Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Joint Resolution 1 (Delegates Stukes and Robinson)
Rules and Executive Nominations

Federal Legislation to Protect Homeowners and Banks

This joint resolution urges the U.S. Congress to pass legislation to • establish a federal agency that will freeze all existing home mortgages for a period of time, adjust mortgage values to fair prices, restructure the interest rates of existing mortgages, and write off speculative debt obligations of mortgage-backed securities; • declare a moratorium on all home foreclosures for the duration of a certain transitional period during which borrowers would make monthly payments to designated banks; and • authorize the governors of the several states to assume the administrative responsibilities of implementing the program created by the legislation, with the federal government providing the necessary credits and guarantees.

Fiscal Summary

State Effect: The bill would not directly affect State finances or operations.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law/Background: By all accounts, recent changes in the real estate market and the economy in general have led to a marked increase in foreclosure events both nationwide and in Maryland. Many such foreclosures have involved residential properties that have been financed through subprime loans and nonbank loan originators, leading to heightened concern regarding the lending practices that surround these nontraditional financing methods.

Due to good real estate market conditions prior to 2006, the traditional mortgage market has evolved from mortgages primarily originated and provided by local banks and financial institutions to mortgages originated through mortgage brokers for nonbank lenders. Through new products, such as "exotic" and other nontraditional mortgages, lenders began to ease borrowing restrictions to allow lower credit borrowers to qualify for mortgages, greatly expanding the subprime market. Subprime loans, which are higher-cost loans, provide opportunities for a wide range of higher-risk borrowers. Consumers with lower credit scores and higher loan-to-value and debt-to-income ratios found that they qualified for mortgages. Further, lenders made loans to customers based on less stringent or no income and asset verification requirements. With the influx of new loans, lenders began to package the loans and sell them to Wall Street as securities to investors. By packaging risky loans with traditional loans in order to spread the risk, investors found the low-risk securities to be attractive, allowing lenders to make even more loans.

During calendar 2006, the real estate market began a downturn as interest rates increased, housing sales slowed, and home prices declined. Terms of many of the "exotic" and other nontraditional loans included adjustable rates whereby the consumer pays a low interest rate for 2 or 3 years, followed by 27 or 28 years of higher interest rates that are generally tied to the market. As the low interest rate period ended, many borrowers then found that they were unable to make the higher monthly payments due after their interest rates reset. Furthermore, many borrowers also then realized that they were unable to refinance due to prepayment penalties or sell their property due to, in some cases, lower property values or decreased demand. In addition, many investor-owners of rental property found that they were unable to obtain the rent needed to pay their mortgages and were unable to sell due to the depressed resale market.

It is unclear exactly how much of this situation is attributable to unethical lending practices and how much is a result of borrower risk taking; however, it is evident that many lenders have filed for foreclosure as a result. As foreclosure filings have mounted, lenders have not received all expected payments from borrowers, forcing them to curtail the number of new loans, decrease the products available to borrowers with low credit scores, and tighten overall lending practices and standards. Wall Street investors have also responded by pulling out of the risky mortgage market, and the combination of these and other factors has led to a decrease in overall nationwide housing sales and home equity growth.

Opinions differ regarding the exact number of recent foreclosures in Maryland, as well as the severity of the situation, but all sources report a substantial recent increase in foreclosure activity in the State. For example, in November 2007, the Homeownership Preservation Task Force reported that the total of all foreclosure events in the State during the second quarter of 2007 numbered 4,092, an increase of 344% when compared to the 920 events in the second quarter of 2006. According to the task force report, these foreclosure events could be one of three activities: • a notice of default; • a notice of foreclosure sale; or • a foreclosure sale. These data were originally obtained by the Department of Housing and Community Development from the company RealtyTrac, a business that sells real estate data to consumers, investors, and real estate professionals seeking to locate, evaluate, purchase, and sell real property. The report also states that these data were analyzed by DHCD's Office of Research in order to remove duplicate foreclosure events that occurred for a single property within reporting quarters.

According to the National Delinquency Survey from the Mortgage Banker's Association, in the second quarter of 2007, 4.19% of all mortgage loans for one-to-four unit residential properties reported serviced in Maryland were past due. Furthermore, 1.46% of all loans for similar properties during this period were seriously delinquent, meaning 90 days or more delinquent or in the process of foreclosure. This is an increase from 3.26% past due and 0.96% seriously delinquent in the second quarter of 2006. NDS comprises data collected from approximately 120 reporting loan servicers, including mortgage bankers, commercial banks, savings banks, savings and loan associations, and life insurance companies. As of the third quarter of 2007, NDS includes data from over 45 million mortgage loans that relate to residential properties with one to four units.

In response to the situation, the Senate Finance Committee and the House Economic Matters Committee have been reviewing whether statutory changes should be made as a result of the lending practices that may have contributed to the current mortgage situation. The Senate Judicial Proceedings Committee and the House Environmental Matters Committee are also investigating the situation, concentrating mostly on the foreclosure process. In June 2007, Governor O'Malley appointed the Homeownership Preservation Task Force and created the Homeowners Preserving Equity initiative within the Department of Housing and Community Development.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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