Testimony of

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Field hearing entitled
"THE HOUSING CRISIS IN LOS ANGELES AND RESPONSES TO PREVENTING FORECLOSURES AND FORECLOSURE RESCUE FRAUD"

Before the
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

March 28, 2009

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Good morning Chairwoman Waters and members of the Subcommittee, my name is Heather Peters and I am the Deputy Secretary for Business Regulation and Housing at California's Business, Transportation and Housing Agency. I am also the Chair of Governor Schwarzenegger's Interdepartmental Task Force on Non-Traditional Mortgages. On behalf of Governor Schwarzenegger and Secretary Bonner I thank you for the opportunity to testify here today about the foreclosure crisis, foreclosure prevention and foreclosure rescue fraud. We appreciate the committee's interest in these important subjects.

UPDATE ON FORECLOSURE CRISIS IN CALIFORNIA

Since I last testified before this Subcommittee at the end of 2007 the foreclosure crisis has continued to disproportionately affect Californians. According to DataQuick, notices of default (the first step in California's foreclosure process) consistently hovered around 35,000 per month from January through August of 2008 and notices of trustee sales (the last step in the foreclosure process) rose from approximately 15,000 to a high of over 28,000 per month in that same timeframe.

In September of 2008, both notices of default and notices of trustee sales dropped dramatically in California by 63% and 39% respectively. This was attributed in large part to lenders and servicers adjusting their practices to comply with SB 1137, a new California law effective in September of 2008 requiring diligent attempts to contact borrowers to explore loan restructuring options 30 days before initiating the foreclosure process. The law mandates notice to the borrower that he or she has the right to request a meeting with the lender or servicer within 14 days to discuss options to foreclosure and that free help was available from HUD-certified counselors through a toll-free number.

Notices of default remained below 20,000 per month statewide from September through November of 2008, but then began to climb again to a new high of 44,104 in February 2009. Notices of trustee sales have remained lower since September of 2008, and are currently are at approximately 40% of their high mark, but these notices normally follow notices of default by at least 90 days, so it would not be surprising if they also spike again in the near future.

Los Angeles County has followed a similar pattern, with notices of default hovering between 6,000 and 7,000 per month for most of 2008, then dipping dramatically after the passage of SB 1137 only to climb to new heights of 9,157 in February of 2009. Notices of sale in the county are currently at approximately 64% of their high mark.

These numbers are more than just statistics, they represent the deterioration of our neighborhoods. With the passage of HR 3221, the American Housing Rescue and Foreclosure Prevention Act of 2008 provided $3.9 billion nationwide for the Neighborhood Stabilization Program (NSP) for state and local governments to purchase abandoned and foreclosed homes and residential property. We thank the Chairwoman for her leadership in establishing this program which has the potential to revitalize some of California's neighborhoods most hard hit by the foreclosure crisis and begin the recovery process.

Under HR 3221, HUD was to address the number and percentages of foreclosures, subprime mortgages and notices of default in States and localities as they developed their funding formula. Unfortunately, HUD added additional criteria to the formula resulting in less funds being allocated to California in the initial round. At the time, California had 27% of the foreclosures and 26.6% of the Notices of Default, yet the State received only 14% of the funds from the first round of NSP awards. We were surprised and disappointed by this initial allocation and hope to receive a greater share of the next round of NSP funding to help California neighborhoods recover and eventually thrive.

UPDATE ON FORECLOSURE PREVENTION EFFORTS

California has been on the forefront of foreclosure prevention efforts since early 2007 when Governor Schwarzenegger first formed his Task Force on Non-Traditional Mortgages. In November of 2007 Governor Schwarzenegger announced the first voluntary agreement in the nation with major loan servicers to fix teaser interest rates on subprime loans where borrowers could afford their initial payments, but not the resets. Since then the Department of Corporations has tracked detailed monthly statistics on various types of loan workouts.

In his state of the state address in 2008 the Governor set a goal of helping 100,000 borrowers avoid foreclosure and, by the end of last year, 136,785 loan modifications were completed for California families just by the ten parties to the Governor's agreement and others who have been voluntarily reporting their statistics. Not only are the raw numbers of loan workouts we track steadily increasing, but the reports show that the types of workouts achieved have shifted to include more than 50% loan modifications, the type of workout most beneficial to consumers, and fewer of the less sustainable workouts such as repayment plans and temporary forbearance.

In addition to these voluntary agreements and reporting, last month our legislature answered Governor Schwarzenegger's call to pass a new law (SBX2 7) that further encourages foreclosure prevention by precluding the initiation of a foreclosure sale for up to 90 days on loans made from January 1, 2003 through January 1, 2008, ***unless*** the loan servicer has implemented a comprehensive loan modification program that has been approved by the Commissioner of the Department of Corporations, Department of Real Estate or Department of Financial Institutions. Emergency regulations are currently being drafted regarding the procedures for obtaining approval and the provisions of the new law are expected to be effective in the first week in June.

It is hoped that most servicers will opt to choose to implement comprehensive loan modification programs to avoid the delay. It is expected that a servicer with a comprehensive loan modification program such as that implemented by the FDIC at IndyMac or the Homeowner Stability Initiative recently announced by President Obama's administration will receive expedited approval by the Commissioners and that countless California families will benefit from wider availability of formalized streamlined loan modification programs.

Additionally, the California Housing Finance Agency and its partner Rural Community Assistance Corporation are working diligently to help California families avoid foreclosure by administering grants funded by the Federal Government under the National Foreclosure Mitigation Counseling Program. To date our subgrantees have provided over 14,200 units of free counseling to assist California families in distress.

Unfortunately, despite our best efforts to facilitate foreclosure prevention for free, a cottage industry of foreclosure rescue scams had emerged where unlicensed and unscrupulous individuals prey on distraught homeowners facing foreclosure.

ACTION THE STATE HAS TAKEN TO PREVENT FORECLOSURE RESCUE SCAMS

These scams take many different forms, but most often they involve former lending industry employees promising distressed borrowers loan modifications in exchange for substantial up front fees often exceeding several thousand dollars. Unless you fall within some very narrow legal exemptions, California law requires that you have a real estate broker license or be a California licensed lawyer performing services in the course of your legal practice, in order to perform loan modification services. If you are a real estate broker you can only collect an up front fee if you have a written fee agreement that has been reviewed by the Department of Real Estate. Even then, you can only collect an upfront fee from a borrower before a notice of default has been filed.

In an attempt to deter real estate licensees from going astray, the California Department of Real Estate (DRE) has issued bulletins to its licensees reminding them of the legal limits on for-profit loan modification services. However, many of the for-profit loan modification providers are still operating without licensees or in violation of other California laws and they are being aggressively pursued by the DRE in cooperation with other state regulators, the California State Bar, the Attorney General and local prosecutors.

On the state level, the DRE is on several task forces headed by local district attorney offices, and include investigators from a number of law enforcement organizations. In Southern California, DRE regularly attends the Los Angeles County Real Estate Fraud Task Force, which includes law enforcement agencies from Los Angeles, San Bernardino and Riverside Counties. This group is occasionally joined by representatives of the FBI, IRS, and HUD. The DRE attends meetings with the Ventura County Real Estate Fraud Advisory Team, which is comprised of both public and private sector organizations organized to address fraud in that county. The DRE is also currently working with Orange County assisting them in establishing a real estate fraud task force.

In addition, the DRE recently participated in a press conference with Mayor Villaraigosa on loan modification scams. In Northern California, DRE participates in the Northern California Real Estate Fraud Task Force, which is attended by local district attorney offices, as well as state and local law enforcement organizations.

The DRE also works closely with its federal counterparts including participation as a member in the Eastern District Fraud Task Force, lead by the United States Attorneys Office. In addition, the DRE participates in regular meetings with the Southern California Foreclosure Fraud Task Force, as well as the Northern California Foreclosure Fraud Task Force, and the Federal-State Reverse Mortgage Law Enforcement Working Group, all of which are headed by the Federal Trade commission (FTC).

As a result, the DRE currently has over 500 pending enforcement cases involving for-profit loan modification operations and the DRE posts its enforcement actions on its website so consumers can easily identify scammers. Persons violating California's laws in connection with various foreclosure rescue scams are being prosecuted in various ways.

- A foreclosure consultant who violates the Mortgage Foreclosure Consultants' Act is guilty of a misdemeanor, and can be imprisoned in county jail or state prison for up to one year, and fined up to $10,000. See section 2945.7 of the Civil Code. See also section 2945.4 (d) of the Civil Code, which provides additional criminal penalties. The Attorney General has recently charged a violation of the Consultants' Act as a felony.

- Under the Real Estate Law (section 19139 of the B&P Code), any person who operates as a real estate licensee without a license can be imprisoned in a county jail for up to six months, and is subject to a fine of up to $20,000 if an individual (and up to $60,000 if a corporation).

- Under section 487 (a) of the Penal Code, taking money (in excess of $400) for a fictitious loan modification program is guilty of grand theft, is a felony. In a recent criminal complaint filed by the Attorney General, there was a special allegation of "excessive taking" under Penal Code section 12022.6 (a)(1). The assertion is that in committing the felonies of grand theft and doing prohibited acts under the Foreclosure Consultant's Act, the value taken was excessive.

- In addition to criminal penalties, the District Attorney in Ventura is civilly prosecuting a loan modification company under section 17200 of the Business and Professions Code. That provides significant financial awards against those who are engaged in unlawful, unfair or fraudulent business acts or practices, and it can be a powerful tool.

These enforcement cases have resulted from traditional regulatory investigations, as well as a number of creative efforts designed to actively ferret out scam artists. Each prosecution starts with a tip. The DRE takes traditional consumer complaints directly from victims, but the DRE has also taken many proactive steps to generate leads from non-traditional sources. The DRE has trained non-profit housing counselors, the State Bar and local law enforcement on how to spot and report scams. This training is being incorporated into a kit that will be distributed to local law enforcement in cities where homeownership preservation events are scheduled. The kit will effectively be a force multiplier necessary to rise to the challenge of addressing such widespread scams in a state as large as California.

Some of the more creative investigations have involved the DRE partnering with local law enforcement to attend foreclosure prevention fairs where they immediately cite violators that they find working the crowd to identify new victims. Recently, in Stockton, the DRE joined with the San Joaquin District Attorneys Office in issuing misdemeanor citations to unlicensed loan modification solicitors who appeared at a "Project Homeowner" event. The following week, the DRE and the San Joaquin District Attorneys Office attended a seminar sponsored by an unlicensed loan modification company attempting to solicit individuals to act as their agents as a way of earning income. The seminar was immediately disbanded. The sponsor was served with a Desist and Refrain Order issued by the DRE for its unlicensed loan modification activities, and the individuals in attendance were informed that the company was operating in violation of the law. The DRE has also instituted a "secret shopper" program where investigators respond to suspicious advertisements posing as distressed homeowners.

Just this week Desist and Refrain Orders were issued by both the DRE and the Department of Corporations in a joint investigation of 2nd Chance Negotiations Inc. and its principals who had illegally charged homeowners millions of dollars in fees in just a few short months.

No matter how many scam artists are caught and prosecuted it is always preferable to stop a crime before it happens, so in addition to its enforcement actions, the DRE is very active in raising public awareness of the scams and of the availability of free help. DRE has produced public service announcements and Op-Eds in both English and Spanish to let consumers know they can get help for free from HUD-approved counselors and that they should be extremely cautious before paying anyone a fee for a loan modification.

The Real Estate Commissioner and his staff also routinely do both television and radio interviews to raise awareness of scams and have participated in several "telethons" in both English and Spanish where borrowers can call in to speak live with HUD-certified housing counselors. To date, over 50 news stories have resulted from DRE's efforts to prevent foreclosure rescue scams. Additional consumer information on all aspects of mortgages can be found at www.yourhome.ca.gov or www.sucasa.ca.gov.

I hope this discussion of our efforts and accomplishments has emphasized California's commitment to aggressively address the foreclosure crisis. In so doing, Governor Schwarzenegger encourages others to do the same as only multifaceted solutions reaching across Local, State and Federal jurisdictions, and across public and private partnerships, can begin to address this multifaceted problem. The Administration remains firmly committed to collaborating with all stakeholders and to find innovative ways to lead us out of this crisis and restore the American dream in California and across the nation.

This concludes my statement. I thank the Subcommittee for the opportunity to meet with you today to discuss these important issues.