CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: RULES AND OPEN GOVERNMENT COMMITTEE

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: January 23, 2008

Approved Christine J. Shippey

Date 1-23-08

Council District:
SNI:

SUBJECT: SUPPORT FOR FEDERAL HOUSING LEGISLATION: H.R. 3915 (MILLER) – MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2007 IF AMENDED, S. 2036 (SCHUMER) – PROTECTING ACCESS TO SAFE MORTGAGES ACT, AND S. 2452 (DODD) – HOMEOWNERSHIP PRESERVATION AND PROTECTION ACT OF 2007

RECOMMENDATION

The Housing Department recommends that:

1. The Mayor and City Council support H.R. 3915 (Miller) if amended, S. 2036 (Schumer), and S. 2452 (Dodd).
2. The Committee provide a one-week turn around for Mayor and City Council review.

OUTCOME

If the Rules and Open Government Committee and the Mayor and City Council accept staff's recommendation, the City lobbyist could begin seeking support for H.R. 3915 (Miller) if amended, S. 2036 (Schumer), and S. 2452 (Dodd).

BACKGROUND

The 2007-2008 Federal Legislative cycle has featured many bills that address the subprime lending crisis. Three of these bills are of particular interest to the City's Affordable Housing programs. An analysis of H.R. 3915, S. 2036, and S. 2452 are attached to this memo for the Rules and Open Government Committee consideration.

ANALYSIS

A fact sheet and analysis of H.R. 3915, S. 2036, and S. 2452 are attached.

PUBLIC OUTREACH/INTEREST

☐ **Criteria 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This legislative item does not meet any of the above criteria.

COORDINATION

This memorandum was coordinated with the Intergovernmental Relations Director in the City Manager's Office and the City's federal lobbyist, Patton Boggs.

POLICY ALIGNMENT

The attached fact sheets and analyses are consistent with the Council-adopted 2008 Legislative Guiding Principles, and the Council-adopted guidelines.

CEQA

Not a project

~~LESLYE~~ KRUTKO
Director of Housing

For more information call Melissa Whatley, Policy Manager, at (408) 975-4418

Attachments (3)

H.R. 3915 (MILLER D-NC, WATT D-NC, AND FRANK D-MA) – MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2007

What's the issue the bill is trying to resolve?

It is estimated that more than two million families will lose their homes as a result of the subprime lending crisis. The "Mortgage Reform and Anti-Predatory Lending Act of 2007" addresses many abusive lending practices that contributed to today's foreclosure crisis, including abusive underwriting practices and subprime prepayment penalties. Major protections included in the bill are:

1. **Establishes a federal "duty of care" to borrowers.** Mortgage originators must act in the best interest of the consumer and must present borrowers with loan products that are appropriate for the borrower's circumstances. The legislation prohibits steering and calls for licensing and registration of mortgage originators, including brokers and bank loan officers.
2. **Requires subprime lenders to determine whether the borrower has the ability to repay the loan.** Must take into account fully-indexed rate and fully amortized payment on adjustable rate loans; consider amounts for taxes and insurance; must verify and document information.
3. **Prohibits abusive loan flipping** and requires subprime creditors to determine that a refinanced loan will provide a net tangible benefit to the consumer. The legislation sets a minimum standard for all mortgages which states that borrowers must have "reasonable ability to repay."
4. **Prohibits subprime prepayment penalties and limits prepayment penalties** on conventional loans to three years. It bans mandatory arbitration on any residential mortgage and prohibits class actions against and provides other protections from liability for assignees of loans.
5. **Prohibits selling negatively amortizing loan** to first time homebuyer without evidence of counseling from HUD-certified homeownership counseling.
6. **Includes special protections for extremely high-cost mortgages.**
   - Those mortgages with points and fees exceeding 5% of the loan amount.
   - Prohibits the following on high-cost loans: balloon payments; recommending or encouraging default; excessive late fees; call provisions; financing any points and fees or prepayment penalties; abusive modification or deferral fees; excessive fees for receiving a payoff statement.
   - Borrower must receive **pre-loan counseling** before receiving a high-cost loan

How would the passage of this bill affect San José?

According to research conducted by RealtyTrac, San Jose/ Santa Clara County ranked fifty-six in the top 100 metro areas for foreclosure rates in the first half of 2007. San Jose/ Santa Clara County experienced 4,197 foreclosure filings, a 105% increase from the first half of 2006.

H.R. 3915 requires accountability from mortgage lenders/originators and protects residents of the City of San José from harmful predatory lending practices. The bill provides a heightened standard of care for originators, who must "act solely in the best interest of the consumer, including finding the residential mortgage loan that best meets the needs of the borrower." Finally, H.R. 3915 increases consumer confidence in the mortgage industry and decreases the possibility that predatory lending practices will continue to occur.

What is staff's Proposed Position?

Staff recommends that the City support H.R. 3915 if amended. Staff recommends several amendments to H.R. 3915:

1. **Remove the preemption clause** - the preemption clause overrides State laws that protect homeowners and provide remedies against assignees.
2. **Prohibit Yield Spread Premiums** - as currently drafted, homeowners have no rights against the actual holder (the entity that will foreclosure) of the loan until a foreclosure has begun. As originally introduced the bill prohibited yield spread premiums (YSP). The YSP is the cash rebate paid to a mortgage broker based on selling an interest rate above the wholesale par rate that the borrower qualifies for. The current language in the bill authorizes these practices as long as there is disclosure to the consumer. Research by several anti-predatory lending organizations suggests that disclosure has no effect on preventing abusive lending practices.
3. **Require an "ability to pay" standard to all loans** - the bill requires no ability to pay standards for approximately 90% of the current mortgage market and creates a presumption that any loan below 8.25% is affordable.

In summary, staff believes the language of H.R. 3915 should be strengthened to change the incentive structure for mortgage originators in order to provide protection for borrowers and remove the broad preemption clause.

Who are the bill's supporters and opponents?

The following organizations have submitted a joint letter in support if amended for H.R 3915: Association of Community Organizations for Reform Now (ACORN), Black Leadership Forum, CDFI Coalition, Center for Responsible Lending, Central Illinois Organizing Project, Consumer Federation of America, Leadership Conference on Civil Rights, National Association for the Advancement of Colored People (NAACP), Ohio Attorney General Marc Dann, and Opportunity Finance Network. There is no registered opposition to H.R 3915.

What is the current status of the measure?

H.R. 3915 was passed in the House of Representatives on November 15, 2007. The bill was referred on December 3, 2007 to the Senate Committee on Banking, Housing, and Urban Affairs.

S. 2036 (SCHUMER) – PROTECTING ACCESS TO SAFE MORTGAGES ACT

What's the issue the bill is trying to resolve?

S. 2036, "The Protecting Access to Safe Mortgages Act," temporarily lifts the limits on the government-sponsored enterprises (Freddie Mac and Fannie Mae) mortgage portfolios by 10% in an effort to respond to the current housing crisis and resulting defaults and foreclosures.

Fannie Mae offers banks and other mortgage lenders financing, credit guarantees, technology and services so lenders can make more home loans to more consumers. Fannie Mae also helps finance affordable housing and community development projects, working with local, state and national housing partners. Freddie Mac increases the supply of funds that mortgage lenders, such as commercial banks, mortgage bankers, savings institutions and credit unions, can offer to homebuyers and multifamily investors. Freddie Mac conducts its business primarily by buying mortgages from lenders, packaging the mortgages into securities and selling the securities – guaranteed by Freddie Mac – to investors. Both entities rely on a conventional loan limit for non-government mortgages that is referred to as a "conforming loan" limit. Anything above this limit is referred to as a "jumbo loan," which carries a higher rate because it is assumed that larger loans imply more lender risk.

S. 2036 increases the conforming loan limit by up to 50% in "high-cost areas." The proposal would increase the "conforming loan limit" from the current limit of $417,000 to the lesser of the median house price or 150% of the current limit. In San José, the loan limit would increase to 150% of the current limit, or $625,500.

By increasing the limit by 10%, approximately $145 billion will be available for purchase of new mortgages. S. 2036 specifies that half of the $145 billion be used specifically for refinancing mortgages for borrowers whose existing adjustable rate loans are scheduled for an interest-rate reset between June 2005 and December 2009. The increases on both the portfolio caps and the loan limits would sunset one year after the bill's enactment.

How would the passage of this bill affect San José?

The current "conforming loan limit" is too low for high cost areas like San Jose. A very small percentage of new homebuyers are able to obtain a conforming loan, since most new borrowers need a loan greater than $417,000. The City has long supported the revision of conforming loan rates to account for high-cost areas. Under this bill, the conforming rate would increase to $625,500 for a year's time. This would help many recent homebuyers who face foreclosure to refinance their houses at a lower interest rate. The additional interest costs associated with a jumbo loan can translate to tens of thousands of dollars worth of additional interest payments over the life of loan.

What is staff's Proposed Position?

Staff recommends that the City support S. 2036. The bill provides assistance for San José homeowners who may be affected by the increasing number of foreclosures in the area. The

City further supports legislation that revises the conforming rate on an ongoing basis for high cost areas. Some states like Alaska have a higher conforming loan, but this has not yet been made available to California homeowners.

Who are the bill's supporters and opponents?

As of January 16, 2008, staff has not identified any supporters or opponents of S. 2036.

What is the current status of the measure?

S. 2036 was introduced on September 10, 2007 and referred to the Committee on Banking, Housing and Urban Affairs.

S. 2452 (DODD) – HOMEOWNERSHIP PRESERVATION AND PROTECTION ACT OF 2007

What's the issue the bill is trying to resolve?

There is a growing crisis in the mortgage markets with over two million homeowners facing foreclosure at a loss of over $160 billion in home equity. S. 2452, the Homeownership Preservation and Protection Act of 2007, is designed to protect homeowners and includes the following provisions which are similar to H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007."

1. **Establishes a federal "good faith and fair dealing" duty for all lenders and a standard of care for lenders and loan servicers** - Mortgage lenders and loan servicers must act with reasonable skill, care, diligence, good faith, and fair dealing in any transaction, practice, or course of business associated with home mortgage loans. The legislation prohibits steering and requires documentation of all sources of income verified by numerous sources. Steering the practice of showing potential buyers homes located only in certain neighborhoods.
2. **Requires lenders to determine whether the borrower has the ability to repay the loan on subprime and non-traditional mortgage loans** - Must take into account the fully indexed interest rate and fully amortized payments; include a repayment schedule that achieves full amortization over the life of the loan; if the loan allows negative amortization, the initial loan amount plus any balance increases that may accrue from the negative amortization provision must be considered; evaluate the capacity of the borrower to make payments assuming market changes to the contract index rate over the period of the loan; and include taxes and insurance.
3. **Prohibits prepayment penalties** – No subprime or non traditional mortgage loan may contain a provision that requires a consumer to pay a penalty for paying all or part of the principal before the due date.
4. **Foreclosure prevention counseling** – If borrowers are more than 30 days late on mortgage payments, the lender or loan servicer will notify the borrower of housing counseling agencies approved by the Secretary of Housing and Urban Development.
5. **Includes special protections for high-cost loans** –
   - Those mortgages with points and fees exceeding 5% of the loan amount.
   - Prohibits: balloon payments; recommending or encouraging default; excessive late fees; call provisions; financing any points and fees or prepayment penalties; yield spread premiums; acceleration of debt; abusive modifications or deferral fees; excessive fees for receiving a payoff statement.

In addition to these provisions, S. 2452 also addresses several key issues that are not included in H.R 3915:

1. **Prohibits Yield Spread Premiums** – No person or mortgage originator may receive any compensation for originating a home mortgage loan that is more costly than that for which the consumer qualifies.

2. **Full Assignee Liability** - the bill contains full assignee liability that would hold mortgage lenders and Wall Street legally accountable for unfair and deceptive terms and conditions present in securitized loans.
3. **Non-traditional Loan Products are included under in the Protections Portion of the legislation** - option-ARMs, 2/28 and 3/27 mortgages are included in the protections portion of the bill.

How would the passage of this bill affect San José?

In Santa Clara County there were 4,197 foreclosure filings between June 2006 and June 2007, a 105 percent increase from the prior twelve-month period. Notices of default have also doubled, from a monthly count of 249 in September 2006 to 580 in September 2007. Lenders repossessed 1,429 homes in the County between January and November 15, 2007. As the rates on adjustable mortgages continue to reset upwards, it is expected that the number of foreclosure filings and repossessed homes will increase

In addition to the provisions noted above, S. 2452 includes:

1. **No Preemption Clause** – S. 2452 does not include a preemption clause and thus will not override existing State law. Regulations under subsections of the legislation will be considered supplemental to State laws governing unfair and deceptive acts and practices and may not be construed to preempt any provision of State law that provides equal or greater protections.
2. **Requires a Standard of Care for Appraisers** – All appraisals carried out by an appraiser will be accurate and reasonable. An appraiser shall have no direct or indirect interest in the property to be appraised or the home loan involved.

Maintaining access to subprime credit on fair terms is important, and the primary goal of S. 2452 is to provide more reliable access to credit. Addressing this issue while simultaneously establishing new lending standards to ensure that loans are affordable and fair, providing adequate remedies to ensure the standards are met; and creating a transparent set of rules for the mortgage industry will greatly benefit the residents of San José.

What is staff's Proposed Position?

Staff recommends that the City support S. 2452.

Who are the bill's supporters and opponents?

As of January 4, 2007, staff has not identified any supporters or opponents of S. 2452.

What is the current status of the measure?

On December 12, 2007, S. 2452 was introduced and referred to the Senate Committee on Banking, Housing, and Urban Affairs.