



May 7, 2012

House Financial Services Committee

Subcommittee on Capital Markets & Government Sponsored Enterprises

Hearing entitled "An Examination of the Federal Housing Finance Agency's

Real Estate Owned (REO) Pilot Program"

Statement of Mr. Dick Pruess

On behalf of

Community Associations Institute

Chairman Garrett, Ranking Member Waters, and members of the subcommittee, my name is Dick Pruess and I live in the Castlegate Homeowners Association in Pasadena, California. Thank you for the invitation to testify this morning on behalf of Community Associations Institute (CAI).

CAI is the only national organization dedicated to supporting community associations, association homeowners, and the more than two million volunteers who serve their neighbors on association boards. There are approximately 62 million residents of community associations living in 315,000 individual associations across the nation. Community associations are organized under state law as a homeowner, property owner, or condominium association or a housing cooperative.

I am the volunteer chairman of CAI's California Legislative Action Committee. We represent the interests of the nine million individual residents of community associations in our state. As a homeowner living in a community association, I believe all owners should be active in protecting their investment in their home. Working both locally and at the state level in Sacramento helps me, my community association, and the 49,000 community associations in California. I am pleased extend this work to the U.S. Congress.

Our homeowners and communities have faced substantial challenges throughout the housing crisis stemming not only from the collapse of home values but also the complete breakdown of the foreclosure process. I believe considering the unique perspective of community associations will be helpful as the Federal Housing Finance Agency (FHFA) continues its pilot program to dispose of enterprise REO through bulk sales to investors.

Impact of the Housing Crisis on Community Associations

All homes in a community association are bound by certain deed-based covenants, conditions, and restrictions, commonly known as CC&Rs, as well as by association by-laws and other rules and regulations adopted by the association's board. Application of these requirements ensures all residents—both homeowners and tenants—enjoy access to amenities, that common property is maintained, critical association services are funded, and reserves are set aside to cover significant future costs.

Community associations also undertake responsibilities such as road maintenance, storm water management, waste disposal and other similar services that otherwise are the responsibility of units of local government. These activities save local taxpayers billions of dollars across the country each year. To fund these association services, all association owners pay assessments, which are lien-based. Research shows that in 2009, association homeowners generated more than \$41 billion in funds to operate their communities while also maintaining approximately \$35 billion in reserve accounts.

It is generally accepted that a foreclosure or an abandoned home reduces property values in a neighborhood. The resulting sale of these distressed properties only adds to downward pressure on home prices. Otherwise stable owners watch as what little equity may be in their home vanishes. It is even worse for those owners who already owe more than their house is worth. This holds true for both association and non-association homeowners.

How the Foreclosure Crisis Impacts Community Associations

Unfortunately, these negatives are compounded in community associations when owners of distressed properties fail to pay their share of association expenses. As the housing crisis has evolved to a continuing foreclosure crisis, community associations have faced significant shortfalls in assessment income and report that

assessment delinquencies have increased at an alarming rate. Without funds to continue association services, the financial stability of these communities is jeopardized.

Assessment delinquency rates have almost tripled since 2005. According to a recent nationwide survey of community association managers, 63 percent of associations now have delinquency rates exceeding 5 percent, up from 22 percent of associations in 2005. One in three associations has a delinquency rate exceeding 10 percent, and for almost 1 in 10—or close to 30,000 associations nationally—the rate is more than 20 percent.

In response to these high delinquency rates, community association residents are increasing their regular assessments, voting for special assessments, deferring critical maintenance projects, and reducing contributions to reserve funds. These actions, which residents deem necessary to ensure continuance of critical association functions, have increased housing costs for association homeowners and generated considerable controversy within communities. However, such actions can damage the long-term stability of a community and are not a solution to the crisis that association residents face.

If this is not a good solution, why are these homeowners still choosing this path? The answer to that question is straightforward: Associations must still pay their bills. Storm water systems must be maintained; insurance premiums must be paid; residents cannot live in condominium units when the building has no water or electricity; trash collection cannot be halted; and common property must be maintained. These are not optional services or luxuries that can be scaled back or eliminated to save money. These are mandatory community costs.

To illustrate these points, I have included as an appendix to my testimony results from a recent survey of approximately 120 community association managers and association management companies in California. We asked about the impact of the crisis on their

client associations and how this impacted homeowners. I believe you will find the results of this survey to be informative; I personally found them astounding.

Lender and Servicer Behavior Has a Profoundly Negative Impact on Associations

It is frustrating for residents of associations when their neighbors stop paying assessments for their share of community costs. What is infuriating though is when homeowners leave their property after receiving a foreclosure notice and the lender or servicer allows the property to remain vacant for hundreds of days before completing the foreclosure. The association cannot track the prior owner and the other responsible parties will not foreclose. The property languishes, and what maintenance and care it receives come from neighbors and the association. Unfortunately, even when the foreclosure is completed and the property moves into a REO portfolio, association homeowners will more likely than not continue to shoulder the burden of property upkeep. According to a second CAI survey of community association managers, associations receive timely payment of assessments on less than 30 percent of REO properties. That's tens of thousands of homes nationally.

The failure of lenders and servicers to maintain REO in community associations and act as responsible property owners is consequential. As assessments increase because fewer owners can contribute to the association's expenses, more owners fall delinquent, thereby increasing the pressure on the association's ability to perform its functions. In many instances, as association assessments increase, owners are forced to choose between paying their assessments and paying their mortgage as they cannot afford both. This can be a significant problem for owners with a fixed income. The choice in a normal market might be for homeowners to sell; however, that option is not always a viable one given the depressed state of home values and the substantial number of owners with negative equity.

Fraudulent foreclosures and violations of servicing standards have also substantially harmed association homeowners. Regrettably, in many of these instances there was no

reasonable opportunity to prevent foreclosure or for a borrower to qualify for or sustain a loan modification. Lenders and servicers cut corners and were caught by federal and state regulators. This added almost a year to the completion of these foreclosures, forcing more association homeowners to pay extra housing costs.

By delaying the foreclosure process or failing to record a change in title promptly after foreclosure, lenders and servicers avoid paying their fair share of association costs. CAI's members do not believe it is equitable to allow the remaining owners in the neighborhood to pay higher housing costs that in most cases benefits and protects the value of these properties. Lenders and servicers must meet their obligations and not push these costs on their neighbors. The inequity is even greater when homeowners must pay higher housing costs due to lender and servicer fraud and negligence.

Lender and Servicer Failures Could Jeopardize FHFA Bulk Sales Plan in Associations

It is this failure on the part of lenders and servicers to move hopeless foreclosure cases through the process, to maintain property, and act responsibly that may frustrate plans for bulk sales of enterprise REO in community associations. CAI believes that FHFA and its partners in the bulk sales pilot program should consider the unique aspects of community association property ownership in the design and execution of these programs. Otherwise, community association homeowners in states with high foreclosure rates or which have been hardest-hit by the housing crisis may not receive the intended benefit from efforts to put REO properties back into commerce.

Bulk Sales Program Should Support Community Association Model of Housing

To be successful, CAI's members believe an enterprise REO bulk sales program must both account for and correct lender and servicer behaviors that have harmed homeowners in community associations. Correcting these failures upfront will minimize frictions that may frustrate bulk sales of enterprise REO in community associations and will ensure that community associations can participate as full partners in moving REO

back into commerce and stabilizing the larger community of which the association is a part.

Satisfy Outstanding Liens Prior to Sale

It is very common for community associations to place a lien on vacant and abandoned property for assessment delinquencies and other violations of the association's CC&Rs. Treatment of association liens during foreclosure can vary from state to state as well as by form of community association depending again on state statute. Several states have adopted legislation giving super-lien status to association liens. These statutes generally allow an association to collect up to six months worth of delinquent assessments, subject to certain restrictions. Other states provide for different treatment of association liens and payment of attorneys fees while the federal bankruptcy code adds an additional layer of complexity. Given the scale of the crisis in many community associations, it should come as little surprise to federal policymakers that associations are seeking to use every legal remedy available to recover assessment delinquencies on vacant and abandoned properties as well as REO.

To avoid needless delays and complications in closing bulk transactions on enterprise REO, FHFA must ensure all outstanding association liens and other recoverable amounts have been satisfied before completing a bulk sales transaction. Unless these liens and other recoverable debts attached to the property have been satisfied under applicable state law, any purchaser of this REO will likely be subject to legal action by the association to recover these amounts.

Resume Timely Foreclosure and Recordation of Title Changes

Given the state of the housing economy, it may seem counter-intuitive to call for a return to a functioning, legal foreclosure process, but for residents of community associations this is an imperative. These homeowners cannot continue to face higher housing costs, which places them at greater risk of default and foreclosure, as lenders and servicers allow vacant and abandoned properties to lie fallow month after month.

Our experience has been that servicers and lenders take only limited if any action to counter the community blight created by allowing properties to languish in foreclosure. CAI's members cannot comprehend how federal financial regulators seemingly permit the rapid dissipation of value of lender collateral in this manner. When a home cannot be saved, delaying the foreclosure process harms the borrower in default, the lender, and association residents.

When a foreclosure auction is completed and title transferred to either Fannie Mae or Freddie Mac, the enterprises, as property owners, are required to pay association assessments. By doing so, the enterprises diminish the risks that other borrowers in the neighborhood will default and also protect the value of their collateral. By ensuring properties move through foreclosure properly and promptly, the enterprises can enhance the return on REO sales and provide investors with properties that are in good standing with the community association.

Structure of Bulk Sales Contracts Should Support Responsible Ownership by Investors

CAI applauds FHFA for structuring the first bulk sales pilot transaction to require that investors be pre-qualified prior to bidding. Pre-qualification of investors ensures that bulk sales of enterprise REO are made only to well-capitalized, competent investors with demonstrated experience managing a substantial residential real estate portfolio.

Given the unique aspects of property ownership in a community association, CAI urges that potential investors also be required to demonstrate experience in managing property located in a community association. Investors should be required to demonstrate a working knowledge of community association law and community management industry standards (or how this expertise will be obtained) prior to bidding on any transactions with substantial amounts of REO located in a community association.

Further, the pre-qualification process and bulk sales contracts should anticipate purchaser business failures and provide to the greatest extent practicable for maintenance and disposition of properties held by a purchaser that has filed for bankruptcy protection. Associations currently experience significant difficulty in learning who actually controls vacant, abandoned or REO properties. If an investor fails, the bankruptcy process could result in questions of title to properties and other variables that will put the community association in an even more untenable situation than currently exists.

Policies Supporting Responsible Ownership

CAI strongly recommends that investor purchasers acknowledge basic contractual obligations of common ownership in community associations, including timely payment of association assessments. As a goal of the bulk sales pilot program is stabilizing communities, CAI offers the following recommendations on policies that support responsible ownership of investor rental properties in community associations:

- » Timely payment of assessments on association properties is imperative.
- » Purchasers must preserve, protect, maintain, and insure properties according to all applicable association requirements at all times, including during any vacancies.
- » Purchasers (or the enterprises) should provide a property report indicating the condition of the property being purchased, plans to remedy deficiencies, and a timeframe in which restoration of the property will occur.
- » Purchasers must provide the association with a single point of contact to facilitate prompt response and curative action for all violations of CC&Rs, rules, and regulations.
- » Purchasers must ensure lease terms comply with CC&Rs, rules, and regulations, including any applicable association lease riders (i.e. CC&Rs routinely require that tenants comply with association governing documents, with failure to do so constituting a default under the lease).

Access to Mortgage Credit for Condominium Unit Owners

CAI strongly urges FHFA and the Administration to ensure that current condominium project approval standards enforced by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), and the enterprises be revised to account for rental units under this program. The FHA, VA, and both enterprises require a condominium project to meet specific standards prior to insuring, guaranteeing, or purchasing individual condominium unit mortgages. In short, if the condominium violates program standards, access to mortgage credit is substantially restricted for unit owners.

There are numerous requirements under current FHA, VA, and enterprise condominium standards that could be violated by bulk sales of REO in condominiums. These include limiting to no more than ten percent the number of units in the condominium owned or controlled by a single entity and mandatory owner occupancy standards. In particular, FHA considers REO in its owner occupancy standard, so simply moving these units from REO to investor ownership will continue the violation of FHA standards. Condominium associations across the country are already grappling with stringent FHA condominium rules. Unless these and similar guidelines at the enterprises are modified to account for sales under this program, these unit owners will continue to have limited access to mortgage credit.

Protecting the Rights of Condominium Unit Owners

CAI strongly recommends that purchasers be contractually bound to respect and protect the rights of resident owners in condominiums. FHFA should take appropriate action to avoid investor controlled condominium associations. In these cases, investor owners control a majority of voting rights within the association, which may be sufficient to unilaterally dissolve the association, degrade owner rights and duties, or otherwise conduct the affairs of the association irrespective of resident owner interests or involvement. FHFA must avoid any potential for the rights and interests of resident owners to be degraded by investor owners.

Conclusion

The failure of lenders and servicers to adequately preserve and protect their collateral before, during, and after foreclosure has left community associations little choice but to engage in litigation to seek judgments on assessment arrearages or to judicially seize properties. Absent corrective action on the part of lenders and servicers, community associations will continue to seek redress for payment of bad debt and other costs in property disposal scenarios.

CAI's members do not seek to impede the progress of any program to support bulk sales of enterprise REO. Rather, CAI's members believe such a program could be of significant benefit to housing markets and to homeowners and tenants living in community associations. However, our members reject the notion that community association residents can be coerced or expected to fund property maintenance and asset protection that is by contract a responsibility of another party. This is harmful to homeowner interests and creates instability in affected communities.

Private investors purchasing REO in bulk are already encountering significant legal obstacles to ownership in states and municipalities where the community association model of housing is commonplace. Investor purchasers in California, Nevada, Arizona, and Florida are facing legal actions by community associations seeking to recover arrearages. Until these outstanding matters are satisfied, investor purchasers are often unable to obtain clear, unclouded title to properties. Implementing the policies recommended above will reduce these frictions in an enterprise REO bulk sales program, improving returns for the enterprises and providing stability for the homeowners who have shouldered the financial burden of maintaining these properties.

Additionally, federal financial regulators should contribute to the success of a bulk REO sales program and lessen the negative impact of foreclosures in community associations

simply by requiring that lenders and servicers fulfill their contractual obligations in a timely manner. The Office of the Comptroller of the Currency (OCC) has taken such a step by issuing OCC Bulletin 2011-49, which instructs lenders and servicers to meet obligations to community associations under private pooling and servicing agreements as well as enterprise seller/servicer guidelines. The OCC's bulletin is an appropriate first step to address what is a widespread crisis for community associations.

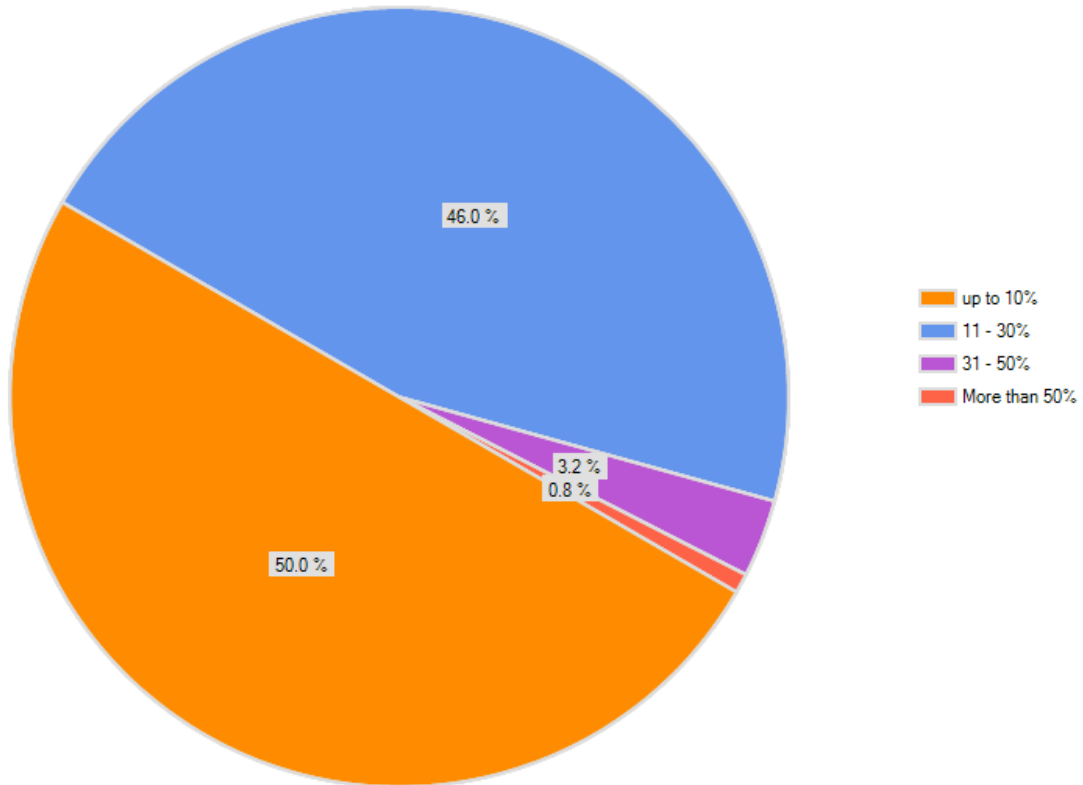
Fannie Mae recently reminded its servicers of their obligations to community associations starting from a borrower's first missed payment to recording a change in title to reflect Fannie Mae's ownership of the property. Interestingly, the bulletin largely restated existing requirements under Fannie Mae's Seller/Servicer Guidelines, instructing servicers to be in compliance with those guidelines within approximately 90 days.

CAI members encourage that all federally insured depository institutions, mortgage servicers, and state chartered institutions subject to federal supervision demonstrate compliance with property preservation requirements for REO or properties in foreclosure. Failure to meet these obligations may constitute a safety and soundness concern as institutions face heightened exposure to litigation and reputation risk while the value of the institution's real property assets is degraded.

On behalf of CAI's membership, I express our appreciation for the thoughtful and open process being employed to craft an enterprise REO bulk sales program to the benefit of households across the country. This is a critical issue for community associations and CAI's members will continue to work as partners with the federal government to ensure the program's success.

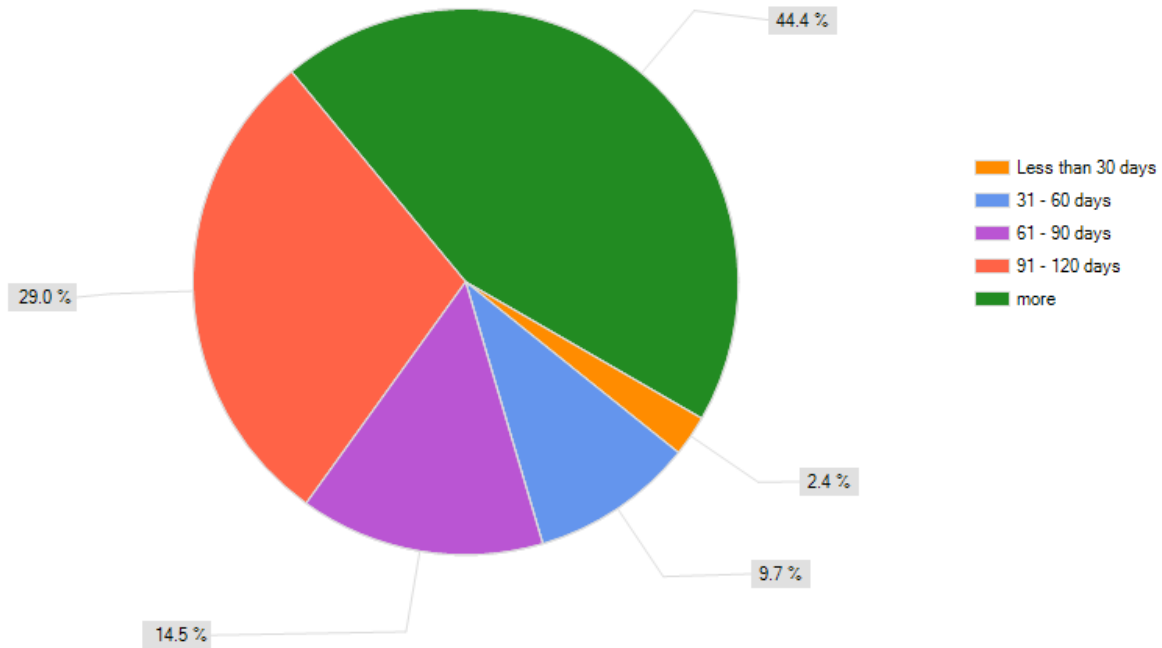
Appendix A

What percentage of home owners in your association(s) were delinquent in their assessments in 2011?



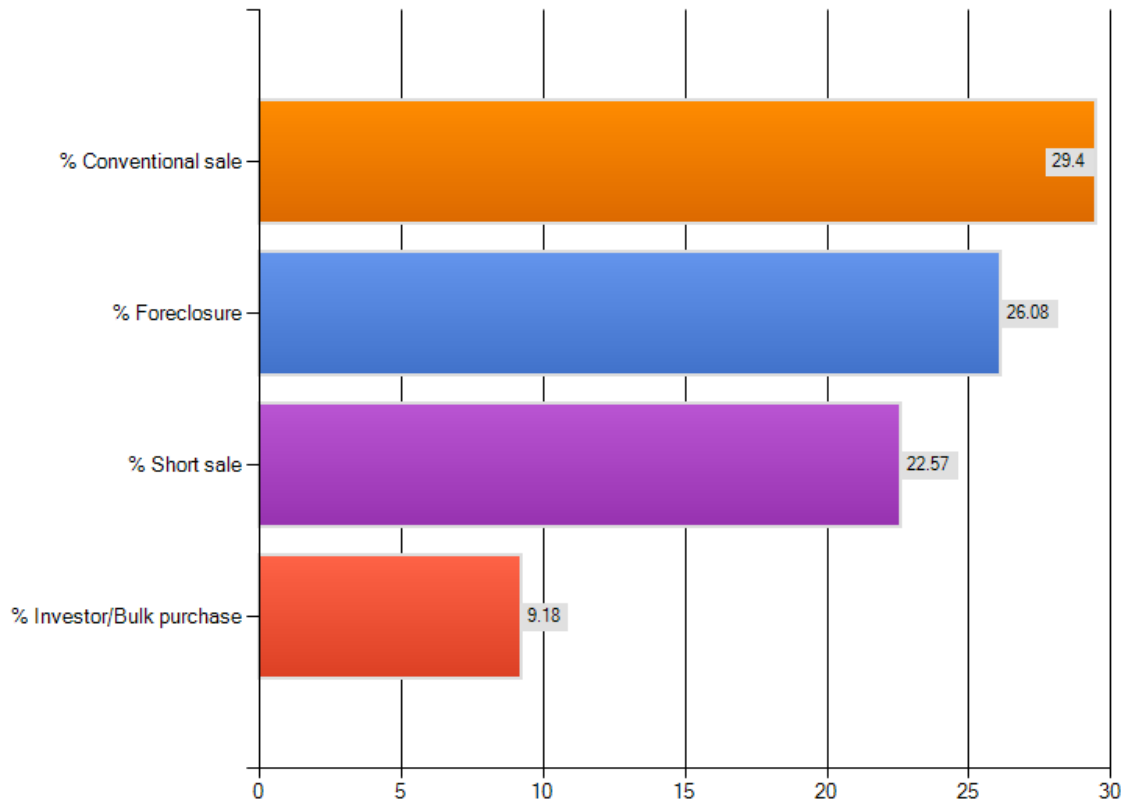
- » Half of HOA's surveyed had delinquencies of more than 10%.
- » 46 percent of HOA's surveyed had delinquency rates between 11 and 30 percent.

What is the period of time that these owners have not paid their assessments?



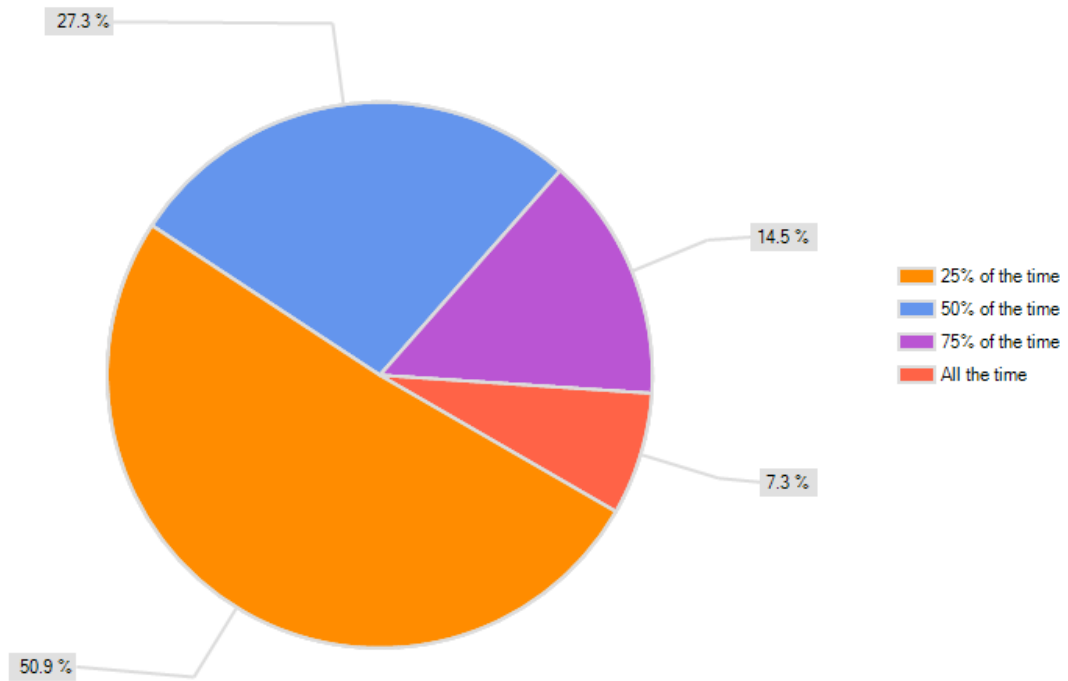
- » 97 percent of delinquent assessments are more than 30 days late.
- » 73 percent of delinquent assessments are more than 91 days late.
- » 44 percent of delinquent assessments are more than **4 months** late.

What percentage of units that have been sold this year were due to:



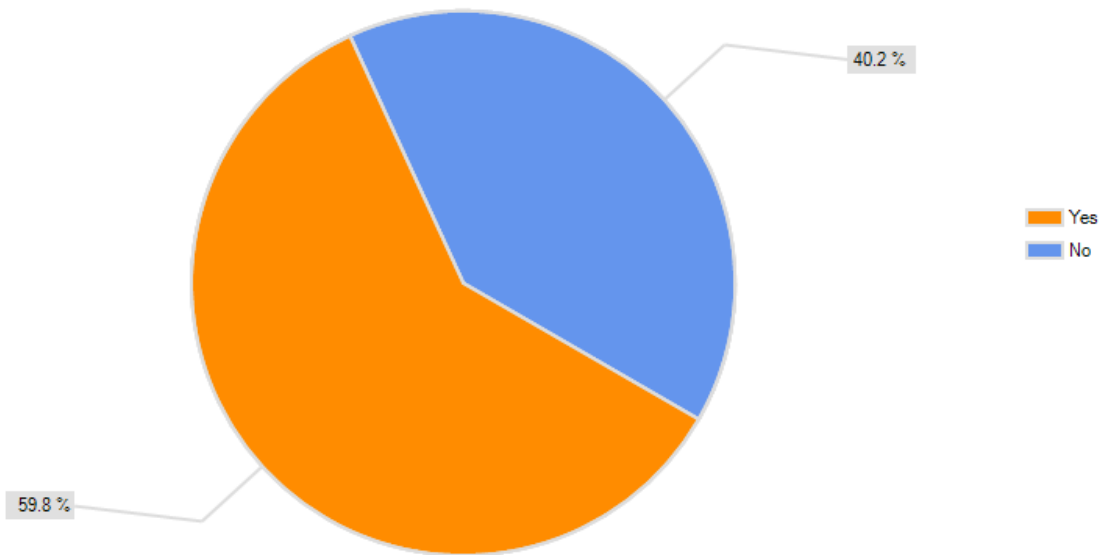
- » 49 percent of all common interest development sales in 2011 were foreclosure and short sales.

How often has the lender not foreclosed even though the owner has vacated the unit or failed to make mortgage payments?



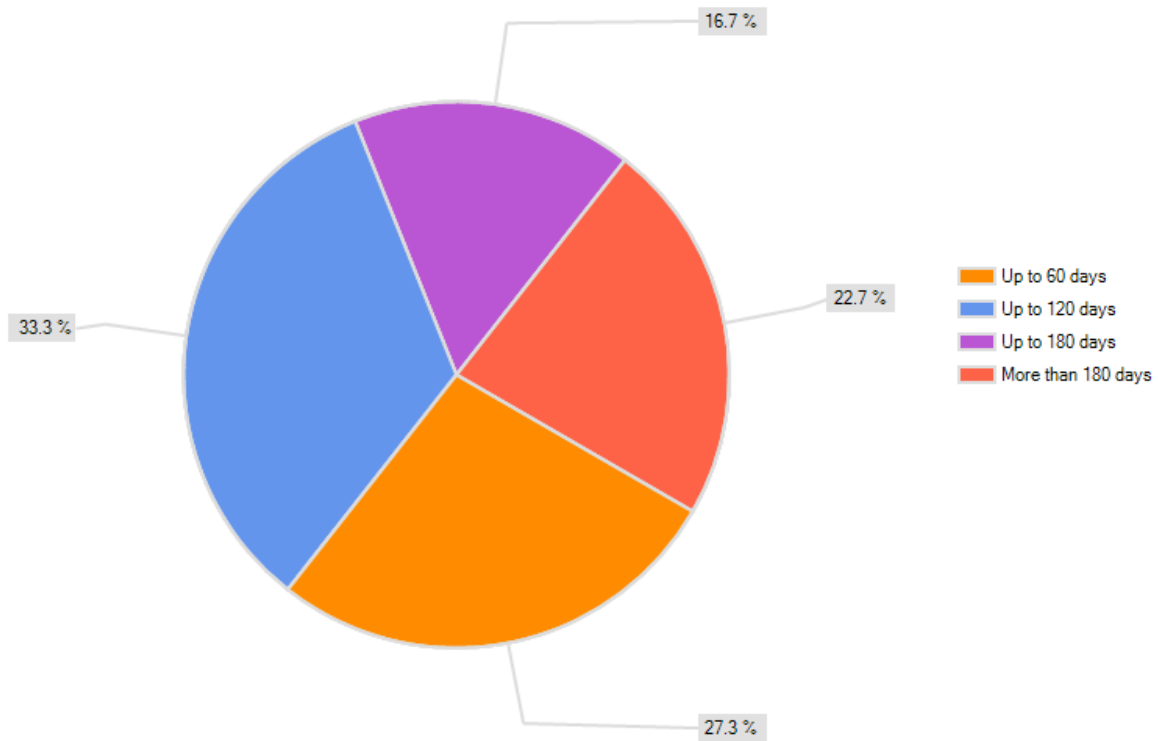
- » Lenders routinely fail to foreclose on properties after vacated by the owner.
- » 38 percent of communities report that lenders refuse to foreclose on vacant and abandoned properties more than 50 percent of the time.

Does the successor in interest delay recording the sale if the sale was due to a foreclosure?



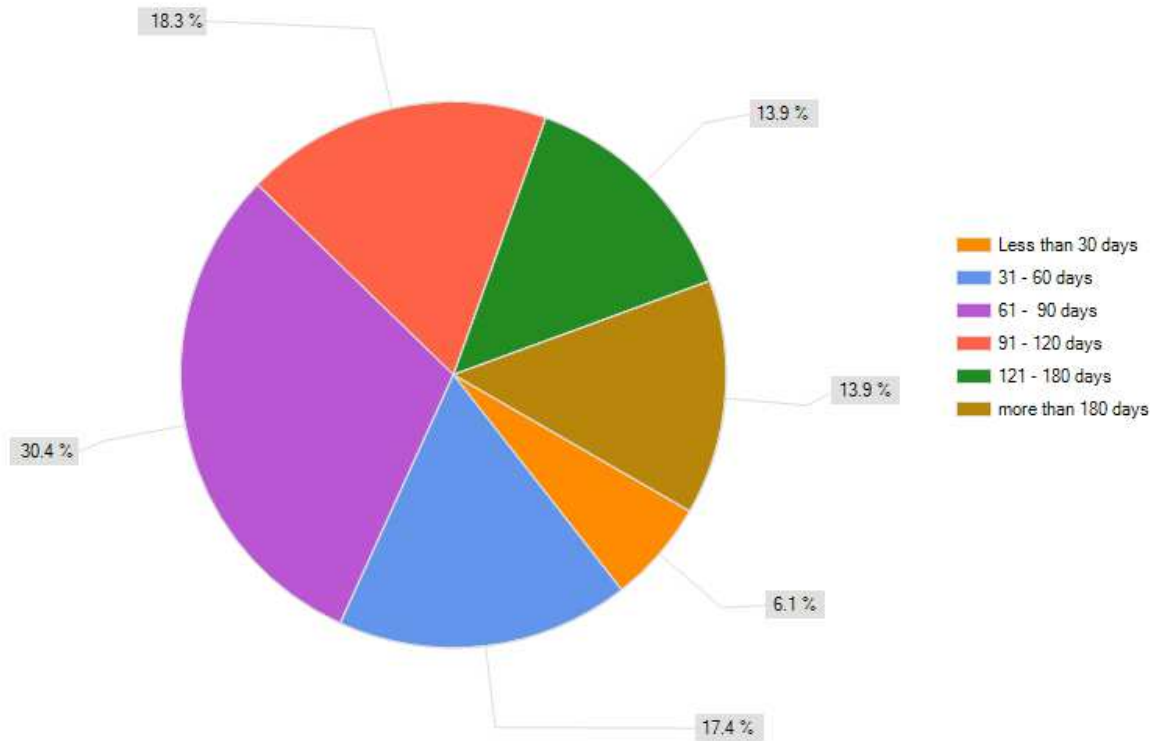
- » 60 percent of foreclosure sales are not recorded in a timely manner by the foreclosing party.

If you answered "yes" to the above question then how long was the delay?



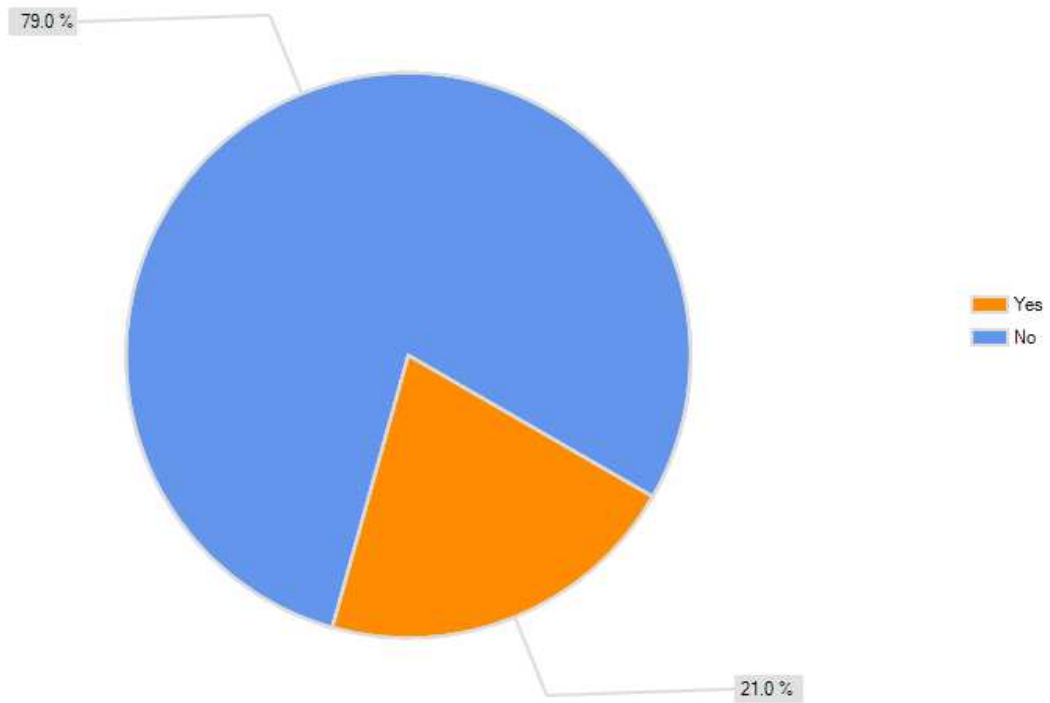
- » 73 percent of delayed foreclosure recordations were delayed more than 60 days.
- » *23 percent of delayed foreclosure recordations were delayed more than 6 months.*

How long does it typically take before foreclosing parties start paying assessments?



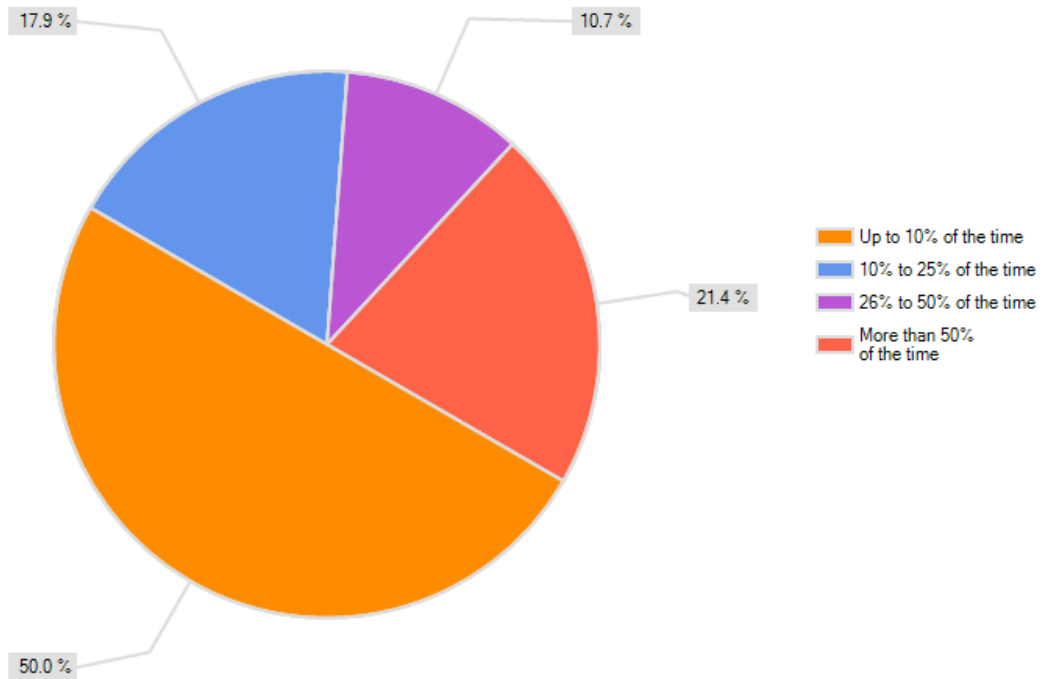
- » 24 percent of the foreclosing parties begin to pay assessments within 60 days of sale.
- » 76 percent of the time, assessments are not paid until more than 60 days after the sale.
- » 28 percent of the time, assessments are not paid until more than 4 months after the sale.
- » 14 percent of the time, assessments are not paid until more than 6 months after the sale.

Do the foreclosing parties pay ANY portion of the past due assessments?



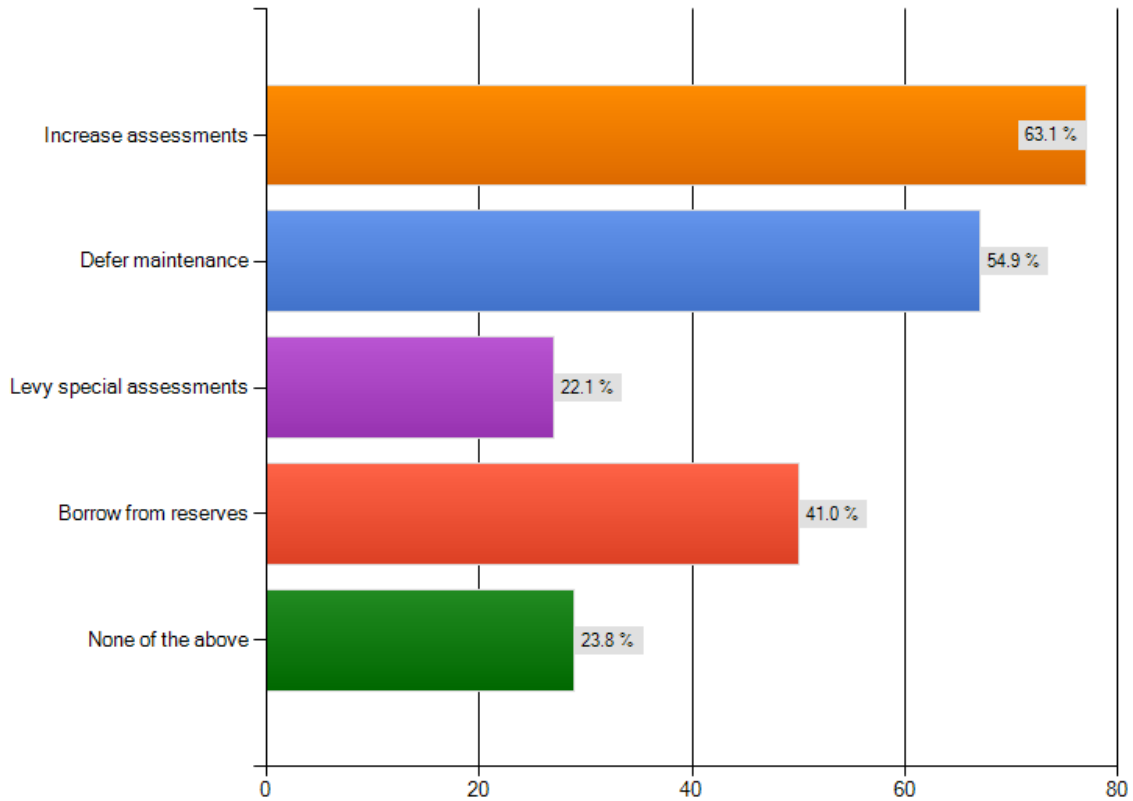
- » 79 percent of the time, foreclosing parties fail to pay **ANY** portion of past due assessments.

If you answered "Yes" to the above questions then how often do the foreclosing parties pay?



- » Of the foreclosing parties that do pay delinquent assessments, their "consistency rate" of payments varies from as low as 10 percent to as high as 50 percent of the time.

As a result of non payment of the homeowner assessments, did the HOA:



This chart illustrates the HARM that is done when foreclosing parties fail to timely record sales, leaving the HOA with no ability to identify or locate the new owner for purposes of invoicing assessments.

- » 63 percent find it necessary to raise assessments, harming fixed income owners, perhaps to the point of causing them to become delinquent in their payments.
- » 55 percent defer maintenance, drastically reducing the curb value of the properties and community, in addition to incurring future expensive repairs.
- » Only 22 percent of HOAs can or elect to levy special assessments due to financial limitations of the association members.

- » 41 percent of HOAs find it necessary borrow from their own reserves, if they have any. This method requires prompt repayment and supplants the very purpose of the reserve account which is for major rehabilitation of the community's physical plant.

- » 24 percent of the time, no relief is available to make up for the loss of delinquent assessments. This eventually invites neighborhood blight, which ironically reduces the foreclosing parties' asset value in the property they now own.