



Memorandum

**TO: RULES AND OPEN
GOVERNMENT COMMITTEE**

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: May 7, 2008

Approved

Date

5-13-08

Council District: City-wide
SNI: N/A

**SUBJECT: FOLLOW-UP TO QUESTIONS REGARDING STATE FORECLOSURE
LEGISLATION**

RECOMMENDATION

It is recommended that the Committee recommend that the City Council:

1. Accept staff's response to questions raised at the April 16th Rules and Open Government Committee and approve staff's recommendation to support SB 1137 (Perata) and AB 2586 (Torrico) and support if amended for AB 2509 (Galgiani).
2. Approve a general set of "guiding principles" for the support of legislation related to the foreclosure crisis.

OUTCOME

If the Mayor and City Council approve the administration's recommended "guiding principles," the City's State and Federal Lobbyists will continue to work with various stakeholders and Legislative offices to ensure that the City Council's priorities are represented in foreclosure legislation being considered by the Legislature and Congress.

BACKGROUND

On April 16, 2008, the Housing Department requested that the Rules and Open Government Committee approve a position of support for AB 2586 and a support if amended position for AB 2509. At this meeting, Mayor Reed and Councilmembers Cortese and Chirco requested clarification regarding two State legislative bills brought forward for consideration by staff. The

two bills were AB 2509 (Galgiani), which establishes the Homeownership Preservation Mortgage Guarantee Program through the California Housing Finance Agency, and AB 2586 (Torrico) that proposes changes to existing State law for tenant notification in event of a foreclosure. The following section responds to these questions and establishes a set of guiding principles that will help shape the City's priorities related to future foreclosure legislation.

ANALYSIS

AB 2509 and AB 2586

On April 16, 2008, the Rules and Open Government Committee asked the following questions:

Q: Are the conforming loan lenders being told about the equity lenders coming in behind them? Is there an element of fraud by homebuyers if they are not telling the first lender about the equity lender?

A: This combination of loan products does not constitute fraud. Several years ago when interest rates were at record lows, home equity loans and home equity lines of credit were commonly used as second mortgages because they offered the least expensive way to get homebuyers into a new home. Lenders were not only aware of this practice, but strongly encouraged it. Furthermore, there are additional safeguards in place when a homebuyer initially purchases a home. In order to qualify for a home loan, borrowers are required to include financial information on where the monies that will be utilized in the purchase of the home are from, including a second mortgage as a home equity line of credit. A first lender will always be notified, and must accept the terms when a borrower intends to further encumber their property. Thus, there is full disclosure when a borrower is utilizing a home equity line of credit in the initial purchase of their home.

Q: In some instances the primary and secondary lenders are the same. How does AB 2509 address that situation?

A: AB 2509 defines the loans eligible for assistance under the Homeownership Preservation Mortgage Guarantee Program as "the mortgage loan on a home, plus any secondary or other loans on that home, not including home equity loans." The legislation does not specifically mention instances where the primary and secondary lenders are the same entity, but does provide refinance assistance for both the first and second mortgages.

Q: How are leases treated post foreclosure?

A: Any lease is voided by foreclosure and the lender need only give tenants a 30-days' notice. In the case where the lease is signed before the landlord took out the mortgage on which she/he defaulted, the lender must allow the tenant to stay for the entire lease period. However, the foreclosure process in California takes a long time, and even if the tenant's lease was signed before the landlord took out the mortgage, it is unlikely that the tenant would have more than a couple of months left on the lease.

Q: What are the differences between a month-to-month lease agreement and a term lease and should a tenant with a month-to-month lease be given 60 days notice before eviction?

A: Existing California law provides certain protections for tenants, including those whose rental agreements are terminated by landlords. A landlord can end a periodic tenancy (for example, a month-to-month tenancy) by giving the tenant proper advance written notice. The landlord must provide a 60 days' advance written notice that the tenancy will end if the tenant has lived in the rental unit for a year or more. However, 30-day notice may be provided to a tenant that has lived in a unit less than one year or if the landlord has contracted to sell the unit to another person who intends to occupy it for at least a year. Currently, State law requires a 30-day notice to tenants evicted due to foreclosure. However, there is strong evidence that this does not allow adequate time for a lower-income person to find other affordable living arrangements, especially in a tight rental housing market.

Guiding Principles Regarding Foreclosure Measures

Due to the complexity and volume of foreclosure legislation making its way through the State legislature and Congress, the Administration has developed guiding principles to highlight the most important issues for San Jose. Of the 134 State housing related bills that the Department is currently tracking, 22 address foreclosures. In addition, the Department is tracking 101 federal housing bills, of which 28 address foreclosures.

Attachment A outlines some of the major themes and concerns with many of the proposals, including areas we would like our State and federal lobbyist to help us resolve. Adoption of these principles will help the City to act proactively and expediently to frame our concerns with the authors and be more successful in getting changes that could benefit San Jose.

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 City Attorney's Office, the Intergovernmental Relations Director in the City Manager's Office, and the City's federal and State lobbyists.


LESEYE KRUTKO
Director of Housing

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

Attachment



FORECLOSURE LEGISLATION GUIDING PRINCIPLES FOR ADVOCACY

The City of San José is a high-cost housing market with serious affordability problems. Indicators show that San José may be in the beginning stages of the foreclosure crisis that other localities have already experienced for months. More homeowners in Silicon Valley faced the threat of foreclosure in the first three months of 2008 than at any time on record. More than 3,000 notices of default were sent to homeowners in Santa Clara County in the first quarter of 2008, up 42% from the fourth quarter of 2007, and 191% from the first quarter of 2007.

Foreclosure is disproportionately impacting lower-income homeowners in areas of the City where home prices are typically lower. These homeowners entered the market at the peak, where prices were at their highest levels; these new owners planned to refinance their loans when their adjustable mortgages were due to reset. Others were victims of predatory lending practices, which we have found to be all too common in San José's lower-income neighborhoods.

Prevents Future Problems

As an increasing number of residents in San José receive notices of default and are facing potential foreclosure, it is important to ensure that any legislation that is signed by the President or Governor contains elements that would prevent families from losing their homes. The City of San José supports legislation that would:

1. **Provide Funding for Counseling and Homeowner Education**—Many homeowners facing foreclosure are fearful and don't know what to do or who to talk to. Because mortgages have often been sold, homeowners often are not even sure who their lender is and how to reach them. Funding for counseling is needed to help people before they lose their homes. Homebuyer education is needed to ensure that people are well informed prior to signing loan documents.
2. **Prevent Predatory Lending Practices**—Laws need to be strengthened to ensure that lenders, appraisers, and others involved in the lending business do not use inappropriate and unfair tactics to convince unsuspecting families to accept loans they cannot afford. These tactics include: aggressive and deceptive marketing, excessive prepayment penalties, making loans without consideration of a borrower's ability to pay, financing excessive fees into loans, requiring balloon payments, and steering borrowers (particularly minority and elderly borrowers) to subprime loans when they could qualify for prime loans with better terms.
3. **Provide Funding to Help People Refinance their Homes**—It is important for community stability, neighborhood vitality, and the housing market to keep people in their homes. Efforts need to be made to appropriate funds to programs that would allow current homeowners to keep their homes and avoid foreclosure.

4. **Require Lender Participation**—Lenders should be required to contact borrowers in person or by phone prior to filing a notice of default to determine whether any new payment plan can be arranged.
5. **Better Oversight of the Industry**—Currently, there are no national standards for mortgage brokers and lenders. All of the players in the industry—whether mortgage brokers, lenders, appraisers, or investors—should be required to abide by certain regulations to ensure that this economic tragedy does not reoccur. National standards and oversight of the lending industry is needed.

High Cost Areas

San José is a high cost area. Oftentimes, legislation that is passed does not take this in consideration, and programs and funding do not work in San Jose. To ensure that legislation that passes helps San José residents under threat of losing their homes, the City supports legislation that:

1. **Permanently Increases FHA and conforming loan limits**—FHA offers mortgage loans at affordable rates to homebuyers who don't qualify for the most competitive mortgage rates and terms offered by private lenders. FHA loans, however, have had little or no practical value in the Bay Area because the maximum loan was set at \$362,790 and most home values exceeded that amount. The FHA loan limit was increased through the President's economic stimulus package, but the increase is temporary. Similarly, the conforming loan limit was \$417,000 prior to a temporary one-year increase to \$729,000. Both the conforming loan limit and the FHA loan limit should be permanently increased to provide assistance to homebuyers in high-cost areas.
2. **Ensures that Funding is Flexible**—Any funding program approved to help either those facing foreclosure or to respond to the number of homes already lost should take into consideration the needs of high cost areas. Programs should be flexible in terms of use of funds, and incomes of people assisted. For example, it may not be economically feasible for the City to purchase foreclosed homes if they are selling for \$400-\$600,000, but it would be a good use of funds to provide refinancing alternatives, mortgage restructuring assistance, secondary loans, homebuyer programs, and other approaches that would keep people in their homes or facilitate re-occupancy. Additionally, San José would benefit from allowing funds to be used to pay for the high costs of city services needed to mitigate blight on vacant or abandoned properties through code enforcement, security measures, or maintenance. Funding should be provided as a block grant, and entitled to any large City rather than requiring a competitive process.

Protects Tenants

Many tenants are unaware their homes are in foreclosure. Renters are caught off guard through no fault of their own and often have to scramble to find a new place to live. Many are not recovering security deposits in enough time to secure other housing, if they recover funds at all. The City supports legislation that:

1. **Provides Protections for Tenants**—Anyone foreclosing on a loan should be required to provide tenants with appropriate notice if they will be required to vacate their unit. Additionally, tenants should be provided any money due, including any security deposit or unused rent.

Protects Communities

When homes are foreclosed upon, they often sit vacant and unattended, without having been secured. As a result, we have had several situations in San Jose where the homes have been used by teenagers as party houses, or by squatters seeking a place to live. This has disrupted neighborhoods and has required that the City's Code Enforcement Division beef up its staffing to address these neighborhood concerns. The City supports legislation that:

1. **Requires Lenders to Secure their Properties**—When a lender takes ownership of a home after foreclosure, it should be required to fully secure and monitor the home to ensure it is not a nuisance.