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Background Brief on ...

Mortgage Lending

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Mortgage Lending Market in Oregon

The mortgage lending industry has changed dramatically over the past six months, both in Oregon and throughout the United States. On the national level, problems were triggered by a rise in foreclosures, particularly for subprime loan borrowers, as the real estate market slowed down. The widespread dispersion of credit risk and the unclear impact on financial institutions caused lenders to reduce lending activity or to make loans at higher interest rates. Furthermore, a large number of subprime loans with initial low interest rates, non-traditional negative amortization or “interest-option” features began to re-set to higher interest rates, finding many subprime borrowers unable to refinance due to the unavailability of subprime loans. This has resulted in an increase of lenders taking back properties, which has led to the increase in the number of houses for sale and slowing the real estate market even further.

To date, Oregon and the Northwest have fared better than most regions in the U.S. According to the RealtyTrac *February 2008 U.S. Foreclosure Market Report*, Oregon is ranked 25th in the nation in properties with foreclosure filings and the Mortgage Bankers Association (**MBA**) has reported that Oregon had the third lowest rate of delinquent loans in the country through the third quarter of 2007. However, recent reports have shown that the level of foreclosure filings in Oregon has increased and the housing market is softening. For instance, the inventory of unsold homes in the Portland metropolitan area has increased and the most recent Standard & Poor's Case-Shiller report (January 2008) indicates that home values for the Portland metropolitan area have dropped for the first time since recordkeeping began in 1987.

Licensure

The Department of Consumer and Business Services (**DCBS**) has statutory authority of state-chartered banks and credit unions as well as mortgage bankers, mortgage brokers, and loan originators through the Division of Finance and Corporate Securities. Federally chartered banks, national banks, federally chartered credit unions and their respective operating subsidiaries are regulated or supervised by a federal agency.

The state requires licensing for mortgage bankers and mortgage brokers and for each licensee to maintain a surety bond or irrevocable letter of credit of at least \$25,000 and use an in-state clients' trust

account if the licensee accepts clients' funds prior to the close of escrow. Each licensee is also required to employ an experienced person who has at least three years experience in mortgage lending. The law provides for the licensing of the company, not the individual loan originators.

Since January 2002, licensees have been required to notify DFCS of the names of loan originators working for the licensee that originate Oregon residential mortgage loans. All loan originators also must complete 20 hours continuing education every 2 years. Senate Bill 1064 (2008), authorizes the DCBS to regulate the activities of loan originators (see *Recent Legislation*).

Foreclosures and Subprime Lending

The MBA reported that in the third quarter of 2007, 0.57 percent of Oregon households were in the foreclosure process, representing a 50 percent increase from the third quarter of 2006 (0.38 percent).

The foreclosure rate is significantly higher for homeowners with a subprime loan. For instance, the MBA reported an 83 percent increase in subprime loan foreclosure from third quarter 2006 to the third quarter 2007 and a 127 percent increase in subprime adjustable rate mortgages (ARM) during the same time period.

According to an October 2007 study from the U.S. Government Accountability Office, there are approximately 88,400 outstanding subprime mortgages in Oregon and an estimated 12,000 loans expected to go into foreclosure in the next 2 ½ years. The MBA reports that in the third quarter of 2007, 5.17 percent of borrowers with subprime loans and 7.01 percent of borrowers with subprime ARMs were at least 90 days delinquent on their payments.

Foreclosure Process

Foreclosure is the legal process that the financial institution who has an interest on a mortgage loan can initiate to take away a property in default. Foreclosures can be initiated by anyone who has a lien on the house, including a lender or the county if property taxes aren't paid. Lenders

may foreclose on deeds of trusts or mortgages in default by using either a judicial or non-judicial foreclosure process.

The judicial process of foreclosure, which involves filing a lawsuit to obtain a court order to foreclose, is used when no power of sale is present in the mortgage or deed of trust. In general, the home is auctioned off to the highest bidder after the court declares a foreclosure. The borrower may redeem the property by paying the purchase price with interest, the foreclosure costs, and the purchaser's expenses in operating and maintaining the property within 180 days after the date of sale. The borrower must file a notice no less than 2 days and not more than 30 days with the sheriff to stop the foreclosure process.

The non-judicial process of foreclosure is used when a power of sale clause exists in a mortgage or deed of trust, in which the borrower pre-authorizes the sale of property to pay off the balance on a loan in the event of the default. If a power of sale clause exists, the power given to the lender to sell the property may be executed by the lender or their representative, typically referred to as the trustee.

Required directives for the non-judicial process depend on whether the time, place, and terms of sale are included in the clause. If such information is not included, a notice of default must be recorded in the county where the property is located and the borrower and/or occupant of the property must be served with a copy of the notice at least 120 days before the scheduled foreclosure sale date. A copy of the notice must be published in a local newspaper once a week for 4 successive weeks, with the last notice being published at least 20 days prior to the foreclosure sale, and include specified information. The borrower may stop the foreclosure process by paying all past due amounts, plus costs. If the sale goes forth, the sale must be at auction to the highest bidder for cash. Any person, except the trustee, may bid at the sale that takes place between 9:00 a.m. and 4:00 p.m. at the location stated in the notice of record. The sale may be postponed for up to 180

days from the original sale date if at least 20 days advance notice is given, by mail, to the original recipients of the notice.

Examples of Current State and National Initiatives

Governor's Mortgage Lending Work Group - In September 2007, Governor Kulongoski announced several initiatives to help Oregonians who could be facing a foreclosure. The Governor directed the DCBS to look at ways to immediately help homeowners, such as connecting Oregonians with free pre-foreclosure counseling, working with the lending industry and government agencies to identify refinancing options for those facing foreclosure, and increasing enforcement against misleading advertising that is aimed at enticing borrowers to refinance.

The DCBS also established the Governor's Mortgage Lending Work Group, comprised of legislators, consumer advocates, and mortgage industry representatives, to look at a variety of short-term and long-term issues related to the mortgage lending market. Items to be addressed include mortgage rescue schemes, adequate notification of a foreclosure, how subprime loans are underwritten, and how borrowers are assured that they are offered the best possible loan under the terms for which they qualify.

The work group developed two bills for the February 2008 Special Legislative Session (see *Recent Legislation*) and will continue to look at additional legislation for the 2009 Legislative Session.

Mortgage Forgiveness Debt Relief Act - If a property is sold at auction or is transferred to the lender and the amount for which it was sold or transferred is not enough to cover the balance of the mortgage, the financial institution, with certain exceptions, may have to cancel or forgive the balance between the fair market value of the house and the amount owed (known as "cancellation of debt"). The institution will file the applicable IRS forms with the amount(s) owed and other relevant information and the

homeowner will receive a copy of applicable 1099 form(s) in reference to the amount "forgiven." With certain exceptions, a homeowner may have to include this amount as part of their income when filing income taxes.

The Act amends the Internal Revenue Code and provides additional exclusions for some homeowners who lost their homes to foreclosure (if the home was their primary residence) and the lender canceled or "forgave" a debt secured by the house. It can be applied for residential discharged debts of up to \$2 million (\$1 million if married filing separately) made on or after January 1, 2007 but before January 1, 2010.

Changes to Regulation Z (Truth in Lending) - On December 2007, the Federal Reserve Board started the process for changes to Regulation Z (Truth in Lending) that protect consumers from unfair or deceptive home mortgage lending and advertising practices. The rule that would be adopted under the Home Ownership and Equity Protection Act would restrict certain practices and would also require certain mortgage disclosures to be provided earlier in the transaction.

Highlights of the proposal include key protections for higher-priced mortgage loans secured by a borrower's principal dwelling such as prohibiting creditors from engaging in a pattern or practice of extending credit without considering the borrower's ability to repay the loan; requiring creditors to verify the income and assets they rely upon in making a loan; and limiting prepayment penalties only if certain conditions are met, including the condition that no penalty will apply for at least 60 days before any possible payment increase. Also, creditors would have to provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer's principal dwelling such as a home improvement loan or a loan to refinance an existing loan. Consumers could not be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining their credit history. If adopted, the proposal's effective date is

October 1st that follows by at least six months the date of promulgation.

Project Lifeline - Six of the nation's largest mortgage lenders are participating in Project Lifeline, which postpones foreclosure proceedings for 30 days while lenders and borrowers who have fallen seriously behind in their house payments try to work out payment options. The program is available to borrowers with any type of home mortgage.

HOPE NOW - HOPE NOW is a cooperative effort between counselors, investors, and lenders to maximize outreach efforts to homeowners at risk of foreclosure. The alliance's development was encouraged by both the Department of the Treasury and the Department of Housing and Urban Development (**HUD**) as a way to reach and help as many homeowners as possible. The goal of HOPE NOW is to create a standardized model to use in increasing work flow, productivity, and communications between servicers and counselors; expand the capacity of an existing national network to receive, assess, counsel, refer, and connect borrowers to servicers; develop common communications guidelines to respond to at-risk borrowers in order to offer them the best possible solutions; and work toward cross-industry technology solutions to more effectively connect servicers and counselors together in order to better serve the homeowner.

HOPE NOW members have agreed to use industry-wide standards to provide systematic relief to qualified borrowers either by refinancing an existing loan into a new private mortgage; refinancing through an FHA Secure loan; or freezing their current interest rates for five years.

FHASecure - Administered by the Federal Housing Administration (**FHA**), FHASecure is a temporary program designed to provide refinancing opportunities to qualified homeowners. Conditions to participate in the program include the mortgage being refinanced must be a non-FHA ARM that has reset, and the borrower's payment history on the qualifying mortgage must show that, prior to the reset of the

mortgage, the borrower was current in making the monthly payments, i.e., the homeowner's mortgage payment history during the six months prior to the reset showed no instances of making mortgage payments outside the month due. The loan application must be signed no later than December 31, 2008.

According to HUD, the program should help about 250,000 home owners through 2008.

Recent Legislation

House Bill 3630 (2008) regulates the activities of foreclosure consultants and equity purchasers. It also requires a trustee of a property to send a homeowner facing foreclosure with a clearly written notice at least 120 days before the sale that outlines their rights and options of avoiding foreclosure as well as a list of legal resources and other counseling services.

Senate Bill 1064 (2008) provides the DCBS with the authority to regulate loan originators. The bill allows the department to suspend or bar a loan originator from working for either an Oregon mortgage broker or mortgage banker if the loan originator has violated Oregon mortgage lender law, been dishonest or incompetent while conducting a transaction, or failed to account for all money received in a mortgage loan transaction. The bill also establishes a registry system that will provide consumers with information about loan originators such as enforcement actions, and requires the DCBS to collect data from Oregon mortgage lenders which will help the department determine short- and long-term trends and shifts in patterns.

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