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TO THE
HOUSE COMMITTEE ON

FINANCE

THE TWENTY-SIXTH STATE LEGISLATURE
REGULAR SESSION OF 2012

Wednesday, February 29, 2012
10:00 a.m.

TESTIMONY ON H.B. 2019
RELATING TO MORTGAGES

TO THE HONORABLE MARCUS OSHIRO, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Iris Ikeda Catalani, Commissioner of Financial Institutions ("Commissioner"). I would like to provide comments on H.B. 2019 relating to mortgages.

The Bill prohibits requesting and rendering deficiency judgments for short sales when mortgagors have been in continuous occupancy of properties used as their principal residence; when mortgagors used proceeds secured by the real property to

purchase the real property; and when mortgagors have not refinanced the mortgage after origination. DFI believes that when financial institutions agree to sell property at a price which is less than the mortgaged amount, the decision is based on a thorough and sophisticated evaluation of the factors relating to the property's value, the economy, and the financial interests of the financial institution. DFI notes that there are situations where the borrower is not delinquent with the mortgage payments, but would like to get out of the loan because the valuation of the property dropped below the amount of the mortgage.

DFI sympathizes with homeowners who entered into mortgage transactions with terms they might not have fully understood or for homeowners who thought they would be able to refinance their loans or resell their homes at a profit during the housing boom. As we saw, the housing bubble burst leaving many homeowners carrying a mortgage that they could not afford. Financial institutions also are enforcing the terms of the mortgage on homeowners.

DFI provides comments to the bill as we believe there are unintended consequences with eliminating deficiency judgments on short sales. A short sale is a tool used by financial institutions as an alternative to foreclosure. A short sale must be agreed to by the parties, and the financial institution must agree to a sale for less than the balance of the mortgage. In addition, a financial institution may collect the unpaid

balance as a deficiency judgment as part of the mortgage terms as the short sale does not release the borrower from their obligations under the mortgage.

1. When working with borrowers, financial institutions consider a number of options when the borrower experiences a financial hardship, one of which allows the borrower to request that the bank accept a discounted payoff (or short sale) in order to release the mortgage lien and allow a borrower to sell their home. Short sale agreements do not necessarily release borrowers from their obligations to repay any deficiencies of the loans, unless specifically agreed to between the parties.

Some borrowers have other properties or assets in which to use to pay the deficiency judgment. DFI sees many cases where borrowers have five or six mortgages and have defaulted on all of them. DFI provides assistance to borrowers in working with financial institutions for their own homes, not for any of the investment properties. DFI explains that any investment property in which the financial institution agrees to a short sale may be subject to a deficiency judgment.

2. Financial institutions may not use short sales as an option in working on a solution with the borrower if they are not allowed to seek deficiency judgments. Since the financial institution must agree to the short sale, if the

sale is significantly below the mortgaged amount, the financial institution may not agree to the sale price even if the seller agrees. The loss to the financial institution may cause the financial institution to be in a situation where it becomes unsafe in the eyes of the federal and state regulators. DFI reviews the short sales, along with all other credit risks when it examines and reviews the financial institution during its safety and soundness examination. DFI cautions the legislature, if there are too many of these loans on the financial institution books, the financial institution may be subject to enforcement orders.

3. Even if the first position lien holder agrees to the short sale, the junior lien holder may not agree to forgive the debt entirely and may require the borrower to pay the difference as a personal obligation which could result in a subsequent collection action against the borrower. Many times, the junior lien holder will not agree to forgive the second mortgage debt since the short sale will only likely satisfy the first lien holder.
4. Although a short sale is used as an alternative to foreclosure, because it may mitigate additional fees and costs to both the financial institution and the borrower, there may be a negative report filed against the property owner (borrower). As required by law, a financial institution must report the negative trade line to the credit reporting agencies. After a short sale, borrowers may

continue to find it difficult to obtain a new mortgage as a financial institution's underwriting guidelines might look unfavorably on a potential borrower who obtained a short sale in the past.

5. When a borrower suggests a short sale as an alternative to foreclosure, the borrower should realize that the financial institution does not have to agree to the short sale. The financial institution does its own analysis on whether the short sale is the best option for the financial institution and for the borrower.

Although DFI understands that allowing financial institutions to obtain deficiency judgments after agreeing to short sales may dissuade borrowers from participating in short sales to fulfill their financial obligations, the potential losses faced by financial institutions may create situations where financial institutions may not be considered safe and sound. Keeping our financial institutions safe and sound is the mission of DFI.

Thank you for the opportunity to provide testimony on this measure and I am available to answer any questions the committee might have.