

DETAILS REGARDING
USE OF MORTGAGE FUNDS

Attorney General Tom Horne has announced a comprehensive multi-year program for the allocation of the \$57 million in mortgage settlement funds aimed at keeping people in their homes and easing the foreclosure crisis for Arizona families and communities.

This \$57 million is comprised of funds awarded to Arizona as part of the national mortgage settlement with the five largest banks plus \$10 million obtained by the Attorney General to settle a separate lawsuit against Bank of America.

I. Meetings to Obtain Input From Stakeholders

In order to determine how to allocate the mortgage settlement funds, the Attorney General's Office sought advice and input from a wide range of stakeholders representing more than thirty-five statewide organizations and agencies including housing nonprofits, legal aid programs, cities and towns, county and state government, federal agencies and congressional offices, as well as real estate, banking, and advocacy groups. In addition, the Office sought and received many thoughtful written comments on the current challenges faced by borrowers and communities throughout Arizona. Recommendations from those on the front line of the foreclosure crisis helped identify the greatest needs, and many of their suggestions are reflected in the decision to allocate the settlement funds to prevention and recovery initiatives.

II. General Principle – Avoiding Moral Hazard

The bulk of the \$57 million will be used to help keep people in their homes. In establishing what programs best achieve this purpose, the Office first determined to avoid what is referred to as “moral hazard”. This has been defined as follows: “moral hazard arises because an individual does not take the full consequences of his actions, and therefore has a tendency to act less carefully than he otherwise would, leaving another party to hold some responsibility.”

For example, when someone buys a house where he cannot afford to make the payments out of his income, but does so in the hope that the value will increase; that is speculation. The individual assumes a risk of loss, and government should not help in that circumstance.

Another example is where someone can afford to make payments on a mortgage, but stops doing so, because the value of the house is less than the amount of the mortgage. The person wants to walk away from the obligation. Government should not help in that circumstance, because it would have the effect of causing others who are making payments to stop, so they could also receive a government subsidy.

An example where help would be appropriate is where someone buys a house that he can afford based on his current income, then suffers adverse economic setbacks that are not his fault. He no longer has the ability to make full payments on his mortgage, but can make part of the

payment. There is no moral hazard involved in that circumstance in helping families stay in their homes.

III. Allocation of Mortgage Settlement Funds

A. Direct assistance to help keep people in their homes and for consumer restitution \$41 million

This \$41 million is the bulk of the \$57 million available. It can be used for the following purposes:

1. Homeowner Assistance Fund: This is a flexible resource pool for bridge loans or grants to keep thousands of Arizona families in their homes or help them get back on their feet if they have lost their home through foreclosure.

Many families facing imminent foreclosure, including veterans with mortgage issues, seniors on fixed incomes, homeowners with a demonstrated hardship and tenants residing in foreclosed properties are at risk of becoming homeless. A majority of households in crisis have children under 18. An emergency revolving loan fund would avoid the dislocation of children from their schools and help stabilize families and neighborhoods.

The Homeowner Assistance Fund can fill the gap for homeowners not eligible for other programs and can provide short-term cash assistance for thousands of struggling families.

- Homeowner recovery loans can assist borrowers at risk of default who need to become current on their mortgages in order to facilitate a refinancing or loan modification. These types of loans may also assist struggling borrowers who have experienced a temporary set-back, such as medical expenses or temporary loss of a job, which has resulted in deficiencies they cannot cure.
- Short term loans can subsidize transactional costs associated with a refinancing or loan modification including fees, appraisals, mortgage insurance and the like.
- Short term loans can assist in emergencies for families who have lost their homes to foreclosure, tenants in properties at risk of foreclosure and those experiencing job loss or reduced income. Families could access resources for transitional assistance, moving and relocation costs, utility payments, security deposits, initial rental assistance and the like.

2. Principal Reduction: The national mortgage settlement requires the settling banks to spend approximately \$780 million for principal reduction in Arizona. However, this applies only to loans held and serviced by the five settling banks. Some of the funds could be available to help secure principal reductions for

borrowers whose loans are owned or serviced by other than the five banks. The principal reduction can be especially useful where someone has a high interest rate, but cannot refinance to the new lower interest rates, because the principal amount exceeds the value of the house. Principal reduction can make refinancing possible, which would considerably lower the interest rate, and thereby leverage the benefit of the funds.

3. Consumer Restitution: Allocating some of the mortgage settlement funds for consumer restitution is consistent with the overall purposes of the agreements. Accordingly, some of the settlement funds will be used to pay uncollected judgments obtained by the Attorney General's Office against foreclosure rescue companies and other companies that targeted distressed Arizona borrowers without providing the promised assistance. Restitution may also be provided to some Arizona consumers who filed mortgage servicing related complaints with the Attorney General's Office if their complaints contributed to the successful resolution of the lawsuit against Bank of America.

4. Purchase of Mortgages: By providing assistance to non-profit organizations that are engaged in purchasing mortgages, refinancing them to what the borrower can afford, and then reselling them, it may be possible to create a revolving fund whose benefits extend into the future.

5. Veterans housing program: Veterans with disabilities may require modified homes that are accessible. Some banks have expressed a willingness to contribute houses free and clear for veterans with disabilities. The mortgage settlement funds could be used to modify these houses to accommodate the needs of veterans with disabilities. Under one particular program, one house has already been donated, and more are committed in the future.

B. Enforcement and Monitoring: \$5 million (\$1.6 million per year for 3 years)

The Attorney General's Office has brought dozens of actions against a range of actors, whose conduct contributed to the foreclosure crisis, including mortgage brokers, foreclosure rescue firms, loan modification firms, lenders, and mortgage servicing companies. These enforcement activities need to be expanded. In addition, resources are needed to monitor the banks' compliance with the mortgage settlement and to administer direct assistance programs, to be sure funds are used as efficiently and effectively as possible to help keep families in their homes. As a percentage of total funds, (8.7%) this is less than a number of other states (Indiana 44.25%, Iowa 17.01%, Kansas 39.91%, Montana 24.14%, North Carolina 24.63%, Utah 9.13%, Wisconsin 9.93%).

C. Housing Counseling: \$5 million (\$1.6 million per year for 3 years)

Distressed homeowners working with a trusted advisor are nearly twice as likely to receive a mortgage loan modification. And studies confirm that borrowers in

foreclosure were 67% more likely to remain current on their mortgage if they received counseling, resulting in fewer re-defaults. Modifications for counseled homeowners resulted in lower monthly payments with about 86% receiving a payment reduction. The housing counseling agencies are also a safeguard against scams by helping to identify and report new trends. As a percentage of total funds (8.7%), this is less than a number of states (Arkansas 70%, Colorado 11%, Delaware 44%, Idaho 12%, Massachusetts 17%, Maryland 16%, Michigan 21%, Mississippi 43%, Montana 51%, Oregon 40%, Tennessee 90% and Wyoming 19%).

Housing counseling, provided by HUD-approved nonprofit agencies, offers free legitimate technical expertise to homeowners or tenants affected by the foreclosure crisis. It is the most cost effective assistance available to the greatest number of households. At-risk borrowers need specialized help navigating a frustrating process dealing with lenders/servicers, understanding the numerous complex array of programs and foreclosure alternatives and need a knowledgeable advocate to represent their interests.

As part of an overall strategy, the assistance of housing counseling agencies will minimize homeowner displacement and foster the stabilization of neighborhoods across the state, including rural communities, and maximize access by Arizona consumers to the various benefits of the national mortgage settlement. This investment in housing counseling, coupled with available legal services, will help households access mortgage loan modifications, principal reduction, refinancing, unemployed/underemployed assistance, assist tenants affected by landlord foreclosures, and help homeowners sustain loan modifications.

D. Legal Services: \$4 million (\$1.3 million per year for 3 years)

The Attorney General's Office cannot provide direct representation to homeowners facing unjust foreclosure, but there are high quality legal aid programs that can. Legal aid programs have extensive experience helping homeowners threatened with foreclosure. As part of a comprehensive strategy to provide assistance to distressed borrowers and tenants residing in properties in or at risk of foreclosure, attorneys will deliver direct legal representation to those facing foreclosure or eviction. Legal services will include assessing potential causes of action to challenge foreclosure and evictions; advising clients on foreclosure options; interpreting and preparing loan documents; providing representation in both the pre-foreclosure and post-foreclosure proceedings; helping families receive appropriate assistance in collaboration with housing counseling agencies. Allocating some of the mortgage settlement funds to legal aid programs will make it possible for people who might otherwise lose their homes to receive quality legal representation and help ensure that borrowers' rights are protected.

The collaboration between legal aid and foreclosure counseling will provide advocates able to handle or settle cases and establish an effective and efficient leveraging of resources through sharing information and strategies to provide homeowners the best

chance to save their homes from foreclosure. As a percentage of total funds (7%), this is less than or consistent with a number of other states (Arkansas 23%, Colorado 3%, Idaho 25%, Illinois 19%, Massachusetts 14%, Maryland 11.5%, Montana 15%, and Oregon 5%).

E. Outreach, Marketing, Education: \$2 million (\$666,000 per year for 3 years)

The Arizona Attorney General’s Office will develop a statewide public awareness and education campaign to inform consumers on ways to gain access to Arizona’s share of the national mortgage settlement benefits. The program goals consist of educating Arizona homeowners about mortgage foreclosure resources available to them through a variety of state and federal programs. The Attorney General’s Office will partner with real estate and mortgage professionals and lenders to raise awareness about the services and financial resources available for struggling borrowers. Outreach and training will also be provided for housing counselors and legal aid providers. In order to create public awareness, the Attorney General’s Office plans to develop and facilitate Community Mortgage Fairs, and collaborate with housing organizations, non- profits, faith-based organizations, libraries, schools, social service organizations, and businesses. The Attorney General’s Office will coordinate education and communication with industry associations, as well as state and local government agencies. The goal is to create a multi-faceted awareness campaign assuring that consumer awareness and scam prevention information is made widely available.

F. Summary:

Direct Assistance to help keep people in their homes, and Consumer Restitution	\$41 million
Enforcement and Monitoring (\$1.6 million per year for 3 years).	\$ 5 million
Housing Counseling (\$1.6 million per year for 3 years)	\$ 5 million
Legal Services (\$1.3 million per year for 3 years)	\$ 4 million
Outreach, Marketing, Education (\$666,000 per year for 3 years)	<u>\$ 2 million</u>
TOTAL	\$57 million