



FILED  
OFFICE OF THE CITY CLERK  
OAKLAND  
2013 NOV -7 PM 6:08

# AGENDA REPORT

TO: DEANNA J. SANTANA  
CITY ADMINISTRATOR

FROM: Michele Byrd

SUBJECT: Informational Report on  
Local Principal Reduction Strategies

DATE: November 6, 2013

City Administrator  
Approval

Date 11-7-13

COUNCIL DISTRICT: City-wide

Staff recommends that Council accept this informational report:

## Informational Report on **Local Principal Reduction Strategies**

As Council discusses principal reduction strategies available to local jurisdictions in the context of deliberating its support for the City of Richmond's principal reduction strategy, this report provides further information to assist Council in its deliberations, namely: 1) background information on prior national, state, and local efforts to achieve principal reduction; 2) the City of Oakland's current and new proposed efforts to prevent foreclosures including through principal reduction strategies; and 3) staff recommendations for additional Council action.

### ANALYSIS

#### ***Principal Reduction and National, State, and Local Efforts***

There is a growing national movement to achieve principal reduction for homeowners in distress which has received support from mainstream financial industry leaders such as Federal Reserve Chair Ben Bernanke, HUD Secretary Shaun Donovan, as well as community advocates and organizers. The term "principal reduction" refers to a strategy where the mortgage lender or servicer would reduce mortgage loan amounts for delinquent borrowers whose mortgages are more than current market value (underwater borrowers) down to the current market value of the home.

However, while principal reduction can be utilized as part of a required loan modification process, there is currently no federal or state requirement that requires lenders or servicers to

Item: \_\_\_\_\_  
Council  
November 19, 2013

Enterprises including Fannie Mae and Freddie Mac are currently prohibited by its administrative policy from engaging in any principal reduction strategies. Fannie Mae holds significant numbers of Oakland mortgages. The following is a snapshot of key national, state, and local efforts that have attempted to achieve principal reduction through their program designs.

The National Mortgage Settlement Agreement (NMSA) requires the five (5) applicable loan servicers to consider principal reduction as part of a required loan modification process for delinquent borrowers and borrowers at imminent risk of default and incentivized the applicable servicers to engage in principal forgiveness.<sup>2</sup> As of August 29, 2013, according to the National Monitor's report, 95,582 borrowers nationwide (23,189 of these borrowers resided in California) successfully completed a first lien modification and received \$10.399 billion in loan principal forgiveness, averaging approximately \$108,795 per borrower. About 61% of borrowers served through the NMSA received some sort of consumer relief to enable them to retain their homes (393,742 borrowers nationally) through a permanent or trial modification, extinguishment, or refinancing assistance. Servicer commitments under the NMSA have been largely fulfilled.

The **Keep Your Home California (KYHC) Program**, administered by the California Housing Finance Agency, utilizes federal Hardest Hit Funds to help prevent foreclosures for eligible homeowners. This is a voluntary program for lenders and servicers.<sup>3</sup> Last year, the KYHC Program issued a new program that would provide up to \$100,000 towards principal reduction for eligible homeowners through participating lenders and servicers. To date, KYHC has provided \$87,234,550 statewide in principal reductions, serving 85 Alameda County homeowners for a total of \$4,596,243.

**Sale of Distressed Mortgage Notes.** In both Ohio and Illinois, the State Housing Finance agencies have partnered with the Mortgage Resolution Fund (MRF), a partnership of four (4) leading national nonprofit organizations, including Enterprise Community Partners, to use Hardest Hit Funds to purchase delinquent mortgage notes with the primary purpose to modify the mortgages through principal reduction whenever possible. Note: MRF is a different entity from Mortgage Resolution Partners (MRP) which is a for-profit entity working with the City of Richmond. To date, MRF has purchased over 1,000 mortgage notes through the Federal Housing Authority Neighborhood Stabilization Auction sale of delinquent notes in Ohio and Illinois. Because these notes were, on average, over 2 to 3 years delinquent, many of the borrowers were no longer contactable and many others did not have sufficient income to afford even the significantly modified mortgage. Despite the length of delinquency of the purchased

<sup>2</sup> [www.mortgageoversight.com](http://www.mortgageoversight.com)

<sup>3</sup> [www.keepyourhomecalifornia.org](http://www.keepyourhomecalifornia.org). The major loan servicers in Oakland that are participating in the Keep Your Home California principal reduction program are Bank of America, US Bank, and Wells Fargo. Chase Bank is participating in the principal reduction program only for loan recasts. A recast is when funds are applied to reduce the existing unpaid principal balance and a new monthly payment is calculated without a loan modification. There are no changes to the interest rate, term or program type.

notes, MRF has been able, so far, to modify in excess of 30% of the mortgage notes purchased, keeping the homeowner in their home as homeowner.

**Sale of Distressed Properties Back to Eligible Homeowners.** This strategy pioneered by Boston Community Capital provides a vehicle for participating lenders and servicers to sell foreclosed properties or those in the foreclosure process of eligible occupants to a nonprofit administering agency at current distressed market value. The nonprofit agency then re-sells the home back to the eligible occupant at current market value with a 30 year fixed mortgage and provides ongoing housing and financial counseling services to help homeowners repair their credit status. Since 2009, Boston Community Capital has expended \$62 million in mortgage financing for 305 properties and assisted 425 families.<sup>4</sup>

### *City of Oakland Efforts to Prevent Foreclosures, Including Principal Reduction Strategies*

Beginning about two years ago when the City of Oakland's finances began to stabilize and federal and state regulatory or other systems changed to support potential principal reduction strategies, City staff worked with national, state, and local experts to research and develop new efforts and strategies to assist Oakland distressed homeowners and tenants and prevent foreclosure and displacement of long-time families.<sup>5</sup>

Central to staff due diligence was understanding the barriers to achieving principal reduction, such as how lending and servicing institutions "account" for financial losses, reluctance to continue lending to a "risky" borrower, and in some cases, concerns about the "moral hazard" of assisting defaulted homeowners. In partnership with community and bank partners, staff then developed current and new local strategies to address these specific barriers, including through making a business case for principal reduction programs, such as the new ROOT loan fund.

Last fall, a comprehensive program design was deployed utilizing available services and strategies, as well as addressing existing gaps through door to door outreach and a new City escalation effort to advocate for residents directly with banks. Part of the program design was to develop a local mechanism for ensuring that Oakland homeowners benefited from national and state changes, such as the National Mortgage Settlement Agreement and the California Homeowner Bill of Rights Act. The City and its partners also launched a new revolving loan fund program (the ROOT Loan Fund program) to purchase and then re-sell properties at market value for eligible families in foreclosure as a strategy to keep families in their homes.

---

<sup>4</sup> [www.bostoncommunitycapital.org](http://www.bostoncommunitycapital.org)

<sup>5</sup> Groups included the Alliance of Californians for Community Empowerment (ACCE), Causa Justa: Just Cause, Oakland Community Organizations, East Bay Housing Organization, Housing Economic Rights Advocates, California Reinvestment Coalition, Enterprise Community Partners, LISC, Community Housing Development Corp, One Pacific Coast Bank, Wells Fargo, Harvard Law School's Legal Aid.

The new efforts served about 700 households to date, including keeping 92 households in their homes and providing alternative housing solutions for 64 other households, with 88 cases pending. The participation of major lenders has been critical to these efforts.

The City has also focused on another major foreclosure recovery effort to address the significant problems with blighted properties in foreclosure. In June 2012, the City Council expanded its vacant foreclosed properties registration program to provide new tools to address both foreclosed and defaulted properties, regardless of vacancy status. City staff has worked effectively with major lenders on its proactive blight abatement and property registration programs, achieving a 94% timely abatement rate in FY12-13, as well as the registration of 2,310 properties, City inspection of 1,075 properties, and direct collection of \$1,061,468 in fees and penalties.

### **New Oakland Efforts to Achieve Systems Changes and Group Benefits**

While the current efforts have been significant, they have not been able to address the scale of the crisis, are very labor and time intensive, and based upon addressing the needs at an individual level. It is critical that these efforts continue as many Oakland homeowners have complex situations that require intensive problem-solving effort.

Building upon past experience and relationships, staff is currently working on the development of systems changes in order to assist greater number of residents in need, including the following:

1. To achieve principal reduction for more households, we are requesting major loan servicers to utilize their existing authority under loan servicing agreements to engage in principal reduction, or sell non-performing mortgage notes to help Oakland families in mortgage default maintain their home, or other principal reduction strategy. Enterprise Community Partners has agreed to help the City with principal reduction strategies, including the development of a distressed mortgage notes program. In addition, staff has engaged in communications with major lenders to request their participation in this effort. A formal Council request to lenders to work with City staff would be helpful in facilitating this new effort.
2. Given Oakland's rapidly escalating housing market, current market value may not be affordable to many long-time homeowners. Staff is working to develop new financial resources to help address the funding gap between market value and homeowner affordability through new Homeowner Preservation Grants<sup>6</sup> and will be also exploring the possible use of KYHC funds with California Housing Finance Agency officials.

<sup>6</sup> Staff has worked with the National Fair Housing Alliance, which administers the recent Settlement Agreement with Wells Fargo regarding property maintenance, to create a fund for distressed Oakland homeowners to access 0% interest loans in order to preserve their homes from foreclosure.

Item: \_\_\_\_\_  
Council  
November 19, 2013

3. Building on the existing outreach, services, and City escalation and tracking systems, to organize a more coordinated and streamlined system with major lenders utilizing a joint “case management” approach. Some major lenders already engage in regular calls with key housing counseling or legal service providers to discuss loan modification efforts for mutual clients. The new system with City involvement would bring additional resources and strategies, such as gap funding assistance and accountability to the City.
4. As part of the new Community Buying program, to organize group purchase of bank-owned properties in order to: 1) assist occupants to remain as new homeowners or tenants with long-term lease protections; and 2) transform vacant properties into new homeownership or affordable rental housing. Mayor Quan, City administration and staff and community partners have met with officials from major banks to discuss bank participation in this new program.

Key groups such as the San Francisco Federal Reserve and HOPE NOW, a national alliance of banks and housing groups sponsored by the Treasury Department and HUD, are interested in supporting Oakland’s above efforts.

#### ***Potential Impacts to Study and Consider***

While the City of Oakland is firmly on the road to economic recovery, its fiscal health and stability is vulnerable to financial market pressures. In addition, while it may be unlikely and unlawful for banks to stop lending activities in Oakland in response to any contemplated Council action, the City has been trying to attract new investments for disadvantaged residents and businesses that would require interests beyond the financial bottom line. City staff has also been able to achieve a high level of cooperation from lenders on Oakland’s foreclosure prevention and blight abatement programs in the interest of distressed homeowners, tenants, and neighborhoods. City relations with banks and investors are critical to bringing these types of resources to Oakland’s impacted neighborhoods and residents.

Pursuant to the City of Richmond documents and as verified by Richmond staff at the November 5<sup>th</sup> Council meeting, the Richmond City Council has not formally adopted the use of an eminent domain strategy to take over any mortgage notes. However, as reported, the financial market has negatively reacted to the perception that Richmond is deploying eminent domain and potentially created barriers for the City in its efforts to attract bond investors for its recent refinancing effort.<sup>7</sup> The Richmond bond transaction was insured by Build America Mutual Assurance Company (one of two insurance company left in the industry with investment ratings) and has a rating of A minus by Standard and Poor’s. However, the transaction had no bidders while other cities with lower ratings successfully sold their bonds. Treasury staff believes that this was a

---

<sup>7</sup> SF Chronicle, “Eminent Domain Plan May Have Spooked Investors,” Aug 29, 2013.

clear consequence of the eminent domain threat. In addition, the City of Richmond passed a resolution on Sept 17, 2013 to sell their annual tax revenue anticipation notes to provide cash flow for regular operations on or about October 29, 2013 but to date have not yet entered the market. This is a sensitive matter that staff advises Council to cautiously explore because there could be negative consequences that may have a fiscal impact on the City even when a decision has not been finalized. Some of the concerns are listed below:

1. **City credit ratings**

- a. Credit Negative: All three rating agencies has indicated that the eminent domain program is a credit negative for a city. Also, with a lower credit rating it would be more difficult to access the market and more costly for the City to borrow. This is because the tax base will be affected.
- b. Limited Liquidity: Lack of investor's interest and restricting credit availability may result in shortage of liquidity for the City to meet cash-flow needs. This means that various projects will be affected if lenders are not willing to loan money.

2. **Bond ratings/sale**

- a. Bond Downgrade: Eminent domain has credit negative consequences in the view of rating agencies, which will lead to potential bond downgrades. The downgrade is reflective of the rating agency believing that the eminent domain program creates uncertainty and exposure to the housing market by affecting the tax base.
- b. Bond Sale: As seen in the recent market, the City of Richmond's transaction was not well received in the market, no investor bid for the bonds. When the market is not receptive to a bond transaction, the results are (1) no bond sale or (2) it would be more costly to sell. Bonds are a crucial funding mechanism to finance projects for the City, without this financing vehicle the City will not be able to fund the necessary projects.

3. **Tax Revenues**

- a. Loss in tax revenues: The eminent domain program will raise mortgage interest rates and reduce mortgage availability, which will in turn limit the growth of property values. As a result, the City will be exposed to a weak housing market and no growth in any taxes related to housing market, which translate to loss of revenues.

At the same time, staff recommends evaluating the viability of all potential strategies to assist distressed Oakland homeowners, learning from national and local experiences including from the City of Richmond, which is still under development.

Information provided in the prior staff supplemental report dated October 30, 2013, identified twelve (12) areas for study of potential impact or benefit including financial, legal, and operational issues. Staff believes that this information is important in formulating any policy considerations to improve the City's response to the foreclosure crisis.

Item: \_\_\_\_\_  
Council  
November 19, 2013

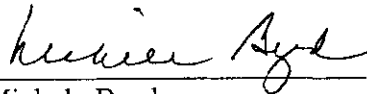
***Staff Recommendations for Council Action***

Staff has conducted due diligence and believes that the below recommendations will provide substantive assistance to Oakland's local principal reduction and foreclosure prevention efforts without incurring negative fiscal risks. Staff recommends the following:

1. Given the sensitivity of the financial market to the perception of local use of eminent domain or similar takeover strategies, staff recommends that the City Administration including staff from Finance and Housing and Community Development have an opportunity to review and provide feedback to Council on motion language.
2. Provide staff with the opportunity to develop Oakland's new principal reduction strategies, as discussed above, and collect sampling data on how many Oakland residents have retained their homes through principal reduction or other sustainable home retention strategies. Staff will return to Council in three to four months with a progress and evaluation report including the level of lender and servicer participation in the new strategies.
3. For Council as a body to request lenders and servicers to continue or begin to work with City staff and community partners on achieving principal reduction outcomes for eligible Oakland homeowners and request State and Federal support for these efforts.

For questions about this report, please contact Margaretta Lin, Strategic Initiatives Manager, at 510-238-6314.

Respectfully submitted,



Michele Byrd  
Director  
Department of Housing & Community  
Development

Reviewed by:  
Katano Kasaine, Treasurer  
Dawn Hort, Financial Analyst  
Finance and Management Agency

Prepared by:  
Margaretta Lin, Strategic Initiatives Manager  
Department of Housing and Community Development

Item: \_\_\_\_\_  
Council  
November 19, 2013