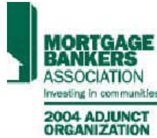

Mortgage Bankers Association of Hawaii
P.O. Box 4129, Honolulu, Hawaii 96812

LATE

February 5, 2013

The Honorable Angus L.K. McKelvey, Chair,
The Honorable Derek S.K. Kawakami, Vice Chair, and
Members of the House Committee on Consumer Protection and Commerce
State Capitol, Room 325
Honolulu, Hawaii 96813

Re: House Bill 21 Relating to Condominiums

Chair McKelvey, Vice Chair Kawakami, and Members of the House Committee on Consumer Protection and Commerce:

I am Linda Nakamura, representing the Mortgage Bankers Association of Hawaii ("MBAH"). The MBAH is a voluntary organization of real estate lenders in Hawaii. Our membership consists of employees of banks, savings institutions, mortgage bankers, mortgage brokers, and other financial institutions. The members of the MBAH originate the vast majority of residential and commercial real estate mortgage loans in Hawaii. When, and if, the MBAH testifies on legislation, it is related only to mortgage lending.

MBAH opposes House Bill 21 Relating to Condominiums.

MBAH opposes House Bill 21 because it will provide condominium associations with a “super lien” over a mortgage lien with an uncapped dollar amount.

With the proposed bill, lenders will need to review their underwriting criteria for condominiums and change the underwriting criteria which may make it more difficult for condominium buyers to qualify for a condominium loan. With an unlimited “super lien”, a buyer of a condominium may need to put a larger down payment. This will impact first time homebuyers who are more likely to purchase a condominium as a first home.

Many lenders sell their loans to the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. Fannie Mae guidelines state that Fannie Mae will not purchase a loan if the collateral is a condominium with a “super lien” of more than six months. Lenders will not be able to sell their condominium loans on the secondary market to Fannie Mae who is one of the largest buyers of mortgage loans in Hawaii.

In the end, consumers as well as the condominium associations will be hurt by this bill with less condominium sales due to tighter underwriting criteria for condominium loans and the inability of lenders to sell condominium loans on the secondary market.

Thank you for the opportunity to present this testimony.

LINDA NAKAMURA
President, Mortgage Bankers Association of Hawaii

LATE

Dante K. Carpenter
3054 Ala Poha Place, #401
Honolulu, HI 96818

HAWAI'I STATE HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Wed. February 6, 2013; 2:30 PM Conf. Rm. 325

HB 21 RELATING TO CONDOMINIUMS

Chair Rep. Angus McKelvey, V. C. Rep. Derek Kawakami and Committee Members:

Aloha kakou. My name is Dante Keala Carpenter, President of Country Club Village, Phase 2 Association of Apartment Owners (CCV-AOAO). This condo consists of two 21-story apartment buildings with 469 units. This Association is in support of HB 21, Relating to Condominiums.

The intent of HB 21, which relates to assessments and liens, repeals the prioritization of liens for unpaid mortgages over subsequently recorded liens for unpaid condominium association fees. Further, its intent is to clarify the obligations of the purchaser of a foreclosed unit under the lien for unpaid association fees.

Recent legislative changes to statutes regarding mortgage handling penalizes those AOAO's who diligently pursue its unit owners to comport to and pay on a timely basis fair assessments established by their respective independent Boards of Directors in accordance with HRS Chapter 514B.

Present mortgage payment obligations are to a large degree "controlled by loan institutions" who may foreclose or unnecessarily delay foreclosure processes to suit their whim or "market conditions" for months or even years! The independent AOAO organization, whose sole purpose is to assure equal participation by all unit owners to live up to their obligations are left to "pick up the tab" for those individual apartment owners who renege on their obligations to pay their fair share of fees on a timely basis. Additionally, this continually forces the AOAO's to increase assessments to other owners to pay all current bills to keep good credit standings.

While there may be other aspects of this bill which need to be addressed, there is a miscarriage of justice in this situation in which numerous Condo Associations are and will continue to be in serious financial trouble due to the above inequities.

We strongly recommend passage of HB 21.

Mahalo a nui loa.

LATE

NEIL ABERCROMBIE
GOVERNOR

SHAN S. TSUTSUI
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

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KEALI`I S. LOPEZ
DIRECTOR

JO ANN M. UCHIDA TAKEUCHI
DEPUTY DIRECTOR

PRESENTATION OF THE
OFFICE OF CONSUMER PROTECTION

TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION AND COMMERCE

THE TWENTY-SEVENTH LEGISLATURE
REGULAR SESSION OF 2013

WEDNESDAY, FEBRUARY 6, 2013
2:30 P.M.

TESTIMONY ON HOUSE BILL NO. 21, RELATING TO CONDOMINIUMS.

TO THE HONORABLE ANGUS L.K. MCKELVEY, CHAIR,
AND TO THE HONORABLE DEREK S.K. KAWAKAMI, VICE CHAIR,
AND MEMBERS OF THE COMMITTEE:

The Department of Commerce and Consumer Affairs ("DCCA"), Office of Consumer Protection ("OCP") appreciates the opportunity to appear today and testify on House Bill No. 21, Relating to Condominiums. My name is Bruce B. Kim and I am the Executive Director of OCP. OCP would like to offer comments regarding H.B. 21.

This legislation would effectively give associations a super lien, allowing them to foreclose regardless of any other liens on the property, or any foreclosure proceedings already in process. Given the difficulties and obstacles that associations have encountered when trying to foreclose, this bill seeks to mitigate the damage and

neglect, as well as the loss of revenue, resulting from the long period of time currently required for a mortgagee to foreclose, judicially. However, it may also have the unintended consequence of accelerating foreclosures by mortgagees, as the removal of an owner-occupant may make the nonjudicial foreclosure process under Part II of HRS Chapter 667 more attractive to mortgagees who are currently foreclosing by action via Part IA of HRS Chapter 667, exclusively, at this time. Because there would be no owner-occupant resident at the time the foreclosing mortgagee initiated a foreclosure pursuant to HRS § 667-22, the foreclosure would not be subject to the dispute resolution provisions contained in Part V of HRS Chapter 667.

OCP takes no position on the policy merits of this legislation, and is cognizant of the detrimental impact that unoccupied and/or delinquent units have on other members of the association and the association as a whole. However, H.B. 21 should not inadvertently be a vehicle to circumvent the mortgagor's right to opt in to the MFDR program under Part V.

Thank you for the opportunity to submit testimony on H.B. 21. I would be happy to answer any questions members of the committee may have.

February 7, 2013

Consumer Protection & Commerce Committee
Chair Rep. Angus McKelvey
Vice-Chair Derek Kawakami
415 S. Beretania Street, Room 325
Honolulu, Hawaii
[via email]

Re: House Bill 21 (Relating to Condominiums)
Hearing Date: February 11, 2013, 2:00 p.m.

Dear Chair McKelvey, Vice-Chair Kawakami
and Committee Members:

I am on the board of the Kaha Lani AOAO, in Lihue, Kauai. I testified at last Wednesday's CPC Committee hearing in support of the bill. During the hearing, Chair McKelvey and Vice-Chair Kawakami granted me the opportunity to respond in writing to Mr. Okabayashi's testimony. Chair McKelvey also asked Mr. Dante Carpenter and me to review pending HB 25 and invited us to submit comments regarding its relationship to HB 21.

FHA GUIDELINES ARE NOT NECESSARILY
A MATERIAL OBSTACLE TO HB 21

The core of Mr. Okabayashi's testimony was his statement that, if HB 21 were to become law, it would harm the local market for condominium loans. He asserted that the rules of institutions such as FHA, FNMA and FHLMC would likely restrict the ability of originating lenders to sell their new loans to the secondary market. There are serious problems with this argument.

The institutions' documentation does refer to a six-month limit on liens. However, these limits are merely contained within a diverse, extensive list of quantitative metrics which lenders are

instructed to use when evaluating the suitability of a condominium as security for a mortgage. The six-month limit is just one of dozens of factors which lenders are advised to consider.

Moreover, these are only guidelines. They appear to be no more than a list of specifications assembled by institutional staff as standard recommendations for determining loan suitability.

Please note that the six-month standard originated in 2000, long *before* the Great Recession and the ongoing foreclosure crisis. When this guideline was adopted, the time necessary to complete a foreclosure was measured in *months*, not *years*. In that context, it made sense for the "super lien" to be limited to six months. But the circumstances of the real estate marketplace have changed radically since 2000. But the original durational limit for the lien has never been adjusted to be reasonably consistent with the amount of time normally required to complete a contemporary foreclosure. As I testified Wednesday (Feb. 6th), bank foreclosures at Kaha Lani have averaged *more than three years* from start to finish. Moreover, Kaha Lani has two units which have been, and remain, in foreclosure since February, 2009. In other words, no maintenance fees have been paid on either of these units for 48 months.

From discussions with our corporate property manager, which handles several condominium properties, Kaha Lani's experience is representative of conditions found in their other managed properties. The "special assessment" lien in 514B-146(h) offsets only an extremely small fraction of the actual loss suffered by the AOAO due to nonpayment of maintenance fees. At Kaha

Lani, the recovery rate for the closed foreclosures *is less than 12%.* In our case, the super lien delivers too little, too late.

The out-of-date six-month limit has become fully separated from the marketplace reality. In order to be reasonably fair and effective, the duration of the super lien should be regularly adjusted to remain reasonably consistent with the realistic foreclosure timeline in each jurisdiction. In Hawaii, the foreclosure process is exceedingly slow. The Hawaii super lien, with its six-month limit does not come close to offsetting the losses being suffered by associations in the contemporary economic environment.

In 2010, Florida broke ranks and increased the duration of the super lien from six to 12 months (Florida Statutes, §718.116(b) 1 a). This unilateral increase of the super lien limit apparently has had no material adverse effect on the closing of new Florida condominium loans or their transfer into the secondary mortgage market. Anecdotal sources indicate that on average, it can take as little as nine months for a servicer to complete a condominium mortgage foreclosure. So there is some rational matching of the duration of the foreclosure process and the Florida super lien.

Hawaii provides a sharp contrast: the duration of the special assessment lien has been frozen at six months since its inception, but the fee delinquencies are lasting three-plus years.

The banking industry is using the same scare tactics it used to defeat a similar bill, HB 2196, in 2010. I submit that the HBA's assertions are largely speculative fear-mongering. The FHA and related institutions (e.g., Fannie Mae, Freddie Mac, VA) likely are

aware of the extreme delays which have become epidemic in Hawaii's foreclosure process and would be reluctant to punish state consumers for the state's efforts to improve the associations' solvency. It seems reasonably more likely these institutions would relax their lien guidelines to accommodate much-needed relief for Hawaii associations. After all, financially secure associations are vital to the health of the local condominium market.

The Hawaii condominium market is a lucrative source of business for the mortgage industry. The Committee should be skeptical of the industry's grim predictions. The foreclosure crisis and the LIBOR interest rate scandal have materially damaged the industry's reputation. The banking community's credibility is at an all time low. I would urge the Committee not to reflexively defer to the mortgage industry's speculative, self-serving claims.

The foregoing discussion has focused on the duration of the so called super lien advocated by Mr. Okabayashi. HB 21, on the other hand, does not provide for a specific durational limitation on the association's basic lien for unpaid assessments because none is necessary. Please bear in mind that HB 21 would do no more than restore to the associations the funds they have expended in good faith to *maintain the bank's security*. If HB 21 is killed, it means that the non-defaulting owners will have to continue subsidizing losses caused by bad mortgages to which they are not a party. They are innocent third parties.

FORECLOSE-AND-RENT IS A HIGH-RISK INVESTMENT STRATEGY

The HBA recommends that associations can achieve relief by foreclosing their liens on underwater units (which are already subject to a pending mortgage foreclosure) and rent them out to earn revenue to offset the uncollected maintenance fees. Mr. Okabayashi offers the following analysis: "[I]f this bill [HB 21] were to become law, there is little incentive for an association to *act prudently* knowing that eventually the entirety of the delinquent assessments will be paid." (Emphasis added.) Mr. Okabayashi seems to be saying that the prudent course for the associations is to ignore the most obvious benefit of HB 21 (i.e., full payment of delinquencies) and, instead, begin investing in underwater units.

There are many reasons why this course of action could have adverse consequences. Some of them are:

1. <u>Acquisition Cost</u>. As noted in John Morris' testimony re HB 25, it would cost an association a *minimum* of $5,000 in legal fees to process a foreclosure.
2. <u>Additional delay</u>. Mr. Okabayashi states that the association's foreclosure could be completed "possibly within six months."
3. <u>Repair Costs</u>, Many of the underwater units have been abandoned by their owners. The interiors of some of these units have not been maintained for months, possibly for years. Many will require thousands of dollars to refurbish them to a point where they would be competitive in the rental market.

4. Liabilities. Given Hawaii's humid climate, some of neglected units may have developed mold conditions which could expose an association to renters' tort claims.

5. Rental Income Speculative. Assuming the unit is rehabilitated to a rentable state, there is no assurance it will generate enough revenue to cover the monthly maintenance fee, let alone recover what may have been a substantial initial investment.

6. Subject to Bank Mortgage. Perhaps the greatest flaw is that a completed foreclosure would do no more than place the association *in the shoes of the underwater unit owner*. The association's ownership would still be behind a mortgage with a balance higher than the unit's fair market value. Is there any assurance that the association will recoup its investment in the unit before the servicer completes its foreclosure, thereby divesting the association's interest?

7. Management Challenges. Most association boards are volunteers, many of whom have limited business experience. Assuming responsibility for one or more rental properties could place substantial and inappropriate administrative burdens on the board. Most associations probably should not be in the real estate business.

Please consider the irony of this situation. In addition to accruing thousands of dollars in unpaid maintenance fees for common elements, how is it wise—or prudent—for the association to also take on the responsibility and expense of refurbishing the interior of a unit, which may soon be taken away by the bank through its pending foreclosure.?

There may have been some isolated situations where the foreclose-and-rent approach has worked. But for virtually all associations the substantial risks inherent in the strategy would far outweigh any possible benefit that might be derived. In my view, the "prudent" course for an association is to avoid this scheme and, instead, support the implementation of HB 21.

THE PRINCIPAL PURPOSE OF HB 25 IS TO FACILITATE THE FORECLOSE-AND-RENT STRATEGY

I do not question the motivations of HB 25's sponsors and supporters. However, as discussed above, I have concerns about the investment strategy it is intended to facilitate. If the intent behind HB 25 is for it to be mutually exclusive with HB 21, I would oppose HB 25. However, it is possible for both bills to be enacte and not conflict with each other. If that were the case, I would not want to limit the choices available to an association, and therfore would neither support or oppose HB 25.

CONCLUSION

The mortgage industry is using speculative scare tactics to discourage support for HB 21. Contrary to the industry's prediction of dire consequences to local mortgage market, HB 21 has much to offer:

1. It would comprehensively remedy the associations' long-standing problem with unpaid maintenance fees from foreclosed underwater units.

2. It would fairly compensate the associations for maintaining the defaulting units' shares the properties' common elements.

3. It likely would cause the banks to become significantly more forthcoming and cooperative in agreeing to and performing on short sales. This would add much-needed inventory to the real estate market.

4. The servicers might stop slow-walking their foreclosures while waiting for the market to improve because the units would become security for payment of the unpaid maintenance assessments.

5. It would address the banks' moral hazard problem because it would relieve the innocent unit owners from the burden of partially bailing out of the banks' losses from bad loans.

Nothing contained in the mortgage companies' submissions eclipses the fair, equitable and contemporary result which would be implemented by passage of HB 21.

Respectfully submitted,

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LATE

HAWAI'I STATE HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Friday, February 8, 2013

HB 25-RELATING TO SUSPENSION OF FORECLOSURE ACTIONS BY JUNIOR LIENHOLDERS

Chair Rep. Angus McKelvey, V. C. Rep. Derek Kawakami and Committee Members:

My name is Dante K. Carpenter, President of Country Club Village, Phase 2 Association of Apartment Owners (CCV-AOAO). This condo consists of two 21-story apartment buildings with 469 units. CCV is in support of HB 21, Relating to Condominiums, however, at the invitation of Chair McKelvey & V. C. Kawakami to comment on the above HB 25 (after Testimony on HB 21 on Wed. Feb. 6th), offer the following comments along with those of Mr. Nicholas Blonder of Kauai, previously submitted to you.

In my comments related to support of HB 21, I stated that CCV (and AOAO's) ***are not in the "foreclosure business."*** Further, notwithstanding legal definition(s), apartment owners generally and the AOAO specifically should not be referred to as the "Junior Lienholders." ***This is because owners of condominius have previously agreed to the conditions imposed by the CC & R's, including AOAO assessments and fees prior to taking out a mortgage loan! This would appear on its face and in real time to make the AOAO the Primary versus Junior Lienholder.*** Further, the many "unknowns" associated with the process of foreclosure such as a $5K attorney representative filing fee, and subsequent repair of a unit which may have many inherent unsuitable and virtually uninhabitable conditions could make this option "problematic" at best. Couple this with the unknown factor(s) related to "repossession" by the mortgage lender at some totally unknown future date?! ***Then too, the absence of a method of recoupment of invested costs by the AOAO in the above process, not to mention the already sustained loss of fee income previously due and owing, makes this alternative speculative at best and a non-solution to a real problem. Encouraging an AOAO Board of Directors to gamble may not be in the best interests of the AOAO financially, and contrary to its fiduciary responsibility!***

I agree with many of the comments attested to by Mr. Nicholas Blonder of Kauai, and concur that each bill, i. e, HB 25 or HB 21 can stand on its merit(s). They are indeed separate measures and not interdependent.

As previously stated regarding HB 21, recent legislative changes to statutes regarding mortgage handling penalizes those AOAO's who diligently pursue its unit owners to comport to and pay on a timely basis fair assessments established by their respective independent Boards of Directors in accordance with HRS Chapter 514B. While there may be other aspects of this bill which need to be addressed, there is a miscarriage of justice in this situation in which numerous Condo Associations are and will continue to be in serious financial trouble due to the above inequities.

We strongly recommend passage of HB 21 and take no position on HB 25.

Mahalo a nui loa. DKC