SB 535

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 535 (Senator Muse)
Judicial Proceedings

Foreclosure - Subprime Mortgages - Moratorium

This emergency bill prohibits creditors from maintaining suit in a court of the State in an action to foreclose a mortgage of a homeowner, unless the creditor shows to the satisfaction of the court that the mortgage is not a "deceptive subprime mortgage." Creditors that fail to make this showing may be liable for damages up to the amount of the mortgage, in addition to any other penalty provided by law.

The bill terminates six months after enactment.

Fiscal Summary

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

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

Small Business Effect: Potential minimal.

Analysis

Bill Summary: The definition of a "deceptive subprime mortgage" contains two requirements. First, an extension of credit to a homeowner by a creditor that employed deceptive means, including exaggeration of a homeowner's potential future income or a failure to properly disclose the current and future interest rate of a mortgage, in order to convince a homeowner to borrower more that the homeowner could afford or could have reasonably been expected to afford. Second, the mortgage must be one that • allows a homeowner to pay only interest for a period of time; • allows a homeowner to make a

minimum payment that may be lower than the payment required to reduce the balance of the mortgage; • has an initial fixed rate that is replaced with a variable rate after a period of time; or • was agreed to with minimal or no income verification information requested from the homeowner.

Current Law: Foreclosures of subprime mortgages are not subject to specific additional requirements beyond those that apply to all foreclosures.

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 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.

Additional Information

Prior Introductions: None.

Cross File: HB 1398 (Delegate Valderrama, *et al.*) – Environmental Matters.

Information Source(s): Department of Legislative Services

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