How Will the California Homeowner Bill of Rights

Impact Our Struggling Economy?

In responding to the foreclosure crisis, the California legislature recently passed a series of bills known as the California Homeowner Bill of Rights ("CHBR"). The CHBR, which goes into effect on January 1, 2013, is focused on mortgage and foreclosure reform. Although well intentioned, the CHBR may have a negative impact on California's struggling economy.

The CHBR is consumer based legislation, which applies to owner-occupied residential properties with 1-4 units. At its core, the CHBR is based on an assumption that by making the foreclosure process more difficult for lenders, homeowners will be protected from predatory lending and will receive increased foreclosure prevention options. The CHBR stalls foreclosure by prohibiting "dual tracking," whereby a lender reviews a homeowner for a loan modification while advancing a foreclosure. If a loan modification is denied, a lender will be required to provide a homeowner with written notice of the denial and 30 days to appeal the decision before proceeding to foreclosure. A lender will also be required to assign a homeowner with a single point of contact to explore foreclosure prevention alternatives. In addition, a lender may be subject to civil penalties of up to $7,500 per loan for recording unverified documents. The CHBR grants homeowners with a right of action to sue for damages and enjoin a foreclosure sale for procedural violations. As well, it allows a homeowner to recover attorney's fees. Overall, the CHBR creates a number of procedural hurdles and exposes lenders to substantial new liability.

The CHBR is based a notion that homeowners will be able to catch up on their loan payments or seek foreclosure prevention alternatives if the process is slowed down. A 2012 study by Beacon Economics, however, found no empirical evidence to suggest that states with a longer foreclosure process have greater rates of loan modifications or a lower share of delinquent borrowers moving into foreclosure.[1] Like a broken crutch, the CHBR may instead aggravate injuries. By lengthening the foreclosure timeline, the CHBR removes the immediate threat of home loss which pushes homeowners to explore options to avoid foreclosure. By increasing the length of non-payment, the CHBR creates an incentive for strategic defaults and increases foreclosure rates. Moreover, by removing the threat of foreclosure, the CHBR erodes incentives to explore short-sales and other options which are favorable to economic recovery.

The CHBR does not focus on the real problems at hand – the inability of certain homeowners to meet their debt obligations and eliminate negative home equity. The CHBR artificially slows down foreclosures, keeping properties off the market that are legitimately in foreclosure. In California, many homeowners are locked into homes with no equity, have already lost their down payments, and are occupying properties that will lack equity for years to come. For many who purchased properties at the peak of the housing market, an option is to simply walk away from a property with negative equity and re-enter the housing market at a later point. A homeowner's damaged credit may recover quicker than the value of his/her home. Legislation, such as the CHBR, which increases costs and creates liabilities, does nothing when homeowners are unable to cure deficiencies and homes lack equity.

[1] Beacon Economics, LLC (2012). Foreclosure Reform in California: An Economic Analysis.
http://www.cmba.com/new/docs/BeaconStudy.pdf

In effect, the CHBR may actually take away the best long term economic solution – allowing properties to go to non-judicial foreclosure so that homeowners can start anew. The CHBR may also cause lenders to pursue judicial foreclosure, instead of non-juridical foreclosure. In the context of a judicial foreclosure a lender may be able to seek a judgment against a residential homeowner's other assets. A switch to a judicial foreclosure system could chill the economy by discouraging individuals from using their home equity to start or expand a business out of fear of a personal judgment for the unpaid dept.

The CHBR leaves lenders vulnerable to those whose only goal is delaying foreclosure. Under the CHBR, any small violation of due process, no matter how minor, may warrant litigation and hefty penalties. The CHBR also contains a one-sided attorney's fees provision favoring borrowers based on an overly broad definition of prevailing party. The CHBR creates an incentive for plaintiff attorneys to advance lawsuits, even if the homeowner has suffered no harm. Such provisions are an open invitation to pursue litigation as a strategy to forestall a lawful foreclosure or extract a settlement. Frivolous lawsuits waste everyone's time and resources, resulting in heightened costs, which will likely have to be passed on to consumers doing business with lenders and taxpayers.

Lenders need to be treated fairly because housing recovery is contingent upon the availability of credit at low rates. The CHBR prolongs the amount of time it will take for a lender to recover its loss and adds additional costs for lender to complete foreclosures, which overall increases the cost of servicing home loans. Lenders will be forced to raise interest rates and tighten lending standards in California, to cover the additional risks, delays, and regulatory compliance requirements. Moreover, some lenders may not transact business California because the foreclosure costs and risks will be too high. This will make it difficult for even well qualified borrowers to obtain affordable credit and may affect any economic recovery.