SENATE BILL REPORT
SB 6695

As Reported By Senate Committee On:
Consumer Protection & Housing, January 31, 2008

Title: An act relating to distressed home transactions.

Brief Description: Concerning distressed home transactions.

Sponsors: Senators Weinstein and Kline.

Brief History:
Committee Activity: Consumer Protection & Housing: 1/25/08, 1/31/08 [DPS].

SENATE COMMITTEE ON CONSUMER PROTECTION & HOUSING

Majority Report: That Substitute Senate Bill No. 6695 be substituted therefor, and the substitute bill do pass.
Signed by Senators Weinstein, Chair; Kauffman, Vice Chair; Honeyford, Ranking Minority Member; Delvin, Haugen, Jacobsen and Kilmer.

Staff: Vanessa Firnhaber-Baker (786-7471)

Background: The foreclosure process on residential property occurs when a homeowner defaults on his or her mortgage payments. The foreclosure process is determined by the type of financing the owner received, such as through a mortgage, deed of trust, or real estate contract. In Washington, deeds of trust are the most common and they are generally foreclosed by a non-judicial sale (a sale outside the court).

If a lender forecloses on a home through a non-judicial proceeding, the lender must provide the homeowner with a notice of default, and then, at least 30 days later, provide the borrower with a Notice of Trustee's Sale and Notice of Foreclosure. Under a non-judicial foreclosure, a homeowner can avoid foreclosure by making the delinquent payments up to 11 days before the sale. The property can not be sold until at least 190 days have passed since the homeowner fell behind in payments; and once the property is sold, the homeowner must move out within 20 days or the purchaser may file an eviction (unlawful detainer) without providing the original homeowner any additional notice.

<u>Credit Services Organization Act.</u> Washington has some laws governing certain practices involving foreclosure of real property. The Credit Services Organization Act (CSOA) applies to any company that performs or claims it can perform certain services for a person, such as stopping, preventing, or delaying a foreclosure, in return for a fee or some other consideration. CSOA requires licensing and bonding of certain credit service organizations,

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requires a written contract with a right of cancellation, and makes a violation of the CSOA a Consumer Protection Act (CPA) violation.

Equity Skimming. "Equity skimming" practices are used to obtain title to properties for the purpose of either taking the equity out of the property or obtaining rents or payments on the property without satisfying any of the underlying obligations that may exist on the property. For example, a person induces a homeowner who is in financial distress to deed the property to the person with the assurance that the person will assume the underlying debt on the property. The person never assumes the debt, but instead rents or sells the property and diverts value from the property to his or her own personal use. The property is eventually foreclosed. In Washington, equity skimming is a class B felony and a violation of the CPA.

Consumer Protection Act. Under the CPA, the Attorney General may bring an action in the name of the state against any person to restrain and prevent an unlawful action. The court may order to restore to any person of interest, any personal or real property acquired by means of any act violating the CPA. The CPA also allows any person who is injured in his or her business or property by a CPA violation to bring a civil action to stop further violations and to recover actual damages, plus reasonable attorney's fees. In addition, the court may award the plaintiff treble damages (three times the actual damages sustained) not to exceed 10 thousand dollars.

Foreclosure Rescue Transactions. Homeowners who are late, or at risk of being late in their mortgage payments or have defaulted on their mortgage, may be approached with offers to assist them with their mortgage problems. Several types of assistance may be offered.

First, a person may offer to buy the homeowner's house and allow the homeowner to continue to live there as a tenant. The buyer may make representations before the sale that after a certain period of time, the homeowner will have paid enough rent to get his or her home back. This is commonly referred to as a sale-leaseback transaction.

Second, a homeowner may be approached with an offer of a "foreclosure surplus sale." When a foreclosed house is auctioned off, the sale may bring more money than is due on the mortgage. That additional money is called "surplus equity." In a foreclosure surplus sale, the homeowner assigns his or her right to the surplus equity to the buyer for a lump sum.

Third, other types of services may be offered to the homeowner. For instance, a person may offer to negotiate with the lender on the homeowner's behalf or offer to arrange a sale of the home that includes an option for the homeowner to repurchase it in the future.

In some circumstances, these transactions may result in the homeowner being misled or defrauded.

Summary of Bill: The bill as referred to committee was not heard.

SUMMARY OF BILL (Recommended Substitute): Regulations are imposed to govern distressed home transactions and distressed home conveyances.

Distressed Home Transactions. A distressed home consultant (consultant) is a person who offers to provide mortgage, credit, or other debt assistance to an owner of a home that is in danger of foreclosure or is in the process of being foreclosed.

In addition to any applicable disclosure or related requirements in the CSOA and the mortgage brokers practices act, a transaction between a consultant and homeowner is voidable by the homeowner at any time unless the following requirements are met.

First, distressed home consulting transactions must: (1) be in writing and in the language that the consultant used to describe his or her services; (2) fully disclose the exact nature of the services to be provided; (3) be dated and signed by the homeowner; and (4) contain the consultant's full contact information.

Second, the transaction contract required must also include a conspicuous notice warning the homeowner that the transaction could result in the loss of his or her home and advising the homeowner to consult with an attorney before entering into the contract.

Third, the consultant must provide the homeowner with a copy of the contract and must also keep a copy of the contract on file for at least five years.

Consultants owe fiduciary duties to homeowner. These duties specifically include: acting in good faith and in the best interests of the homeowner, disclosure of all material facts to the homeowner, using reasonable care, and providing an accounting to the homeowner for all money received from the homeowner.

Licensed attorneys, financial institutions that a homeowner is a customer of, and nonprofit licensed credit counseling organizations are not distressed home consultants and are not subject to the above restrictions.

The provisions of the act may not be waived by the homeowner.

Distressed Home Conveyances. A distressed home conveyance is a transaction in which: (1) a foreclosed homeowner transfers an interest in the distressed home to a distressed home purchaser (DHP); (2) the DHP allows the foreclosed homeowner to occupy the home; and (3) the DHP or a person acting in participation with the DHP conveys or promises to convey the home to the foreclosed homeowner, or provides the foreclosed homeowner with an option to purchase the home at a later date, or promises the foreclosed homeowner an interest in, or portion of, the proceeds of any resale of the home. Terms of a distressed home conveyance include:

- A written contract is required with clearly disclosed terms completed that is signed and dated by the homeowner and purchaser prior to the home's transfer;
- The foreclosed homeowner has a right to cancel the terms of the contract within five business days;
- The purchaser must demonstrate that the foreclosed homeowner is able to meet the terms of the contract including making interest and lease payments and is capable of purchasing the home within the allowable period; and
- The homeowner must receive at least 82 percent of the difference between the home's fair market value and the underlying mortgage in the event of a sale to a third party.

A violation of the distressed home consulting and distressed home conveyance provisions are a per se violation of the Consumer Protection Act (CPA). In a private right of action under the CPA, the court may double or triple the damages award, subject to the statutory limit. However, if the court determines that the defendant acted in bad faith, the limit for doubling or tripling the damages award may be increased up to $100,000. A claim for damages must be filed within four years of the date of the alleged violation. The act neither limits nor supersedes any other remedy or legal theory otherwise available to a homeowner.

Unlawful Detainer Actions Involving Distressed Homes. In an unlawful detainer action involving distressed home, the plaintiff (purchaser) must disclose to the court whether the defendant previously held title to the distressed home and explain how the purchaser came to acquire title.

A defendant who previously held title to the distressed home may not be required to escrow any money pending trial when a material question of fact exists as to whether the plaintiff (purchaser) acquired title from the defendant though a distressed home conveyance.

All other related actions are stayed pending the outcome of the unlawful detainer action.

EFFECT OF CHANGES MADE BY CONSUMER PROTECTION & HOUSING COMMITTEE (Recommended Substitute): Incorporates distressed home conveyance requirements contained in SB 6431, including contract disclosure requirements, a five day right to cancel the contract, and the verification of the ability to pay requirement.

The unlawful detainer provisions of SB 6383 are incorporated, which require a plaintiff in an unlawful detainer action involving a distressed home to disclose to the court that the defendant previously held title to the home.

The $100,000 CPA damages limit is extended to claims involving distressed home consulting contracts.

Fiduciary duties are imposed on distressed home consultants.

There are technical changes to the definitions and terms used for consistency.

Appropriation: None.

Fiscal Note: Not requested.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Recommended Substitute: PRO: In general, the foreclosure process works well; the bidding on homes at auction is competitive. It is only when third parties make dishonest representations that the previous owners of foreclosed homes lose all their equity. When the notices of foreclosures are published, scam artists use these lists to contact homeowners. Homeowners facing foreclosure don't understand the process and are especially vulnerable because they are desperate to stay in their home. Often times, foreclosure is not the worst case scenario, many people get money back after the auction occurs, but homeowners facing foreclosure may not know this. The common element in all foreclosure rescue scams is misplaced trust. This bill will save the state money and will not cost it anything. The people regulated under this bill are similar to financial advisors, so they should be held to a high standard in their dealings with homeowners. This bill is very comprehensive and could stand by itself. Foreclosure rescue scams are becoming increasingly common; we need to nip this problem in the bud. The normal rules of the marketplace don't apply in these transactions, so regulations are needed.

OTHER: This bill would be even better if the distressed home consultant's specific duties to the homeowner were enumerated. The bill may not be a complete solution because a contract containing unconscionable content could still occur.

Persons Testifying: PRO: Jim Sugarman, Attorney General's Office; Fred Corbit, Northwest Justice Project; Kim Justice, Statewide Poverty Action Network.

OTHER: Jim Sugarman, Attorney General's Office; Fred Corbit, Northwest Justice Project.