HB 1477

Department of Legislative Services

Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

House Bill 1477 (Delegate Ramirez, *et al.*)
Environmental Matters

**Prince George's County - Defenses to Wrongful Foreclosures Act
PG 427-08**

This bill permits a record owner of residential property in Prince George's County to raise specific affirmative defenses in an action to foreclose a mortgage or deed of trust.

Fiscal Summary

State Effect: It is expected that any increased workload for the Judiciary could be handled within existing budgeted resources. If the Attorney General's Office receives fewer than 50 complaints per year stemming from the bill, the additional workload could be handled with existing resources.

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

Small Business Effect: Potential minimal.

Analysis

Bill Summary: The bill defines "residential property" as owner-occupied real property with a dwelling designed principally as a residence containing accommodations for up to four families. Under the bill, a record owner may raise specific defenses in a foreclosure action within 30 days of personal service of process. These defenses are • unclean hands on behalf of the lender, a mortgage broker, or agent or affiliate of the lender; • fraud; • unfair or deceptive practices in violation of federal, State, or local laws, including a claim of housing discrimination; or • a violation of federal or State loss mitigation regulations.

The bill grants a record owner the right to conduct discovery pursuant to the Maryland Rules to support the bill's affirmative defenses in a foreclosure action. Such discovery is required to be completed within 60 days of service of process unless extended by the court for good cause. A record owner who raises an affirmative defense is also entitled to a hearing before the sale of the property is ratified by the court. If the record owner proves an affirmative defense by a preponderance of the evidence, then; • the foreclosure action has to be set aside and any sale dismissed; and • the record owner is entitled to an award of reasonable attorney's fees.

Current Law: Most mortgage or deeds of trust include a "power of sale" (a provision authorizing a foreclosure sale of the property after a default) or an "assent to decree" (a provision declaring an assent to the entry of an order for a foreclosure sale after a default). When the lien instrument does not contain a power of sale or an assent to a decree, foreclosure requires the filing of a complaint, and process must be served. In this case, the action proceeds as any other civil action. Under the Maryland Rules, however, it is not necessary to serve process or hold a hearing prior to a foreclosure sale pursuant to a power of sale or an assent to a decree.

In these situations, an action to foreclose is commenced by the filing of an order to docket in the circuit court for the county where the property is located. The homeowner is not entitled to be personally served with process. Notice of the filing of the action is required to be sent to the homeowner by certified and first-class mail; however, the lender is not required to show that the notice was actually received. Written notice of the foreclosure sale must also be sent by certified and first-class mail not earlier than 30 days and not later than 10 days before the date of the sale, but actual notice is not required. The homeowner is not entitled to a hearing before the sale – the only recourse under State law to challenge the lender's claim of default is to file a motion for injunction to stay the sale.

Notice of the sale is required to be published in a newspaper of general circulation once a week for three successive weeks before the sale. A sale can conceivably occur within 15 days after the filing of the order to docket, but this rarely occurs in actual practice. The person making the sale must file a report of the sale with the court within 30 days. The homeowner may file exceptions to the ratification of the sale. Objections are generally based on the insufficiency of the sales price. However, the sales price must be so low as to "shock the conscience of the court" in order to set aside the sale.

Background: According to *RealtyTrac*, Prince George's County reported 2,732 foreclosures in the fourth quarter of 2007, the highest in Maryland. This number represents approximately 28% of the 9,722 foreclosures that occurred in the entire State during that time period. In comparison, U.S. Census Bureau information indicates that Prince George's County contains approximately 15% of the State's total population. Maryland's current foreclosure process, from the first foreclosure filing to final sale, is among the shortest in the nation. Maryland is a quasi-judicial State, meaning that the authority for a foreclosure sale is derived from the mortgage or deed of trust, but a court has oversight over the foreclosure sale process. Consumer advocates contend that the short timeframes and weak notice provisions in current law seriously limit a homeowner's options to avoid foreclosure by, for example, working out a payment plan with the lender or selling the house. In addition, filing a request for an injunction is expensive, time consuming, and not a realistic option for most homeowners.

In June 2007, the Governor established the Homeownership Preservation Task Force to develop an action plan to address rising foreclosures and preserve homeownership in Maryland. The Legal and Regulatory Reform Workgroup of the task force reviewed existing laws, regulations, and practices relating to mortgage lending and foreclosures and developed recommendations to promote homeownership. The Attorney General also formed a workgroup to provide input on issues relating to lending practices in Maryland. In addition, the Senate Finance and Judicial Proceedings committees and the House Economic Matters and Environmental Matters committees held hearings during the 2007 interim to examine various aspects of mortgage lending practices and the foreclosure process.

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 two or three 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 (NDS) 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.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Office of the Attorney General (Consumer Protection Division); Department of Legislative Services

Fiscal Note History: First Reader - March 17, 2008
ncs/hlb

Analysis by: Alexander M. Rzasa

Direct Inquiries to:
(410) 946-5510
(301) 970-5510