STATE OF COLORADO
OFFICE OF THE ATTORNEY GENERAL

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Allocation of Settlement Funds
Mortgage Servicing / Foreclosure Processing Settlement
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Background

Relief Available under the Settlement

On February 9, 2012 this office, along with Attorneys General from 48 other states and the District of Columbia, the United States Department of Justice and the United States Department of Housing and Urban Development reached a $25.0 Billion settlement with the five largest mortgage servicing companies. This settlement resolved consumer protection and other claims that these state and federal law enforcement offices had against these servicing companies regarding their foreclosure practices and conduct related to the servicing of residential mortgage loans.

Under the settlement, the mortgage servicing companies agreed to far reaching servicing standards. The servicing standards are 42 pages in length and govern many aspects of their loan modification and foreclosure practices. The new servicing standards seek to achieve two main goals. First, they uphold the integrity of the states' foreclosure laws. The servicing standards prohibit "robo-signing" and other practices that violated state foreclosure laws. Second, the standards set forth detailed requirements to avoid an unnecessary foreclosure while borrowers try to save their homes through a loan modification. The servicing standards set forth timeframes and other standards that will facilitate loan modifications where it makes economic sense for the servicer to modify the loan. In those cases where a loan modification cannot be worked out, the servicing standards establish requirements to ensure that the foreclosure will be processed in accordance with Colorado law.

The settlement also provides for $25.0 Billion in monetary relief that is designed to facilitate these goals of preserving home ownership and the fair processing of foreclosures. The remedy for the resolution of the federal claims is reflected in the $17.0 Billion of credits that servicers will be able to earn through loan modifications that reduce the principal balances on these loans. If a modification cannot be reached, then servicers can earn credits by extending foreclosure alternatives to borrowers. These foreclosure alternatives include waiving deficiency balances on foreclosures and short sales and offering enhanced cash for keys payments in exchange for a deed-in-lieu of foreclosure. Credits may also be earned for contributing to anti-blight programs. In Colorado it is estimated that as much as $73.3 Million in principal reductions and other credits will be realized by borrowers under this aspect of the settlement.

Under the settlement there is also $3.0 Billion available for the refinancing of mortgages on homes that have been hit hard by losses in property values. A borrower who is current on his or her mortgage but who has been unable to refinance because the loan exceeds the value of the home will be able to refinance into a lower interest rate. This benefit will extend to loans held in the servicers' own portfolios and will allow an average interest rate reduction of 1 – 1 ½ %. This benefit is estimated to bring $46.3 Million in savings to borrowers in Colorado.

In addition to these credits that may be earned, the servicing companies must pay a combined total of almost $5.0 Billion to the federal and state law enforcement offices. Approximately $2.5 Billion will be deducted from this fund for payment to the federal agencies, payments to borrowers and payments to state regulators and national enforcement funds. From this fund, approximately $1.5 Billion will be reserved for payments to borrowers who lost their homes to foreclosure from 2008 – 2011 and who experienced dual track problems or some other misconduct during the course of the servicing or foreclosure of their loan. This payment will be made to approximately 17,000 Colorado borrowers and will have an estimated value of $32.5 Million.

The remaining $2.5 Billion will be divided among the states according to a weighted average based on the number of loans serviced in each state and each state's share of distressed loans. Distressed loan characteristics include the state's share of loans with negative equity, loans that are seriously delinquent and the rate of foreclosure starts in the state. Of this amount $50,170,188.00 will be paid as custodial funds to this office. An additional $1.0 Million will be paid to the Administrator of the Uniform Consumer Credit Code. These funds will be combined for use as specified below.

These funds are custodial funds pursuant to § 24-31-108, CRS because they were generated as a result of the settlement of a lawsuit and are paid for a specified purpose under a court ordered consent judgment. None of these funds are taxpayer generated or general revenue funds. These funds were recovered as an exercise of the Attorney

General's law enforcement power to bring an action under the Colorado Consumer Protection Act (§§ 6-1-101, *et seq.*, CRS) and under the Uniform Consumer Credit Code by the Administrator of that Code. The custodial purposes set forth under the consent judgment for use of these funds include funding of programs to prevent foreclosures, promote loan modifications and promote housing. These funds may also be used for future consumer protection and antitrust enforcement and education efforts.

<u>Colorado's Need: Foreclosure Prevention and Affordable Housing</u>

The mortgage fraud cases that my office has handled over the last 5 ½ years have given me a particular insight into the severity of the foreclosure crisis in Colorado. I established a mortgage fraud unit in this office in 2006. Since this time my office has brought dozens of actions against a range of actors, whose conduct contributed to the foreclosure crisis, including mortgage brokers, property flippers, foreclosure rescue firms, loan modification firms, lenders and, now, mortgage servicing companies.

Through these efforts we have received hundreds of complaints from borrowers who have been victimized by these companies. Many of these homeowners have written about the extensive efforts that they have made to try to save their homes from foreclosure. Oftentimes they have been working diligently with the servicing companies to work out a loan modification. But at the same time, many of these homeowners have been fighting a foreclosure. This process known as "dual tracking" has put borrowers at risk of losing their homes while they have been trying to work out a modification. All too often the servicer moved forward on the foreclosure, but failed to act on the modification. Numerous unnecessary foreclosures resulted from this dysfunctional process.

As my office worked through these complaints I came to learn the value of housing counseling provided by nonprofit HUD-approved housing counselors. The Colorado Foreclosure Hotline has also been instrumental in getting distressed borrowers in contact with this free counseling service and raising awareness about this valuable service. My office has supported the Hotline with grants totaling $1.1 Million since 2009.

My office has also devoted one full time person to a complaint escalation process by which the servicers can address particularly egregious dual tracking problems. This experience has demonstrated the need to support an expanded complaint escalation process. It has also shown the value of expanding legal services for borrowers who may have legal claims that should be addressed through a lawyer.

As set forth below, all of these programs will be supported using these custodial funds. In addition, this settlement provides significant funds that can be used to complement the refinancing benefit and credits that the servicers can earn for principal reduction modifications and providing alternatives to foreclosure under the settlement.

Shortly before this settlement was announced I consulted with the Governor's Office and the Joint Budget Committee about the recovery of these funds and the good uses to which they could be put. The President of the Senate appointed Senator Pat Steadman and Senator Ted Harvey and the Speaker of the Colorado House of Representatives appointed Representative Claire Levy and Representative Chris Holbert to advise about possible uses of these funds. I have also received input from Representative Angela Williams and Representative Angela Giron.

My office has also held several meetings and received input from numerous other stakeholders who are on the front line of the foreclosure crisis, including housing counseling agencies, the Colorado Foreclosure Hotline, Colorado Legal Services and the Colorado Housing Finance Authority (CHFA). Two public hearings were held on February 22 and 29, 2012 to consider all of the proposals. On March 5 I issued a draft decision which set forth my preliminary conclusions as to how the settlement funds shall be allocated. In response to this draft decision I received comments from eleven separate stakeholders.

As a result of this input and in consultation with Senators Steadman and Harvey, Representatives Levy and Holbert, the Governor's Office, the Colorado Division of Housing and CHFA, and after receiving input from numerous other stakeholders I have determined to use the $51.17 Million as follows.

Funding Available

Payment to Uniform Consumer Credit Code Administrator	$ 1,000,000.00
Payment to the Attorney General	$50,170,188.00
Total Funding Available	**$51,170,188.00**

Summary of Funding

Supplemental Loan Modification Programs	$24,000,000.00
Affordable Housing Programs	$18,195,188.00
Housing Counseling Support	$ 5,300,000.00
Housing Counseling Program Administration	$ 325,000.00
Colorado Foreclosure Hotline Support	$ 600,000.00
Outreach and Marketing – Defaulted Borrowers	$ 500,000.00
Colorado Legal Services	$ 1,500,000.00
Attorney General's Office – Enforcement & Monitoring	$ 750,000.00
Total Funding	**$51,170,188.00**

Programs to Leverage Relief Available under the Settlement

I. Supplemental Loan Modification Programs - $24.0 Million

The Governor's Office, the Division of Housing and CHFA have proposed various programs that will complement the loan modification options and refinancing benefits that are available under the settlement. They have proposed funding three programs that will leverage the settlement funds in order to make the benefits of the settlement available to those borrowers who have loans that don't fit within the modification or refinancing benefits under the settlement.

The first two programs will create a loan pool that will assist borrowers in default avoid foreclosure or obtain a modification. The third program will fund a mortgage insurance program to incentivize a refinancing on a loan where the borrower is current, but there is a risk of default or the loan's value exceeds the value of the home. All three of these programs will be funded to extend the benefits of the settlement to those borrowers who have loans that otherwise do not qualify for a modification or refinancing under the settlement.

Flexibility will be built into these programs to allow funding to be moved among these programs to serve the greatest need while at the same time ensuring that the borrower will have a sustainable mortgage payment. My office, in collaboration with the Governor's Office, the Colorado Division of Housing and CHFA, will use the next thirty days to consult with experts and stakeholders as to the most pressing needs. As a result of this process we plan to have programs in place by June 1, 2012 that will have the flexibility to respond to the most immediate needs of borrowers who are in default or at risk of going in to default. Through this process, I will also identify an administrator who can ensure that the funds are responding to the most immediate needs of our state.

Finally, this fund will last only as long as the foreclosure crisis. At this time we are estimating that crisis will abate after three years. My office will continue to monitor these programs throughout this entire period. As my office works in the next thirty days to define these programs, I will also establish criteria to determine when the programs may be dissolved and the funds put to other uses. It is anticipated that any funds remaining after three years, or abatement of the foreclosure crisis will be provided to the Housing Investment Fund. I am working with the Division of Housing to devise criteria based on foreclosure starts and other distressed loan criteria to allow us to make an informed decision as to when the foreclosure crisis has abated.

Covering Borrowers with Loans Outside of the Settlement

The refinancing benefit and the benefit available for principal reduction credits under the settlement are generally available only to borrowers with loans that are held by the servicers on their own portfolios. I have determined that the settlement funds would be best used to facilitate similar modifications for those borrowers whose loans are owned by investors like Fannie Mae and Freddie Mac who do not currently allow principal reduction modifications. These government sponsored enterprises (GSEs) own approximately sixty percent of the residential mortgage loans nationwide. Therefore, leveraging the funds paid to Colorado under the settlement to modify or refinance loans owned by these GSEs should help spread the benefit of this settlement to all Colorado borrowers.

Loan Pool to Facilitate Modifications and Avoid Foreclosure

To assist these borrowers obtain a loan modification, a loan pool will be created with a portion of these settlement funds. Borrowers who are in default can obtain a loan from this fund that will effectively serve to reduce the principal amount on their loan that bears interest. The loan obtained from this fund will be a subordinate lien that does not incur any interest charges. The subordinate nature of this lien also ensures that no additional unnecessary debt will be taken on by the borrower. Of course, this requirement can also be made a condition of this loan. To stretch the coverage of this loan pool, a limit may be placed on the amount of the loan that can be given to a borrower at any one time (i.e., no more than $25,000.00 or some other reasonable amount). When the overall principal is reduced via this loan, it is anticipated that other traditional modification techniques, such as interest rate reductions, will work in combination to put the borrower in a sustainable mortgage payment.

This loan pool can also come into play for those borrowers in default who have experienced a temporary set back, such as medical expenses or temporary loss of a job, which has resulted in a large deficiency that they cannot cure. Borrowers who have weathered this setback typically have a regained employment or maintained a job with an income that does not qualify them for a modification. These borrowers, however, are facing foreclosure because they cannot cure the deficiency resulting from their temporary setback. The loan fund would be available help cure the default in part or in full and would take the form of a non-interest bearing subordinate loan that would be due upon the sale or refinancing of the property.

The borrowers who would benefit from these loans can be identified through the foreclosure deferment program that is currently available under Colorado law. *See* 38-38-801, *et seq.* CRS. Also, through increased outreach and public awareness (discussed *infra*) we hope to bring more borrowers into this program who are not yet in foreclosure, but who are just recently in default. All borrowers eligible for these loans would have to be the owner occupants of the homes at issue. Finally, these loans would be available only as a last resort for borrowers, after they have been determined to be ineligible for modifications under the settlement, HAMP or other applicable modification programs.

<u>Mortgage Insurance Program</u>

These funds can also be used to create a mortgage insurance program that will help avoid foreclosure and sustain property values. The mortgage insurance program can be designed to complement the refinancing benefit that is available under the settlement for current borrowers who are underwater on their loans. Again, the refinancing benefit under the settlement is available on loans held by the servicers on their own portfolios. This mortgage insurance would extend the benefit of the refinancing to a broader universe. When designing this program, consideration should also be given to whether this mortgage insurance can provide supplemental coverage to investors who agree to modify loans of Colorado borrowers by offering a principal reduction or principal forbearance that they would not otherwise authorize. This supplemental insurance can supplement any other insurance such as FHA insurance or private mortgage insurance. Because it is also anticipated that there will be a great demand for this coverage, consideration should also be given to designing eligibility requirements that would give coverage first to those borrowers who are in danger of default.

II. Affordable Housing Programs - $18,195,188.00

The Division of Housing has proposed two programs to make more affordable housing available. The Division of Housing has pointed out that as homeowners have been losing their homes, rental vacancies have been decreasing. This has caused an increase in rental costs. The foreclosure crisis is one cause for this rental squeeze. The first program will stimulate construction of affordable rental housing.

The Division of Housing has also pointed out that there is a need for greater housing and treatment of military veterans. There are numerous federal benefits available for treatment and housing of military veterans. The Division of Housing has pointed out that there is a need for these benefits to be provided at a single facility. It has proposed Ft. Lyon located in Bent County, Colorado to serve as this facility. Both of these programs will be funded with these settlement funds.

Housing Investment Fund - $13,195,188.00

These funds will be placed in a revolving loan pool. The loan pool will be administered by the Division of Housing under the oversight of the State Housing Board. The funds will be available to make low interest short term loans to stimulate the construction of affordable rental housing. It is anticipated that this loan pool will stimulate construction of as many as 750 affordable housing units for the homeowners who have been displaced by the foreclosure crisis. This fund will be leveraged with private activity bonds, thereby stimulating that market. It will also stimulate construction thereby creating more jobs.

Military Veterans' Housing and Treatment - $5.0 Million

The Division of Housing has identified up to $5.0 Million in federal matching funds that can be used to provide housing and treatment for military veterans. Most of these matching funds can be used to provide housing for veterans and treatment for substance abuse and mental health issues. The Division of Housing has pointed out the benefit of administering this housing and treatment program at Ft. Lyon.

The residential treatment center would provide treatment for substance abuse and mental illness for veterans and other Medicaid eligible individuals. The veterans will receive treatment for medical conditions and job training to seek employment once they return to their communities. The services provided will help veterans stabilize, prevent relapse and rebuild their lives in long-term and permanent housing. After treatment they will return to their communities and with permanent housing resources.

Ft. Lyon was selected because of its unique capacity to treat persons with substance abuse and mental health. The facility is well equipped to begin operations as soon as funding is available. Currently the facility is owned by the State of Colorado and is in move-in condition. The location of Ft. Lyon also is a unique asset for the treatment of individuals needing a change of environment.

III. <u>Housing Counseling Support</u> - $5.3 Million

The housing counseling community has made a proposal that includes five elements for funding: (1) fee-for-service counseling; (2) ramp up costs to meet growth needs; (3) expansion to rural areas; (4) program administration; and (5) outreach and support for the Colorado Foreclosure Hotline.

As explained above, my office has received hundreds of complaints from homeowners about the struggles that they experienced when they were trying to save their homes. HUD-approved nonprofit housing counseling agencies have a proven track record. Four out of five homeowners who meet with a HUD-approved nonprofit housing counseling agency successfully avoid foreclosure. The settlement is structured to get assistance to the borrowers who would benefit from being considered for a loan modification or other loss mitigation options. HUD-approved nonprofit housing counseling agencies can guide homeowners through this process. Therefore, I believe that HUD-approved nonprofit housing counseling agencies will provide the best opportunity to help borrowers apply for and potentially receive a loan modification. If a loan modification is not available then these agencies can help borrowers work through a foreclosure alternative. The guidance and assistance provided by these housing counselors will complement the enhanced processes that are set forth in the settlement for handling loan modifications and other foreclosure alternatives.

The additional funding described below will be made available to only HUD-approved nonprofit housing counseling agencies operating in Colorado. To facilitate the outreach efforts, (*see infra*, discussion of outreach and funding for the Hotline), the counseling agencies eligible for this funding must be members of the Colorado Foreclosure Hotline network, unless good cause can be shown to the administrator as to why they are not members of the network. I will commit to the following funding if it can be shown to increase counseling for borrowers in default.

1. <u>Fee for service reimbursement</u> - $4.4 Million

   HUD approved nonprofit counseling agencies shall receive a fee for service payment of $400 per client. It is anticipated that reimbursement at this level will also require a level of monitoring and counseling that results in a resolution for the borrower. The criteria for determining whether a resolution has been reached can be devised by CHFA, as the program administrator. Criteria shall include industry standards for defining a resolution. CHFA may also define the level of counseling that will be necessary to qualify for this rate, but it is anticipated that the counseling should be well beyond the level 1 that is provided for under National Foreclosure Mitigation Counseling (NFMC) grants. CHFA shall also specify reporting requirements to ensure that these funds are used in a way to complement funding that the counseling agencies are already receiving. These funds should be used to expand the number of clients that are reached.

This funding will be available for a period of three years. It is anticipated that with this increased funding at least 11,000 additional clients will be served. Reporting will be required within existing structures to quantify services provided and outcomes achieved, among other factors as identified by CHFA. The participating agencies must also submit to audits and periodic inspection.

2. <u>Ramp-up costs</u> - $625,000

   There will be $25,000 available as ramp up costs to all twenty-five agencies that are currently in the Hotline network or that are expected to join the network in 2012. These ramp up costs will be available to increase staffing in order reach more borrowers. A list of approved expenses will be created to ensure that these funds are being used to expand capacity.

3. <u>Expansion to rural areas with increasing foreclosures</u> - $275,000

   These funds will be available over a three year period of time to increase housing counseling in rural areas where foreclosure filings are increasing. The preponderance of the effort would be oriented towards mountain communities and the Western Slope. Northern Colorado would also be a focus. This funding would be available to expand five housing counseling agencies that will serve rural communities that are currently underserved and where foreclosure filings are increasing.

IV. Housing Counseling Program Administration - $325,000

CHFA already administers counseling grants through NFMC and the Emergency Home Loan Program. It is a logical choice to administer the $5.3 Million housing counseling program as set forth above. It will be necessary to review these counseling efforts on a continual basis and adjust the program to meet the state's needs for counseling of borrowers in default. As mentioned above it will also be necessary to ensure that counseling agencies are not receiving double compensation for counseling a client through another program. As CHFA already administers these other funding sources, I am pleased to appoint CHFA as the administrator of this program.

V. Outreach and Colorado Foreclosure Hotline - $1.1 Million

As discussed above, the servicing companies will be required to adopt fairer and more streamlined procedures to process a loan modification application. There are also financial incentives to modify a borrower's loan using principal reductions. If the loan cannot be modified there will be other alternatives available to save the home under the new loan modification program discussed above using a portion of the settlement funds.

Increased outreach and public awareness will be the key to getting Colorado borrowers in line to receive these benefits. Borrowers in default have been reluctant to come forward to get help. The funds provided for outreach and the Hotline will be designed to ensure that borrowers who want help are well-informed as to the resources available.

1. <u>Hotline Support</u> - $600,000

   In 2011 my office entered into a memorandum of understanding (MOU) that provides $300,000 per year for two years for support of the Hotline. The funds used for this support came from the settlements with Countrywide and Wells Fargo. We are currently midway through this contract. Therefore, under this MOU the Hotline will receive another $300,000 of funding through June 30, 2013. I will extend this support for another two years at this same funding for a total of $600,000. This funding will continue to be administered through my office.

2. <u>Increased outreach</u> - $500,000

   This funding will be used over the next three years to increase awareness of the free housing counseling that will be available to borrowers in default or in imminent danger of defaulting on their loans. This outreach will be coordinated with the Hotline, CHFA and my office. This outreach will be available to fund local outreach efforts that have proven effective in local communities, such as workshops and targeted outreach through trusted institutions such as churches and other community groups.

   This outreach will also employ marketing and public service announcements on a statewide basis which have been utilized previously by the Hotline. This office along with the Hotline and CHFA will solicit input from counseling agencies as to the best methods to reach the communities that they serve.

VI. <u>Colorado Legal Services</u> - $1.5 Million

Colorado Legal Services has submitted a proposal to increase its staff to serve clients who are in default on their loans or who are in foreclosure. Through our enforcement efforts my office has discovered many clients who have been subjected to a host of misconduct during the course of their foreclosure. Primary among these scenarios is the borrower who has been dual tracked. Many of these borrowers would benefit from consultation with a lawyer. This office cannot represent these borrowers. Many of these borrowers are also not in a position to hire a lawyer, as they cannot even afford their mortgages.

Colorado Legal Services provides a valuable and necessary service to these borrowers. Colorado Legal Services provided evidence where their legal services helped save hundreds of homes from foreclosure. These legal services can work in conjunction with the housing counselors to save homes in Colorado.

Through additional funding, Colorado Legal Services will also be able expand its staff to serve areas where foreclosures are on the rise, such as the Western Slope, mountain communities, Northern Colorado and Southern Colorado. Additional staff can also be added to their metro Denver office to assist with foreclosure representation along the Front Range.

This additional funding will also be used to develop self-help resources that all borrowers may use to save their homes from foreclosure. This office will coordinate with Colorado Legal Services to develop these self-help resources.

VII. <u>Attorney General's Office: Enforcement and Coordination</u> - $750,000

As discussed above, our enforcement efforts have put us in contact with numerous borrowers who have been trying to save their homes. After the robo-signing scandal broke, complaints started to stream into my office from borrowers who were trying to save their homes. Since October 2010 I have had one staff person devoted solely to escalating complaints from borrowers who have been subjected to the dual track problem. Since that time my office has escalated over 400 complaints to the mortgage servicing companies. We have been able to save homes through this process.

With increased awareness of the programs and processes available under the settlement to help borrowers save their homes, I want my office to be prepared to escalate complaints from the increased number of borrowers who will contact my office to try and save their homes. I want my office to be in a position to direct these borrowers to the new and expanded resources available under the settlement.

In addition, as one of the Attorneys General that negotiated this settlement, I expect to be involved in the monitoring and continued enforcement of this complex settlement. My office will serve on the monitoring committee. The monitoring committee is composed of state and federal representatives who will work with the court appointed monitor to ensure that the servicing companies comply with the settlement, including the numerous servicing standards and other relief that is provided under the settlement.

To meet these various needs I propose to add three lawyers who will serve for three years to accomplish these various objectives. These lawyers will be employed on a temporary basis and paid an hourly rate.