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Real Estate Finance Industry Faces Dangerous Legislation

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With all the uncertainty clouding the present and future of the real estate finance industry, there is one thing we can all agree mortgage bankers don't need any more of: frivolous litigation. The last few years have not only seen mortgage bankers and servicers ramping up efforts to work with distressed borrowers - legal teams and budgets have also been busily growing. Some of that is inevitable and necessary due to the challenges our industry faces. Some of the growth, however, is unnecessary and wasteful, draining resources from companies that could otherwise be spending on efforts to help borrowers or expand operations.

CMBA's primary mission is to provide representation for the real estate finance industry in Sacramento, before the State Legislature. This year we have seen quite a few bills proposed whose passage would have resulted in a blizzard of new and frivolous lawsuits aimed at the industry. Due to the tireless work of our legislative team, I am happy to report that a number of them have been defeated – for now. The nature of both the legislature and bad ideas is that they never stop working, so we will continue to be vigilant. However, I wanted to bring one of the proposals to your attention so you could be aware of what 'on the table' here in Sacramento.

SB 729, proposed by Senator Mark Leno and Senate President Pro Tem Darrell Steinberg, was a revival of a similar bill proposed last year (SB 1275, which failed on bi-partisan vote). The author's intent was ostensibly to provide additional notifications to distressed borrowers before the servicer initiated the foreclosure process. However, the bill would further delay the foreclosure process, which is already over 300 days in California. Additionally, CMBA opposed the bill for the following litigation-related reasons:

The bill would have granted a new private right of action and awards damages to borrowers irrespective of whether they have experienced real harm. The remedies extended to borrowers under the measure were not narrowly focused on circumstances where the lender had ignored or failed to respond to the borrower, but grants remedies for failing to adequately complete documents in the very precise manner proscribed by the bill. The measure would have allowed for an injunction to further forestall the foreclosure process and remedies that could void a foreclosure sale.

Borrowers under SB 729 would also be granted one year following a foreclosure sale to pursue an action to void the sale. Bona fide purchasers will be unable to purchase property during this time and title insurers will be unwilling to write policies insuring such properties. Consequently, additional residential units will be unmarketable during that year further delaying the clearing of excess inventory and California's economic recovery.

The bill also would have inappropriately meddled with pending litigation. SB 729 would have amended existing law (Civil Code Section 2923.5) which has been the subject of several legal claims and class action

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Issue Brewing in Nevada

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Editor's Note: AB 273, the focus of this article, was signed into law by Governor Brian Sandoval on June 10, 2011

The latest biannual term of the Nevada Legislature brought with it some significant bills affecting both commercial and residential lenders rights in the state. On the short list of bills is Assembly Bills 273 and 284. AB273 has been passed by both houses of the Nevada Legislature and is sitting on the Governor's desk for signature as of the writing of this article. AB273 will have a significant impact on the rights of creditors purchasing debt secured by real property. AB273 will effectively make Nevada a "lend and hold" state for any long-term indebtedness because there is no incentive for a purchaser to invest in loans executed after October 1, 2011. In fact, AB273 would create a serious disincentive to any purchases of loans in the State of Nevada.

If signed into law, AB273 will do the following:

- Require mortgage insurance proceeds be first offset against any judgment obtained by a sold out junior lienholder;
- Limit the recovery of a purchaser of a junior lien to the consideration paid by the purchaser for the lien without regard to the face-value of the lien;
- Prohibit financial institutions from pursuing a sold out purchase money junior lien when the property was continuously owner-occupied without regard to the financial institutions participation in the senior lien sale;
- Shorten the statute of limitations on pursuit of a sold out junior lien from 6 years to 6 months after the senior lienholder's foreclosure sale, or deed in lieu of foreclosure (Note: this provision is effective in any foreclosure completed after July 1, 2011);
- Limit the recovery of a purchaser of a first position lienholder to consideration paid by the

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a QRM, the proposal calls for maximum front-end and back-end borrower DTI ratios of 28% and 36%, respectively; a maximum LTV ratio of 80% for purchase transactions (75% for refis and 70% for cash-out refis); 20% down payment for purchase transactions; and no 60-day delinquencies in the borrower's credit history in the past 24 months. Further, for QRMs, the "points and fees"—a broadly defined term that includes most up-front fees, fees paid to affiliates, and bona fide discount points—must not exceed 3% of the loan amount.

Who has to retain the risk?

The securitization "sponsor" (the party that packages the ABS) is responsible under the proposed rule for the retaining the risk. But the sponsor may allocate a proportional share of the risk retention obligation to the "originator" (the original creditor, but not any intermediate purchaser or transferee) of the securitized assets, subject to certain conditions. While the agreement to transfer a portion of the risk to the originator would be voluntary on the originator's part, it is anticipated that sponsors may require risk retention as a condition of securitization.

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For any ABS in which the sponsor pushes risk retention down to the originator, an originator may be required to take on any amount of risk up to its proportional share of the ABS pool. But only originators with at least 20% of the loans in the securitization may be asked to take on any retained risk. An originator may take on the risk by paying up front for its share, either in cash or a discount on the selling price of the loans. When risk is retained, the holder is precluded from hedging the risk.

What forms can the risk retention take?

The proposed rule seeks to offer flexibility in retaining risk by providing several options that the sponsor and securitizer may choose based on the asset involved, the market, and investor expectations.

The forms of acceptable risk retention include (i) a 5% "vertical" slice of the ABS interests, under which the sponsor retains a proportional share of each class of interests; (ii) a 5% "horizontal first-loss" position, under which the sponsor bears losses on the assets before any other classes of interests; (iii) an "L-shaped" interest, under which the sponsor retains half the risk in a vertical slice and half in a horizontal first-loss position; (iv) a "seller's interest" in securitizations under which the holder participates in revenues and losses on the same basis as the investors; or (v) a "representative" sample, under which the sponsor retains a 5% sample of assets.

What about Fannie and Freddie loans? FHA loans?

For the time being, there is a gaping exception under the proposed QRM rule: for loans securitized through Fannie Mae and Freddie Mac, the government's guarantee satisfies the risk retention requirements. Thus, as long as Fannie and Freddie are under conservatorship, no originator will be required to retain risk for loans securitized through these enterprises. But, especially in pricier markets and if Fannie and Freddie loan limits are drawn down, more loans may become subject to the risk retention provisions.

With respect to FHA, USDA, and VA loans, loans that are fully guaranteed or insured by the U.S. government, or an agency of the government, are exempt from the risk retention requirements.

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purchaser for the lien without regard to the face-value of the lien;

- Limit the recovery against a guarantor of a debt secured by real property to the difference between the fair market value of the real property security and the outstanding balance of the debt.

The impact of AB284 more directly affects the non-judicial foreclosure sale process. AB284 has been signed into law and currently has an effective date of July 1, 2011. If AB273 is signed, the effective date of AB284 will be amended to October 1, 2011.

AB284 provides the following:

- Require the recordation of an assignment of a Deed of Trust before the commencement of the foreclosure proceeding;
- Identify who can be a trustee in the State of Nevada. (Note: this portion of the bill is currently subject to revision as set forth in AB273);
- Require the execution of an affidavit under penalty of perjury that the beneficiary is in actual or constructive possession of the note and list all of the assignments of the Note and Deed of Trust;
- Impose a presumption of actual damages of $5,000.00 against a beneficiary or trustee who fails to comply with the provisions of Nevada's non-judicial foreclosure law;
- Criminalizes, as a felony, fraudulent mortgage lending practices and the "groundless" recordation of an interest in real property.

The impact, if any, on commercial lending activity and investment in Nevada indebtedness based on these provisions remains to be seen. The next legislative session in Nevada kicks off in January 2013 so stay tuned.

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