannot change the loan you receive or the charges you paid at settlement.

Mortgage Loan Disclosure Statement

In addition to RESPA's requirements, California requires lenders to provide borrowers with a **mortgage loan disclosure statement** (RE 882, RE 883, or RE 885), or an alternative disclosure that fully complies with Section 10240(c) of the California Civil Code. This disclosure indicates all of a mortgage's terms and conditions.

A mortgage loan disclosure statement must be provided to a borrower within three days of a lender receiving a completed, written loan application.

Among these disclosures is a uniform settlement statement. A **uniform settlement statement** provides a breakdown of all costs and fees in the transaction. It stipulates the costs for both a borrower and a lender.

All fees charged by a lender must be necessary to the loan approval process. Section 8 of RESPA outlaws kickbacks and referral fees that make the process of applying for a loan more expensive. Should a lender, broker, or other party violate this provision, they could be subject to damages of up to $10,000 and face up to one year in prison. They could also be held liable for up to three times the fee for which the prospective borrower was charged.

RESPA prevents lenders from charging borrowers for:

- Services not rendered
- Services that are completed in order to comply with the Act, such as printing out additional forms or spending time preparing documents
- Advance fee services to be rendered to a principal without first obtaining approval from the Department of Real Estate

A lender cannot charge a borrower before providing them with a uniform settlement statement. It is unlawful for a lender to charge a borrower for creating such a statement.

A mortgage broker must retain copies of all mortgage-related documents and trust accounts for a period of three years. Loan documents (Section 10231.2(b)), the information used to determine investor suitability for private-money loans (Section 10232.45), and self-dealing statements (Section 10238(f)) must be retained for four years.

Files may be stored electronically or digitally.

Example

Question: Sarah offers loan modification services for borrowers who are behind on mortgage payments or are facing financial hardship. To incentivize the lender of her client, Bill, to offer Bill a loan modification with a reduced interest rate, Sarah advises Bill to default on his mortgage. She tells Bill that by falling behind on mortgage payments, he will be able to establish financial hardship. Is Sarah providing sound advice to Bill?

Answer: *While Bill falling behind on mortgage payments may prove financial hardship, Sarah advising him to do so is illegal. Sarah's advice could ruin Bill's credit, begin foreclosure proceedings against his property, and cause more adverse effects to Bill's financials.*

Predatory Lending

Predatory lending is the illegal process of purposefully selling expensive and/or unfair mortgage programs to borrowers who cannot afford them. This results in borrowers making costly mistakes that reduce a property's equity or significantly affect the borrower's ability to afford a property.

Predatory lending is one of the most common defenses for victims of foreclosure. A borrower must prove that a lender willingly misled the borrower about the benefits of a mortgage product.

Financial Code Section 4970 states the rules by which brokers in the mortgage market must abide. They include:

- Mortgage charges restricted to no more than six points
- Prepayment penalties restricted to no more than 36 months
- Prepayment penalties of no more than 2% of the total loan amount
- Mortgage brokers are barred from advising borrowers to default on their mortgages with the intent of convincing a lender to reduce its interest rate
- Limitations for negative amortization programs
- Prohibiting mortgage origination with no direct benefit to a borrower
- Mortgage broker is barred from advising or counseling clients to accept higher interest rate loans than would otherwise be available