



Testimony of Lance E. Olsen regarding the anticipated impact of House Bill 1942 and H-1757 on the enforcement of obligations secured by real property in the State of Washington.

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Opening Statement

Good morning. My name is Lance Olsen and I am a member of the Washington State Bar Association and an attorney in good standing since 1995. I have asked to be heard today on the likely and potential impact of the proposed House Bill 1942 as possibly substituted by H-1757. The comments submitted focus primarily on two portions of the bill. First, sections 1, 2 and 3, that I will call the required foreclosure avoidance sections. Second, sections 8 and 9, that I will call the Trustee Duty sections. When discussing the impact of required foreclosure avoidance, I am relying on my experience as an attorney for secured lenders in Washington who has drafted loan modification agreements, forbearance agreements and property sale agreements that benefit both the lender and the borrower. When discussing the impact of the Trustee Duty sections, I am relying on my experience as an attorney representing trustees charged with following the Deed of Trust Act in Washington.

In recent months, the rise in foreclosure rates has had an impact on many people and businesses in the state of Washington. The causes are many and include a loss of jobs, reduction of income, the cooling of the housing market, and the restricted availability of credit. When a lender forecloses its interest in a Deed of Trust, all sides lose. The borrower loses the home or property and the lender loses money. By recent estimates, the average loss to lenders is \$45,000.00 per foreclosure. Finally, the community can lose as more properties sit vacant and neighborhoods suffer the increased risk of blight.

Recognizing these issues, lenders and investors have taken unprecedented steps to reach out to borrowers and do everything possible to avoid foreclosure. Those steps include:

1. Loan programs that give borrowers interest free unsecured loans;
2. Working with borrowers on the sale of real property the borrower no longer wants to keep;
3. Generous repayment plans or forbearance agreements;
4. Mandating the delivery of letters and the establishment of call centers to assist defaulting borrowers.

Lenders and investors are pushing for new and better ways to participate in long term solutions all across the country.

The proposed legislation threatens to undermine these programs and initiatives and actually make it more difficult for borrowers to secure loan modifications. Further, the proposed legislation will make it much more difficult for a borrower to emerge from a started foreclosure action by dramatically increasing the costs of foreclosure.

Sections 1 through 3 of the proposed legislation impose requirements on lenders that have thus far not been demonstrated as effective in other jurisdictions. Further, the provisions of these sections are not consistent with other sections of Washington law and are quite possibly not

constitutional. For example, how can a state legislature *require* that a mortgagee offer a modification to a deed of trust executed for the benefit of a federally chartered bank? The proposed legislation is an invitation for years of costly litigation over issues such as when a borrower contracts, when modification must be offered, and anticipated recovery versus net present values.

Sections 8 and 9 of the proposed legislation impose standards on a trustee that cannot be met. The burdens placed on the trustee are impossible to understand in some cases and in others, inherently in conflict with provisions of existing law. For example, how can a trustee act impartially as between a borrower and lender while also following all instructions of a borrower?

The traditional role of the foreclosure trustee is to act as an impartial participant to enforcement of the security instrument with a duty to the statute. The trustee is required to strictly follow the statute and prefer no party's interest. Whatever process is imposed by the statute must be followed by the trustee. However, the trustee cannot follow a process that cannot be understood or a process that is internally inconsistent.

The examples above are but two of many difficulties presented in the proposed legislation. As drafted, the legislation will lead to more homes lost, fewer loans modified, a greatly increased cost of foreclosure for all parties -- including borrowers, a reduction in the stability of land title, and likely a reduction in the availability of home loans, or at least an increase in the cost of home loans for Washington residents.

It is my hope that more work can be done by all parties to the process to help develop laws that will offer meaningful assistance to all impacted by the increases in the rate of foreclosure.

The Washington Deed of Trust Act (RCW 61.24), substantially enacted in 1975, was the product of compromise between consumer/debtor advocates and the mortgage banking industry. As recognized by the Supreme Court, the three stated policy goals behind the Act were as follows:

1. That the nonjudicial foreclosure process should be efficient and inexpensive;
2. That the process should result in interested parties having an adequate opportunity to prevent wrongful foreclosure; and
3. That the process should promote the stability of land titles.

Cox v. Helenius, 103 Wn.2d 383, 387, 693 P.2d 683 (1985).

Lenders sought the Act to render enforcement of their security interests less time consuming and, ultimately, less costly. Mortgage investors urged passage of the Act, in part, to make mortgage lending less costly to lenders and more affordable to borrowers in Washington. Consumer groups were interested in the Act because they saw an opportunity to abolish a particularly distasteful byproduct of foreclosure, the deficiency judgment (a judgment against borrowers for the amounts owed to the lender over and above the amount obtained through foreclosure and sale of the property). As a result of the compromise, lenders got a shorter, less expensive foreclosure process with no redemption period. Borrowers/consumers got (a) freedom from deficiency judgments; (b) a less costly process that helps facilitate cure of the default; and (c) an expedited procedure for petitioning the courts to restrain a foreclosure on proper grounds.

Since its enactment, the Act has not been the object of frequent or serious overhauls. When it has been amended, it has been at the recommendation of the Washington State Bar Association after substantial discussion and, most often, compromise between members of the bar who represent consumer/debtor interests and members of

the bar who represent mortgage banking interests. Two more substantial changes to the Act occurred ten years apart, in 1998 and 2008, respectively.

In addition to occasional statutory modifications, the courts have contributed clarity, or in some cases confusion, to the interpretation of the Act. In *Cox v. Helenius*, cited above, the Washington Supreme Court imputed to foreclosure trustees a fiduciary duty owed to borrowers that was not stated in the statute. Subsequent decisions over the ensuing years defined and limited those fiduciary duties. The limitations imposed recognize that applying a strict fiduciary status to a foreclosure trustee (who is appointed by the foreclosing lender, acts at the lender's direction, and often is the attorney for the lender) would have posed too many potential conflicts of interest to allow trustees to continue foreclosing nonjudicially in Washington.

In 2008, recognizing that the fiduciary duty imposed by the *Cox* case often led to unnecessary litigation, increased costs of the nonjudicial foreclosure process, and possible uncertainty into what was intended to be a certain process, the legislature clearly and unequivocally abolished the judicial imputation of fiduciary duties owed to borrowers in foreclosure. Instead, the legislature, at the prompting of the Washington State Bar Association, imposed a "duty of impartiality" to the borrower and the lender and made more simple the process to restrain a foreclosure sale. Trustees and their attorneys believe that this duty should be construed primarily to require foreclosure trustees to follow the statutory procedure for conducting a foreclosure to ensure that the three stated goals of the Act are fulfilled.

Washington, by imposing a "duty of impartiality", already imposes more duties on foreclosure trustees than any other state with which we are familiar, including Oregon (fiduciary duties to borrower explicitly abolished by statute and silent as to any other duties other than to follow the statutory procedure) and California and Idaho (statute completely silent as to any duties owed to anyone other than to follow the statutory foreclosure procedure).

In all, for more that three decades the Act has furthered all of the goals of the legislature, borrowers and mortgage lenders. HB 1942 threatens to upset that delicate balance of interests.

HB 1942

Sections 1 through 3.

Sections 1 through 3 of HB 1942 and 1757 appear to be taken verbatim from legislation passed in California in 2008 by California, Senate Bill 1137. The purported purpose of that law, which became effective last summer, was to compel mortgage loan servicers and investors to provide borrowers more notice of opportunities to discuss loan workout arrangements. Although statistics indicate that SB 1137 had virtually no impact on the rate of foreclosure or the percentage of loans modified, our concerns about Sections 1-6 of HB are more related to the following:

1. A review of the pending legislation suggests that the proposed language was not adjusted to reflect Washington foreclosure procedures or nomenclature. An early example is found in Section 1(1)(a) providing that a "mortgagee, beneficiary, trustee or authorized agent may not file a notice of default under RCW 61.24.030(7) until thirty days after contact is made as required" In Washington, the notice of default is not recorded or filed (there is nothing contemplating filing or recording the notice of default in RCW 61.24.030(7)). Moreover, only the trustee, beneficiary's duly authorized agent or the beneficiary, but never a "mortgagee", issues a notice of default pursuant to RCW 61.24.030(7). On the basis of incompatibility with Washington's statutory framework and statutory terms alone, this bill would result in necessary litigation and challenge.

2. We are informed that, due to vagueness, constitutionality concerns and drafting problems that have resulted in several unanswered questions, California's own

legislature is working on a substantial clean-up bill to address numerous concerns with the bill on which Sections 1 through 3 of this bill is modeled.

3. Substantial question exists as to whether a State Legislature has the authority to mandate that a federally chartered financial institution must offer to impair a contract with a borrower. At a minimum the legislature would have to anticipate challenges to the enactment on constitutional grounds the provisions of Section 2 that provide that a mortgage *shall* offer the borrower a deed of trust modification or workout plan...”.

4. Section 1(6)(b) provides an exception to subsections (1) through (5) if the borrower has contracted with an organization, person or entity whose primary business is advising people who have decided to leave their homes on how to extend the foreclosure process and avoid their contractual obligations. Many borrowers who use this strategy are not necessarily entering into formal “contracts” with these organizations. Many of them simply obtain forms and procedures from websites that are freely available. Are the provisions of 1(6)(b) not applicable to these “non-contracting” but abusive borrowers? This exception needs to be broadened to avoid substantial abuse and unjustified delay of the foreclosure process.

5. Section 2(1) requires servicers to maximize net present value under the pooling and servicing agreement and requires servicers to offer a modification or workout plan if a payment default has occurred (or is reasonably foreseeable) and recovery under the modification or workout would exceed the anticipated recovery through foreclosure on a net present value basis. This section provides a new cause of action for homeowners against servicers who do not discount principal balance when a homeowner later learns that the bank netted less on a resold foreclosure property than they would have if they substantially discounted the principal balance. This litigation would further lead to instability in land titles, assuming the borrower seeks specific performance or attempts to cloud title to the property pending the outcome of the litigation. This could also cause a serious reduction in mortgage lending in the state of Washington at a time when it is needed most.

Ambiguities and language challenges aside, the difficulty with sections 1 through 3 resides with the likely impact that the bill will have on those borrowers seeking loan modifications, forbearance agreements, or even reinstatement of defaulted obligations. Lenders have incentives to mitigate losses by entering into repayment plans, offering forbearance agreements and accepting short payoffs of liens. Recent studies indicate the average loss to a lender on foreclosed property is \$45,000.00 per foreclosure. Recognizing this fact, many lenders and investors now mandate that loan servicers and trustees include with any communication sent to the borrower information on loss mitigation alternatives and information regarding who to contact for further information.

Mandating the form, substance, method and timing of loan modification communications will not result in greater borrower awareness or increased willingness on the part of the lender to discuss options. Rather, such mandates will overstress an already taxed system and divert resources away from efforts at meaningful discussions with borrowers and toward strict compliance with competing state and federal legislation that change by the jurisdiction. In sum, lenders and loan servicers will be forced to concentrate more on simply learning how to comply with the particular idiosyncratic requirements of each jurisdiction, and less on effective solutions to a problem they already have every incentive to address.

Sections 3 and 4

Sections 2 and 4 of this bill provide extended occupancy rights to tenants (as opposed to owner occupants) post-foreclosure. The bill would give tenants occupying after a foreclosure sale 60 days to quit the premises. The current 20 day period to quit the premises would be retained as to owner occupants. As the trustee's involvement concludes at sale, we take no position and have no comment concerning these sections, except to observe that compelling foreclosure sale purchasers to wait longer to take occupancy may chill foreclosure sale bidding, resulting in a less than optimum price for the property -- to the detriment of junior lienholders and, ultimately, borrowers.

Section 7 of 1942 / Omitted from H-1757

Trustees, having a statutory duty of impartiality, do not defend motions to restrain trustee's sales. Therefore, we take no position concerning the proposed amendment to RCW 61.24.130 in Section 7 of this bill. As a practical matter, we can represent that the courts have traditionally been very ready, willing, and able to restrain sales on the request of a borrower or interested party. It is not uncommon for a trustee to be served with an Order Restraining Sale for which no notice has been provided or bond posted. It is also rare to see lenders take aggressive approaches to dissolving restraining orders on purely procedural, as opposed to substantive, grounds.

Section 8 of 1942 / Section 7 of H-1757

The new, unprecedented duties that would be imposed upon a trustee by the proposed amendment to RCW 61.24.010 as embodied in Section 8 of the bill would quite possibly end non-judicial foreclosures in Washington and make irrelevant the remainder of the amendments to RCW 61.24. The proposed changes are so open-ended, potentially vexing, and fraught with ambiguity that it is difficult to believe any credible trustee would consider conducting a nonjudicial foreclosure in Washington. At a minimum, many lenders would choose to pursue judicial foreclosure, thus operating outside of the scope of RCW 61.24. Some of the most troublesome language includes the following:

The trustee must “act in the borrower's best interests.”

This is vague and completely inconsistent with a foreclosure trustee's traditional role. A trustee, as defined in RCW 61.24, has no information as to what might be in the best interests of the borrower and thus no direction on how to act. In some cases, a quick foreclosure might be in the best interests of the borrower as the foreclosure will extinguish the liability of the borrower and forgive the outstanding debt. In other cases,

the filing of a chapter 13 petition in bankruptcy might be in the best interest of the borrower. I think that all can agree that a trustee should not be advising a borrower on the merits of bankruptcy but what if that is arguably in the borrower's best interests? Must the trustee act to recommend this course? The borrower must determine what is in his or her best interests and must work with his or her own advisors, including legal counsel, to facilitate that action.

The trustee must "disclose any and all interests to the borrower including, but not limited to, interests that may lie with the lender that are used to facilitate a borrower's request."

A brief survey of presently qualified trustees confirms that there is no general understanding or agreement as to what any part of this provision means.

The trustee "must carry out all lawful instructions provided by the borrower".

What is a lawful instruction? Is an instruction to cease foreclosure, accept partial payments, reduce the interest rate due on a loan or take a compromised payoff a lawful instruction? If so, how can the trustee satisfy the duty of impartiality owed to the lender as imposed by RCW 61.24.010(4)? If the trustee must follow all lawful instructions without regard to the interests of the beneficiary, then the trustee is no longer an independent party to the process and no beneficiary would subject itself to the nonjudicial foreclosure process.

The trustee "must disclose all material facts of which the trustee has knowledge that might reasonably affect the borrower's rights, interests, or ability to receive the borrower's intended benefit from the residential mortgage loan".

What is a material fact that might reasonably affect the borrower's rights or interests? As drafted, it would appear that the trustee has a duty to audit the loan from origination forward and provide the results of that audit to the borrower at the initiation of the

foreclosure. The ambiguities of this provision will likely lead to many trustees simply refusing appointment and many lenders choosing to instead pursue judicial foreclosure.

Presently, the standard fees for a nonjudicial foreclosure are between \$500.00 and \$700.00 through completion of the process. If this bill were to become law, a trustee's fees would necessarily include fees of legal counsel to review the enforceability of the loan documents and accountants to review the loan transaction history. Further, it is likely that far fewer trustees will be available to complete nonjudicial foreclosures. It is not unreasonable to expect that the fees for this process will be at least \$3,000.00 to \$5,000.00. Assuming the loan documents are in order and the accounting accurate, the borrower will be responsible for payment of these fees as well as any associated costs. Therefore, to reinstate a loan by curing all defaults, the borrower will be forced to pay as much as ten times more in foreclosure fees and costs than he or she presently would be required to pay. This provision alone could quite possibly lead to more foreclosures and more borrowers losing their home than any other provision of the bill.

The trustee must "provide to the borrower an accounting for all money and property received from the borrower".

This provision fails for ambiguity. Must the trustee provide an accounting only for money and property received by the trustee, or the lender as well? What is the form of the accounting? Is the accounting filed with the court as part of a judicial action or simply sent in a statement? If the foreclosure is completed and the real property reverts to the lender, is that property received from the borrower and how is that accounting provided? To the extent a court action is required, the cost of the foreclosure will increase relative to the cost of that action.

In sum, as drafted, the proposed changes to RCW 61.24.010 will lead to the following immediate results:

1. *The increased use of the relatively safe harbor remedy of judicial foreclosure*

Judicial foreclosures cost far more for the borrowers and lenders, clog an already overwhelmed judicial system, and result in neighborhood blight as homes foreclosed judicially can remain unoccupied but unable to be sold for up to 12 months during the prescribed redemption period. This bill will thus undo most all of what the legislature intended to accomplish with the original passage of the Deed of Trust Act that has served the residents of Washington relatively well for more than thirty years. Movement from nonjudicial foreclosure to judicial foreclosure will also be costly for the State of Washington as additional Judges, Clerks and courthouses will be required to process an additional 20,000 to 30,000 new filed lawsuits each year.

2. *Increases in the fees charged by any trustee willing to still conduct nonjudicial foreclosure cases in Washington.*

The risks and duties imposed on any remaining trustee, along with the increased business insurance premiums, will necessitate fees far, far in excess of the present average of \$500.00 to \$700.00 per action.

3. *Fewer reinstatements by borrowers and fewer workout agreements between borrowers and lenders.*

As the costs of foreclosure increase, fewer borrowers will be able to afford cure and lenders will be unwilling to risk having to start over on the new promise of a borrower to resume payments. The net result will be a dramatic increase in the number of completed foreclosures (by either judicial or nonjudicial means) and thus a significant downward pressure on housing prices in Washington as available property supply increases from the swell of foreclosures.

4. Increased litigation as each provision must be interpreted by a court to arrive at definitions of the many, many ambiguous terms and phrases used within the proposed bill.

Litigation will necessarily continue until such time as the Appellate or Supreme Court can publish opinions, further clogging the court system, costing borrowers and lenders hundreds of thousands of dollars in the process.

5. Fewer lenders willing to provide home financing in Washington as the cost of enforcement of the promises within notes and deeds will be simply too high to justify the continued business.

Those lenders that do continue to lend will undoubtedly charge higher fees to offset the increased costs experienced in enforcement. Under every scenario, the costs of lending will increase for Washington borrowers.

Section 9 of 1942 / Section 8 of H-1757

Under section 9, certain challenges that must now be raised prior to completion of a foreclosure sale, of which the borrower is given notice at least five times over a six month period, will survive the final foreclosure sale. Under this provision, title to real property sold at foreclosure sale will be clouded for one year after each sale. The resulting cloud on title will reduce certainty in the transfer of real property, reduce stability of land titles, and necessarily drive down the price of real property and drive up the cost of title insurance. If no party can be certain of clean title to foreclosed property, fewer parties will be willing to purchase properties at foreclosure sale, thus leading to more properties reverting to the lenders and becoming vacant pending re-sale.

The survival of remedies against the foreclosure trustee and the invitation to include the trustee as a party to litigation between the lender and borrower will chill a trustee's

willingness to be involved in the nonjudicial foreclosure process. Those that remain will most certainly raise their fees.

Sections 10, 11, 12 and 13

Sections 10 through 13 of this bill are ministerial or administrative in nature and intended to amend the statute only to recognize the changes made to the body of the Act by Sections 1 through 9. As such, we take no position and have no comment other than to reiterate the comments listed for Sections 1 through 9..