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VIA ELECTRONIC MAIL

MEMORANDUM

DATE: May 20, 2008

TO: All Interested Parties

FROM: Assemblyman Marcus L. Conklin, Chairman, Legislative Commission's Subcommittee to Study Mortgage Lending and Housing Issues

SUBJECT: **Solicitation of Recommendations for Possible Consideration by the Subcommittee**

During the past seven months, the Legislative Commission's Subcommittee to Study Mortgage Lending and Housing Issues has been considering extensive testimony on residential mortgage problems in Nevada. The purpose of this memorandum is to invite all interested persons to submit recommended solutions to the Subcommittee. You may make recommendations in writing or in person.

To assist you, Subcommittee staff have prepared the enclosed summary of issues and conceptual solutions from testimony to date. The staff will review all submittals and testimony and develop a list of potential recommendations, on which the Subcommittee will take action during a work session, tentatively scheduled for July 2008. **Please note that submitting a recommendation to the Subcommittee does not guarantee its placement in the final work session document.**

The Subcommittee may request a limited number of bill draft requests for introduction during the 2009 Legislative Session, send letters to key individuals and organizations, or place position statements in its final report.

Members of the public may submit written suggestions for recommendations, with applicable background information, to Subcommittee staff **no later than 5 p.m., Friday, June 20, 2008**, at the following address:



Attn: Dave Ziegler, Principal Research Analyst
Research Division
Legislative Counsel Bureau
401 South Carson Street
Carson City, Nevada 89701-4747
(e-mail: dziegler@lcb.state.nv.us)

You may also make recommendations in person under an item on the agenda of the meeting scheduled for **9 a.m., Monday, June 2, 2008**, in Room 4401 of the Grant Sawyer State Office Building in Las Vegas, Nevada. Persons may appear and provide concise testimony either in Las Vegas or by videoconference from Room 2134 of the Legislative Building in Carson City.

Thank you for your interest in these important topics. Please do not hesitate to contact the Subcommittee staff (telephone: 775/684-6825; e-mail: dziegler@lcb.state.nv.us) if you have any questions or need additional information.

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Mortgage Lending Problems and Conceptual Solutions

Legislative Counsel Bureau

Research Division

Revised May 19, 2008

Introduction

At the request of the Chairman of the Legislative Commission's Subcommittee to Study Mortgage Lending and Housing Issues, the Research Division compiled this list of problem statements and conceptual solutions from the testimony of witnesses appearing before the Subcommittee on October 22 and December 3, 2007, and January 28 and April 22, 2008.

During its upcoming meetings, the Subcommittee will receive additional testimony and consider specific recommendations for submittal to the 2009 Legislative Session.

1. Consumer Counseling and Education

Problem Statement

Consumers facing delinquency, foreclosure, or interest rate adjustments on their mortgage have a pressing need for counseling on options. Despite its increased caseloads and high foreclosure rate, Nevada has received reduced funding for counseling from the United States Department of Housing and Urban Development (HUD). Federal funding to support service delivery through the end of 2008 will likely be exhausted in August.

Since October, counseling caseloads have increased and available resources have decreased, on a per-client basis. One nonprofit agency is no longer participating in new outreach or accepting referrals from other agencies.

Consumers need access to impartial nonprofit agencies that can help them mitigate potential loss, identify housing options, and prepare for future homeownership. It is important for consumers to learn about counseling services and acknowledge they have a problem early enough to change their outcome. Other needs include: culturally relevant education and communication; education on second mortgages; improved outreach to borrowers, especially regarding foreclosure scams; more comprehensive homebuyer education; and training for counselors on workout options.

Witnesses on October 22, 2007, and April 22, 2008: Gail Burks, President and Chief Executive Officer, Nevada Fair Housing Center, Inc. (NFHC); Joselyn Cousins, Senior Vice President, Community Development Manager, Bank of Nevada, Las Vegas, Nevada

Foreclosure Prevention Task Force (NFPTF); and Michele Johnson, President and Chief Executive Officer, Consumer Credit Counseling Services of Southern Nevada (CCCS).

Conceptual Solutions

- On October 22, 2007, the Subcommittee voted to support submission of a proposal to establish a Statewide toll-free telephone hotline to coordinate consumer services in the mortgage industry, with the funding level to be determined by the Interim Finance Committee.

2. Foreclosure and Foreclosure Consultants

Problem Statement

More holders of second mortgages are now using the foreclosure process. Some counseling clients have second mortgages and virtually all of those mortgages are “piggyback” loans, taken out simultaneously with the first mortgage to cover the borrower’s down payment. Witnesses on April 22, 2008: Gail Burks, NFHC, and Michele Johnson, CCCS.

The Division of Mortgage Lending, Department of Business and Industry (DBI), can issue fines against foreclosure consultants up to \$10,000 per violation of the *Nevada Revised Statutes* (NRS), but the law does not specifically authorize the Division to investigate or issue subpoenas. One person has challenged a subpoena on the basis of lack of authority.

Conceptual Solutions

- On April 22, 2008, Joseph L. Waltuch, Commissioner, Division of Mortgage Lending, DBI suggested amending the NRS to authorize the Division to exercise its normal enforcement authority over foreclosure consultants who are not licensed unless they hold an agent or broker license. Alternatively, Nevada could require foreclosure consultants to be licensed. In addition, he suggested giving the Division authority to order restitution, in addition to levying fines.

3. New Loans and Refinancing

Problem Statement

According to testimony on October 22, 2007, from Tony Ramirez, Field Office Director, Reno Field Office, United States Department of Housing and Urban Development (HUD), his office was working with the Nevada Rural Housing Authority (NRHA) on possible refinancing for the secured and unsecured portions of home loans, using proceeds from the sale of taxable bonds. However, there are no buyers for such bonds.

On December 3, 2007, Mendy K. Elliott, Director, DBI, discussed whether Nevada could create a bond fund for financing covering the secured and unsecured debt of borrowers. In her opinion, such a fund would not be prudent, since there would be no recourse for default on the unsecured portion of a loan.

According to testimony from Gail Burks, NFHC, and Michele Johnson, CCCS, on April 22, 2008, the qualifying criteria for a new loan vary. A lender may require a borrower to be at least 60 days delinquent, or to be delinquent only after an interest rate reset and not before. Investment pools that make mortgage loans typically set limits on the number of loans they will modify. In addition, clients with second mortgages have problems refinancing, because lenders will not loan more than the value of the property. Also, since Nevada is now classified a high-risk market, appraisals are automatically reduced by 10 percent.

Conceptual Solutions

- Gail Burks, NFHC, made three recommendations: (1) because qualifying criteria are very specific, agencies should focus their outreach precisely; (2) the FHA should relax the requirement that a borrower must be at least 60 days delinquent to qualify for an FHASecure loan; and (3) lenders should receive incentives to use the FHASecure program.

4. Neighborhood Protection

Problem Statement

On October 22, 2007, Gail Burks, NFHC, said that five or more foreclosures in a neighborhood drag down the home values in the entire neighborhood. At the same meeting, Ken Lobene, Field Office Director, Las Vegas Field Office, HUD, said that if a homeowner cannot stay in a home, it is critical to transfer the home to stable ownership as soon as possible.

On January 28, 2008, Ernie Adler, Counsel, NRHA, testified that Nevada lacks enabling legislation for community land trusts, which would be useful in neighborhood preservation efforts.

On April 22, 2008, Ms. Burks said that NFHC has seen some borrowers who have not sought help lose confidence in their ability to obtain assistance, walk away from property, and damage or destroy property in REO¹ inventory. Property damage makes it more difficult to get an adequate appraisal for refinancing and reduces the value of other property in the neighborhood.

During discussion on April 22, 2008, Senator Michael Schneider mentioned problems of delinquencies and defaults within homeowner associations and common-interest communities

(CICs). Borrowers in default typically do not pay their association dues and other owners must pick up the slack. When lenders take property back, they may turn off the utilities and let the home deteriorate. There are particular problems with landscaping and swimming pools, just as there are outside CICs.

Conceptual Solutions

- Michele Johnson, representing CCCS, recommended the creation of lease-back programs that would allow occupants of foreclosed homes to continue to occupy the homes as tenants.
- Tony Ramirez, representing HUD, recommended the creation of mechanisms to get investor-owned homes in foreclosure into the hands of first-time buyers, with good loans.
- Ernie Adler, representing the NRHA, recommended enactment of enabling legislation for community land trusts. (Subcommittee staff subsequently received a written recommendation from Mr. Adler.)
- Senator Schneider suggested: (1) requiring lenders who have taken property back to maintain the property, including the landscaping and pool; (2) requiring pools to be covered or drained; and (3) addressing the problem of squatters, as necessary.

5. Licensing and Oversight of Agents, Brokers, Escrow Agencies, and Lenders

Problem Statement

On October 22, 2007, Joselyn Cousins, NFPTF, and Tony Ramirez, HUD, both testified about a critical need for information on foreclosures and for a Nevada housing database.

On April 22, 2008, Joseph L. Waltuch, Commissioner, Division of Mortgage Lending, DBI, said there is a lack of regulation of loan servicers in Nevada. The Division regulates only those escrow agents and agencies located in and doing business in Nevada. According to *Nevada Revised Statutes* (NRS) 80.015, collection of mortgage debt does not constitute doing business in Nevada. Also, Mr. Waltuch said the Division can fine an escrow agent or agency up to \$500 per violation, while they can issue fines up to \$10,000 per violation against other licensees for similar actions.

If a mortgage broker is not a natural person, NRS 645B.021 requires the broker to designate a natural person as a qualified employee (QE) to act on behalf of the broker. However, Mr. Waltuch said that the law contains no explicit requirement that a QE obtain a license. If the QE takes part in a violation of NRS, the Division's recourse is against the broker, and there is no record of discipline of the QE.

During discussion with the Subcommittee on April 22, 2008, Mr. Waltuch said that Nevada does not require mortgage brokers to post a bond. Many other states require a bond.

Assembly Bill 329² of the 2007 Session requires the Commissioner of Financial Institutions, in cooperation with the Commissioner of Mortgage Lending, to adopt regulations on nontraditional mortgage loan products and practices. The regulations must be substantially similar to the guidance the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) published in November 2006 and must apply to all persons and institutions making loans secured by real property and holding a license as a bank, other financial institution, or mortgage agent, banker, or broker. However, the CSBS and AARMR later issued an interagency statement on subprime lending, in June 2007. According to the April 22, 2008, testimony of George Burns, Commissioner of Financial Institutions, DBI, the statement does not cover eight privately-insured credit unions and one privately-insured thrift in Nevada at this time.

On April 22, 2008, witnesses and subcommittee members discussed the idea that the interests of lenders and consumers in mortgage transactions are not the same. Mr. Matthews, CSBS, said that no one represents the borrower in a mortgage transaction. Assemblyman Marcus L. Conklin, Subcommittee Chairman, asked how to help consumers make better decisions and, at the same time, preserve competition in the industry. To enhance accountability, other states have imposed a fiduciary duty or similar duty on mortgage brokers.

Conceptual Solutions

- Mr. Waltuch suggested increasing the maximum fine for violations of NRS by escrow agents and agencies to \$10,000, consistent with the maximum fine for other licensees.
- Mr. Waltuch said that the Division will address the licensing of QEs in an amendment to the *Nevada Administrative Code*.
- Regarding the bonding of mortgage brokers, Mr. Waltuch said that conceptual options include requiring brokers to post a bond or carry liability insurance.
- Regarding the accountability of mortgage brokers, Mr. Waltuch said that one option would be to impose a fiduciary duty on a broker performing brokering tasks (as opposed to lending). Mr. Matthews, CSBS, said that the Nationwide Mortgage Licensing System (NMLS) gives each originator and broker a unique identifier, which the industry can use in a performance scoring system to create more accountability.

6. Practices of Agents, Brokers, Escrow Agencies, and Lenders

Problem Statement

Many borrowers took out loans that were not suitable for their situation. In a sample of 400 case files, the NFHC determined that 85 percent of the counseling clients had good credit, could afford the home, but had received a bad loan. Another 7 percent had good credit, but could not afford the home and had received an inappropriate loan.

Some borrowers who were unprepared and had insufficient income to become homeowners were caught in a “buy-now frenzy.” They lacked sophistication to question products suggested by persons who had a vested interest in closing the deal, who bore very little risk (i.e., contingent liability), and who may have received incentives to entice borrowers into less suitable loans. Witnesses testified that underwriting standards were lowered and that loans were made without impound accounts for taxes and insurance, giving the impression of lower monthly payments.

Further, one party to the mortgage transaction often has more information than another (i.e., asymmetry of data). This may occur between borrowers and brokers, or among brokers, lenders, and investors.

When borrowers have trouble making their mortgage payments, some lenders say they are willing to work with clients to modify their loans but, in practice, they are not willing to do so.

Witnesses on October 22 and December 3, 2007, and April 22, 2008: Gail Burks, NFHC; Joselyn Cousins, NFPTF; Douglas Duncan, Ph.D., MBA; Michele Johnson, CCCS; and Tony Ramirez, HUD.

Conceptual Solutions

- Mr. Duncan said that better disclosure to all parties in a mortgage transaction would assist in solving these problems.
- Ms. Burks said that the NFHC reports lenders to the appropriate regulatory entities when they say they will work with borrowers but do not.

7. Fraud and Deceptive Trade Practices

Problem Statement

Douglas Duncan, Ph.D., Chief Economist, Mortgage Bankers Association (MBA), testified on December 3, 2007, about two types of borrower fraud. One type is first-payment default, an

indicator of a fraudulent loan usually resulting in foreclosure. In another type, a borrower simply misrepresents on the loan application his intention to occupy the home.

On April 22, 2008, Gail Burks, NFHC, said that her agency has seen an increase in apparent violations of Assembly Bill 440³, although it is not always clear whether the violation occurred on or after the bill's effective date.

Bill Matthews, representing the Conference of State Bank Supervisors (CSBS), testified that the extent of mortgage fraud is "woefully underestimated," and that Nevada ranks high in a national ranking of mortgage fraud.

Conceptual Solutions

- During discussion on April 22, 2008, Senator Bob Beers suggested that a bill draft request (BDR) could address the problem of intentional misrepresentations on a loan application.
- Mr. Matthews suggested that Nevada's participation in the Nationwide Mortgage Licensing System (NMLS) would help alleviate some problems related to fraud.

8. Policies and Practices Affecting Tenants

Problem Statement

Credit counseling agencies are seeing more renter evictions and consider this the "next wave." The majority of non-owner-occupied homes with problem mortgages have a tenant. Tenants have few rights under existing laws, unless they are part of the federal Section 8 program. Dishonest landlords may take advantage. When tenants are evicted with little or no warning, they may have insufficient time to relocate, may use all their discretionary income to relocate, and may not get a refund of their security deposit and last month's rent. Also, renters who earn more than 80 percent of the area median income (AMI) do not qualify for certain types of assistance.

An out-of-state landlord may allow a house in Nevada to go into foreclosure and file for bankruptcy in his home state. The tenant probably cannot afford to hire an out-of-state attorney to intervene in the bankruptcy proceeding and will lose his security deposit.

In general, renters in rapidly growing areas face problems similar to those that homebuyers face: high housing prices force them to use a higher percentage of their income, or they are forced to commute long distances. There is a long waiting list for Section 8 assistance.

Witnesses on October 22, 2007, January 28, 2008, and April 22, 2008: Ernie Adler, NRHA; Gail Burks, NFHC; Michele Johnson, CCCS; and Jon Sasser, Washoe Legal Services.

Conceptual Solutions

- On April 22, 2008, the Subcommittee received a report on policies and procedures that may alleviate the problems foreclosure creates for tenants. At the request of the Chairman, Senator Warren B. Hardy and Assemblywoman Marilyn Kirkpatrick queried stakeholder groups regarding their current policies and suggestions.
- In a foreclosure action, the stakeholders generally agreed that tenants should receive the notice of sale⁴ at the same time as the borrower. Some stakeholders said this should be a statutory requirement, while others said lenders should be asked to comply voluntarily. Nevada Legal Services recommended making the change in statute; authorizing a tenant to break his lease upon receipt of the notice; and giving a tenant 90 days to move.
- Other stakeholder suggestions included:
 - Encouraging dialog between lenders and property managers (Nevada Legal Services);
 - Encouraging lenders to comply with existing laws on security deposits (Nevada Legal Services);
 - Requiring landlords to disclose if they are renting a property subject to a foreclosure sale (Nevada Legal Services);
 - Through outreach, urging renters of single-family homes to be cautious about defaults and pending foreclosures (Nevada Bankers Association).
 - As a general policy, attempting to establish new rental agreements with tenants when the lender has decided to hold on to the property (Nevada Credit Union League); and
 - Aligning the requirements of NRS with the provisions of federal legislation H.R. 3915⁵, giving tenants a right to remain for 90 to 180 days after a foreclosure sale (Nevada Legal Services).
- In addition, representatives of southern Nevada constables offered the following suggestions:
 - The statutes should be amended to require the constable to post the notice of sale at the physical address of the property;

- A tenant should have the right to contact the lender to receive information and updates concerning the foreclosure; and
- In a subsequent eviction proceeding in District Court, the lender or new owner must produce an affidavit of service proving that the constable posted the notice of sale at the physical address.

9. Mortgage Lending and Housing Issues, Generally

Problem Statement

Mortgage problems impose substantial third-party costs. They impact borrowers, lenders, neighbors, and government. Testimony indicated that:

- Foreclosure losses for lenders in southern Nevada range from 20 to 60 cents on the dollar, an estimated \$58,800 per foreclosure;
- For every 1 percent decline in single-family residential value, the average southern Nevada single-family household loses \$3,225 in household wealth;
- The estimated average municipal cost of a foreclosure in southern Nevada is \$6,937; and
- The Global Insight report prepared for the U.S. Conference of Mayors estimates fiscal impacts on metropolitan areas throughout the country.

In general, Nevada faces a lack of affordable housing relative to the trend of income. Housing prices jumped significantly, becoming more like those in other major western metropolitan areas. About one in three persons in southern Nevada, where weekly wage workers earn less than the national average, faces a housing cost burden over 40 percent. This situation may affect economic growth if new employers and employees decide not to relocate to the area.

In addition, some parts of Nevada experienced speculative over-building related to a rapid run-up in housing prices. The speculative component was not sustainable real demand. Southern Nevada saw very clear speculative behavior and the permitting of too many new units. In recent months, many consumers have lost confidence in the real estate market.

Witnesses on October 22, 2007, and December 3, 2007, included Jeremy Agüero, Applied Analysis; Joselyn Cousins, NFPTF; Douglas Duncan, Ph.D., MBA; Keith Schwer, Ph.D., University of Nevada, Las Vegas; and Dave Ziegler, Principal Committee Policy Analyst, Legislative Counsel Bureau.

Conceptual Solutions

- Regarding a loss of market confidence, Gail Burks, NFHC, recommended working with professionals within the first-time homebuyer program to restore confidence, stressing that there is opportunity even during bad times.
- The witnesses identified no other conceptual solutions to these problems. (The Subcommittee may also wish to refer to the final report of Legislative Commission's Subcommittee to Study the Availability and Inventory of Affordable Housing (A.C.R. 11 [File No. 97, Statutes of Nevada 2005]) to the 2007 Legislative Session.)

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¹ "REO" means "real estate owned," usually by the lender.

² Chapter 91, *Statutes of Nevada*.

³ Chapter 492, *Statutes of Nevada 2007*.

⁴ The majority of residential foreclosures in Nevada are non-judicial proceedings under a deed of trust in accordance with the provisions of NRS 107.080 through 107.100. The notice of default and election to sell, also known as the notice of default, must be recorded at least three months before the power of sale granted in the deed is exercised. The notice of sale must be recorded at least three months after the notice of default and must be provided to the trustor, posted for 20 days, and published once a week for three weeks before the sale may take place. (See NRS 107.080.)

⁵ The House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act of 2007 (Rep. Brad Miller, NC) on November 15, 2007. The bill would amend the federal Truth in Lending Act. Section 206 of the bill addresses the effect of foreclosure on a preexisting lease. In the event of a foreclosure on a mortgage entered into after the bill's date or enactment, the successor in interest must give any bona fide tenant at least 90 days to vacate. A tenant with a lease has a right to occupy the premises until the end of the lease or six months after the notice of foreclosure, whichever occurs first. A tenant without a lease or with a lease terminable at will under state law has a right to the 90-day notice mentioned earlier.