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TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION & COMMERCE

TWENTY-FOURTH STATE LEGISLATURE
REGULAR SESSION, 2008

Thursday, January 24, 2008
2:00 p.m.

TESTIMONY ON HOUSE BILL NO. 2251 – RELATING TO REAL PROPERTY.

TO THE HONORABLE ROBERT N. HERKES, CHAIR, AND MEMBERS OF THE COMMITTEE:

The Department of Commerce and Consumer Affairs ("Department") appreciates the opportunity to testify regarding House Bill No. 2251, Relating to Real Property. While the Department is in strong support of initiatives designed to protect our citizens from the ravages of equity stripping and real estate fraud, it has concerns that the current version of this bill will not effectuate its desired goal. In this regard, we would respectfully request that the Committee give favorable consideration to another bill which seeks to achieve the same laudatory protections as House Bill No. 2251. The bill

is House Bill No. 3104 Relating to the Prevention of Mortgage Rescue Fraud. My name is Stephen Levins, and I am the Executive Director of the Department's Office of Consumer Protection.

House Bill No. 2251 proposes to add a new chapter to the Hawaii Revised Statutes, designed to protect Hawaii consumers from persons who prey on homeowners facing property foreclosures, liens, or encumbrances. These so-called mortgage rescuers offer phantom help to homeowners, taking a fee of a few thousand dollars for supposedly negotiating with the homeowners' secured creditors. After collecting the money, many do little or no work and essentially abandon the homeowners. In the most insidious cases, the consultant will persuade families to deed their house to investors for a year. The homeowners supposedly can use that time to clear up their credit and refinance the property, then take back title free and clear. In many cases the homeowners wind up becoming tenants and then being evicted. The purpose of House Bill No. 2251 is to protect these vulnerable homeowners by requiring that they be provided with adequate disclosures prior to signing a contract with an equity purchaser, require fair dealing, and impose a cooling off period of five days during which the homeowner may be able to get out of their obligations under the contract. While the Department appreciates the intent of House Bill No. 2251 it has several concerns about its provisions. The following list is indicative of difficulties associated with this measure:

1. Section 1, Definition of "covered contract", page 3, lines 19 and 20: The protection provided by H.B. 2251 is limited to "covered contracts" that include a "reconveyance arrangement". A "reconveyance arrangement" is defined starting on page 5, line 8 through page 6, line 3, as transfer of title by the consumer or "equity seller" to the buyer or "equity purchaser" that includes a subsequent conveyance or promise of a subsequent conveyance back to the consumer. This ignores the fact that buyers or "equity purchasers" who are taking advantage of distressed consumers facing foreclosure will structure or disguise the transfer of title in many different ways which may not always include a provision or promise that the consumer will be allowed to regain possession of the property. In other words, to get around H.B. 2251, a buyer could promise many things and simply not promise the consumer any right to repossess the property.

The biggest consumer protection concern is the initial transfer of interest in the residential property to a buyer whether or not there is any promise of a consumer regaining possession his or her property. Once the initial transfer occurs, consumers lose the ability to sell the property and extract the equity for themselves, lose the opportunity to work out a repayment plan with the foreclosing lender, and/or are subject to eviction by the buyer who can assert ownership rights.

2. Section 1, Definition of "covered contract", starting on page 3, lines 21 through page 4, line 5: It is unclear what the relevance and/or legal implication is of any

"reference" to a sale. If the intention of this provision is to define "sale of a residence" then a separate definition would appear to be provide a clearer legal standard.

3. Section 1, Definition of "default", page 4, lines 6 and 7: To be more consistent with a consumer's actual experience, "default" should be defined as the equity seller having received a notice of default. It is at that point that a consumer may become vulnerable and seek out the assistance of a buyer or "equity purchaser".

4. Section 1, Definition of "equity purchaser", page 4, lines 12 and 13: Excluding or excepting a buyer who uses the property as a primary residence from the definition of an "equity purchaser" allows buyers to avoid the protections of H.B. 2251 by simply using the subject property as a primary residence. Again, buyers who are specifically targeting distressed consumers facing foreclosure will structure the transfer of title in any way to get the property to escape statutory restrictions and prohibitions.

5. Section 1, Definition of "equity purchaser", page 4, lines 18 through 20: The exception for any "spouse", "parent, grandparent, child, grandchild or sibling" ignores the possibility that a buyer who victimizes a distressed consumer facing foreclosure might be a family member, such as an adult child taking advantage of an elderly and/or incompetent parent or grandparent.

6. Section 1, Definition of "equity purchaser", page 4, lines 21 and 22: It is unclear what a "not-for-profit housing organization" or a "public housing agency" is.

7. Section 1, Definition of "equity purchaser", page 5, line 1: Excepting a "bona fide purchaser or encumbrancer for value" from the definition of an "equity purchaser" and, as a result, excluding said persons from coverage imposed by H.B. 2251, would allow a buyer and a subsequent buyer or "bona fide purchaser or encumbrancer for value" to work together (a "bona fide purchaser or encumbrancer for value" is defined starting on page 2, line 20 through page 3, line 7). An initial buyer or "equity purchaser" who did not have the financial ability to pay off or refinance the existing foreclosing mortgage loan might routinely and regularly partner with a subsequent buyer who could pay off or refinance the existing foreclosing mortgage. If the initial buyer recorded a deed obtained from the consumer, the subsequent buyer could argue that the deed was positive notice that the "equity seller" had no "continuing right to, or equity in" the subject property. The filing of a deed obtained by the initial buyer from the consumer would provide the subsequent buyer grounds to argue that he acted in good faith and, as a result, is not subject to the provisions of H.B. 2251.

8. Section 2, Document format, starting on page 6, line 21 through page 7, line 2: The provision allowing "any instrument of conveyance" to become effective after the fifth business day after the "covered contract" is executed contradicts or defeats the protection provided by Section 6(a)(1), Cancellation period, page 12, lines 12 through 19. Section 6(a)(1) prohibits an equity purchaser from accepting any "instrument of conveyance". Section 2 makes "<u>any</u> instrument of conveyance" obtained by an equity

purchaser within the five-day cancellation period effective once the cancellation period expires whether the "covered contract" itself is cancelled or not.

In addition, Section 2, page 7 lines 1 and 2; Section 3, page 8, lines 12 through 15; Section 4, page 9, lines 15 through 19; Section 5, page 11, lines 9 through 15 do not clearly specify when a "covered contract" is considered to be executed. A buyer or "equity purchaser" seeking to take advantage of a distressed consumer facing foreclosure may not sign the agreement when the sellers sign and date the "covered contract" and tell them that the agreement is not yet executed, only to later fill in all the dates and claim that the five-day cancellation period has expired.

9. Section 3, Contract contents, page 9, lines 9 through 13: This provision also contradicts or defeats the protection provided by Section 6(a)(1). Section 3 will allow any "covered contract", even one under which an "equity purchaser" improperly accepts an "instrument of conveyance" within the prohibited five-day cancellation period (Section 6(a0(1)) to remain enforceable.

10. Section 7, Transaction voidable, page 15, lines 3 through 9: This provision is more limiting than the statutory period allowed by Haw. Rev. Stat. § 480-24 which allows an action to be brought under Haw. Rev. Stat. § 480-2 within four years after the action accrues.

11. Section 9, Criminal violation, starting on page 17, line 15 through page 18, line 22: H.B. 2251 does not provide for any civil penalties to be imposed nor does it

specifically provide that a violation of H.B. 2251 constitutes a violation of Haw. Rev. Stat. § 480-2.

The time appears to be ripe for the legislature to do something about the problems associated with mortgage fraud. During the past year, numerous complaints have been filed with the Office of Consumer Protection from people who sought help from equity purchasers. Instead of receiving help, several found that they were being forced out of their home. Although many of the provisions of House Bill No. 2251 appear to be meritorious, the above enumerated problems indicate that House Bill No. 3104 (which is modeled after laws in Minnesota and Illinois), is a better vehicle to help homeowners in distress.

Thank you for this opportunity to testify on House Bill No. 2251. I will be happy to answer any questions that the members of the Committee may have.

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January 23, 2008

The Honorable Robert Herkes, Chair
House Committee on Consumer Protection & Commerce
State Capitol, Room 320
Honolulu, Hawaii 96813

RE: H.B. 2251 Relating to Real Property
Hearing Date: January 24, 2008 @ 2:00 p.m., Room 325

Dear Chair Herkes and members of the House Committee on Consumer Protection & Commerce,

On behalf of our 10,000 members in Hawaii, the Hawaii Association of REALTORS® (HAR) opposes H.B. 2251.

The intent of the measure is admirable as it seeks to protect homeowners from unscrupulous equity purchasers; however, the legislation goes too far in allowing the rescission of a transaction by the equity seller within two years of the date of the recording of the conveyance of the residential real property in foreclosure or default. We are concerned that this provision may have a chilling effect on the housing market, as it serves as a disincentive for a potential buyer to purchase a foreclosed property. The potential risk of a new owner losing his or her property due to an equity purchaser violating the law is a risk that many will not be willing to take.

Mahalo for the opportunity to testify.