

LOS ANGELES
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Loan Stars

FOCUS COLUMN
By Mark S. Blackman

In July 2008, the California Legislature attempted to stem the rising tide of foreclosures by enacting Senate Bill 1137, which amended California's foreclosure statutes and required that loan servicers and lenders contact their borrowers to discuss their financial condition and the alternatives to foreclosure before they could commence a foreclosure. Since Senate Bill 1137 contained no actual requirement that a loan modification be offered to borrowers, the previous legislation prolonged the foreclosure process without achieving its desired effect. As a result, on Feb. 20, 2009, a second set of amendments to the foreclosure statutes were enacted by the state Senate and Assembly, SB 7.

The California Legislature, finding that the state is facing an unprecedented threat to state and local economies due to skyrocketing foreclosure rates that have adversely affected California residential property values, the foreclosure rate will have greater adverse consequences as foreclosure rates rise and it is essential to avoid such harmful effects on the residential housing market, determined that the foreclosure process must be modified to ensure the current crisis does not become exacerbated by adding more foreclosures to the glut of foreclosed properties already on the market.

Beginning May 20, 2009, SB 7 extends the time a lender must wait to record a notice of sale - from three months to three months plus 90 days - unless the lender or loan servicer obtains an exemption order from the commissioner of one of the three California governmental entities regulating that particular lender or loan servicer.

Industrial banks, savings associations and credit unions that make mortgage loans will be governed by the Department of Financial Institutions; licensed real estate brokers servicing mortgage loans will be governed by the Department of Real Estate; and residential mortgage lenders and servicers and finance lenders and brokers servicing mortgage loans and all other loans not serviced by the identified departments will be governed by the Department of Corporations.

Exemption orders will certify that the lender or loan servicer has implemented a loan modification program that meets specified standards set forth in SB 7 and will be implemented by regulations issued by the state.

Loans Affected by SB 7

As with Senate Bill 1137, the Legislature designated only certain types of loans and exempted others. Specifically, SB 7 applies only to loans as set forth in California Civil Code Section 2923.52(a) and applies only where all four of the

following conditions are met: loans where the deeds of trust were recorded between Jan. 1, 2003, and Jan. 1, 2008; first mortgages or deeds of trust; loans where the borrower occupied the property as the borrower's principal residence at the time the loan became delinquent; and loans where the notice of default has been recorded on the property (covered loans).

Even if a loan is a covered loan, it may be exempted if: the borrower has surrendered the property (evidenced by a letter from the borrower or delivery of the keys to the lender or its agent); the borrower has contracted with an entity whose primary business is to advise debtors how to extend the foreclosure process and avoid their contractual obligations to their lenders; or a bankruptcy case has been filed and no dismissal, order of closure or relief from stay has been obtained.

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New Requirements

If a loan is a covered loan, the new law modifies existing California foreclosure law in order to allow the parties to pursue a loan modification to prevent foreclosure.

Existing California foreclosure law requires that a borrower be given only three months to cure a default before a notice of sale may be recorded. California Civil Code Section 2923.52(a) enacted under SB 7 requires that at the end of the three months set forth in Civil Code Section 2924, a notice of sale may not be recorded for an additional 90 days.

For first trust deed lenders, in addition to the requirements imposed in July 2008 (under SB 1137) to contact the borrower to discuss the borrower's financial status and the alternatives to foreclosure (followed by a 30-day waiting period), the lender must now wait an additional 90 days before it may record a notice of sale. The foreclosure process, which prior to July 2008 took approximately four months, will now take eight to nine months.

To encourage implementation of loan modification programs, SB 7 includes an exemption from this new 90-day waiting period if a lender or loan servicer applies for and obtains a valid order of exemption from its regulating entity at the time the notice of sale is given to the borrower on or after the date of the notice of default expires (three months after recordation). Specifically, Section 2923.53 requires a lender to implement a comprehensive loan modification program, which includes all of the following features: the program must be intended to keep borrowers whose principal residences are California homes in those homes when the anticipated recovery or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis; The loan modification program must also target a borrower's housing-related debt - (principal, interest, property taxes, hazard insurance, flood insurance, mortgage insurance and homeowner association fees) to-gross income of 38 percent or less

on an aggregate basis.

The program may also include a combination of the following features: An interest rate reduction, as needed, of at least five years; an extension of the loan amortization period to no more than 40 years from the original loan date; a deferral of some portion of the unpaid principal balance until maturity of the loan; a principal reduction; compliance with a federally mandated loan modification program; or other factors determined by the regulatory agency commissioner. The commissioner may consider efforts in other jurisdictions that have resulted in foreclosure reductions. When determining a loan modification solution under the program, the servicer must seek to achieve long-term sustainability for the borrower.

Implementation

SB 7 should be implemented in early June 2009. While the new laws become effective on May 20, Civil Code Section 2923.53(d) requires state regulators to promulgate regulations related to the loan modification program exemption provisions within 10 days after the law becomes effective. Civil Code Section 2923.52(d) provides that the extended foreclosure period does not become effective until 14 days after the regulations are issued.

Any person or entity that violates the new foreclosure law will be deemed to have violated the obligations under his, her, or its license to lend or service loans. Nothing in the new law requires a servicer to violate contractual agreements for investor-owned loans or to provide a modification to a borrower who is not willing or able to pay under the modification.

Notices of sale recorded for covered loans must state whether the loan servicer obtained an exemption that is valid on the date the notice is recorded or whether the timeframe for giving notice does not apply because the loans are either exempt or are

otherwise not covered loans.

Loan Servicing Exemption Orders

To implement a loan modification program, the commissioners of the California governmental department that govern lenders and loan servicers will create a form application that must be completed and returned by the loan servicer or lender to the appropriate department. Upon receipt and review of the exemption application by the commissioner, the commissioner will notify the applicant of the date of receipt of the application and issue a temporary order effective from the date of receipt exempting the mortgage loan servicer from the new 90-day stay of foreclosure.

The temporary order will remain in effect until a final order is issued (which must occur within 30 days of receipt of the application). If the initial exemption application is denied, the temporary order will remain in effect for an additional 30 days in order to permit the lender or loan servicer to submit a revised application. After review of the application, the commissioner will issue a final order exempting the loan servicer from Civil Code Section 2923.52, if the program meets the requirements.

If the commissioner determines the program does not meet the requirements, the application will be denied, however, a loan servicer may submit a revised application. The commissioner may later revoke a final order following reasonable notice and opportunity to be heard if the loan servicer submitted a materially false or misleading applicant; or if the approved program has been materially altered.

A revocation will not be retroactive. Whether the latest efforts of the California Legislature results in more loan modifications and less foreclosures remains to be seen, but the goal is in line with recent federal efforts to slow and ultimately reverse the mortgage meltdown that has plagued the state for the better part of the last two years.

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