California AG, Kamala Harris Interview of Rich Rydstrom, Esq. by Phil Hall June 2012

California budget deficits are serious and need a comprehensive plan to solve. However, taking monies from the recent AG mortgage settlement should be off-limits. The California Commitment fashioned by California AG Harris, is a significant improvement from the original National Settlement. Funds and benefits earmarked for the benefit of California homeowners and investors (CalPERS) should not be subsumed into the state budget deficit reduction efforts. California homeowners will suffer from loss of funds necessary to provide homeowner relief – guaranteed – by The California Commitment.

California AG, Kamala Harris obtained certain benefits for the California homeowner and investor, including the preservation of the rights to file lawsuits against the banks/servicers. The California Commitment, although, an improvement over previous efforts, is far from sufficient to solve California housing issues due to wrongful banking and issuer conduct. Just as the National Settlement would not sufficiently redress the wrongs, the $18 billion California Commitment will not materially act to stabilize the California housing markets, or redress homeowners or investors (i.e.: CalPERS).

However, AG Harris understands that to make a significant impact in California (and redress losses for California major investors like CalPERS), Fannie and Freddie must supply payment relief (by principal reduction) to its homeowners, since 62% of California mortgages are owned or insured by Fannie and Freddie. AG Harris preserved the false claims lawsuits which should eventually result in additional redress for California pensions and investors.

The California Commitment does call for a *verification* of the banks promises, adding teeth to the hope and promises which were received in the prior Countrywide settlement. The California Commitment generally calls for a:

- $12 billion in principal reduction and short sale relief for California homeowners;
- $1 credit to banks if and only if the homeowner actually receives that $1 (in principal reduction and or short sale); unlike Countrywide deal that banks got credit for the promise;
- Refinance for homeowners who are current but underwater ($850,000,000);
- Hardest hit communities have priority (built in from banks by incentives and penalties);
- Restitution for foreclosed homeowners ($279,000,000)
- Los Angeles should receive about $4 billion;
- Mortgage Fraud Strike Force against licensed Attorneys/Brokers (Predators; Bottom Feeders)

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Problem: Principal reduction and or short sale are competing social solutions;

California AG, Kamala Harris was correct to hold out for more money for principal reduction, and continue to demand principal reduction from Fannie and Freddie.

The national offer was that $10 billion (of the $25 billion) was allocated to principal reduction. However, it was insufficient to make a meaningful impact. In a congressional hearing on April 13, 2010, David Lowman, chief executive of Chase's mortgage business estimated that 'reducing loan balances so no homeowners would owe more than the value of their homes would cost up to $900 billion – with 150 billion of that borne by the government.' After the hearing, the police had to escort and protect Mr. Lowman out of the Rayburn House as consumer groups chased him through the hallways. Recently, Edward J. DeMarco, acting director, FHFA, released a report "concluding that principal forgiveness did not provide benefits that were greater than principal forbearance." He estimated that forgiving mortgage debt could cost the government-supported companies almost $100 billion. If the average homeowner underwater owes approximately $52,500 over the current fair value of the home, then exposure is approximately $520.5 billion. We need more than $10 billion to deal with this issue.

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It is no secret that AG Harris has called for DeMarco to step aside. She is demanding that Fannie and Freddie make principal reductions available in California (which holds or insures 62% of its mortgages). I agree with the California AG (Harris) that principal reduction (or forgiveness) should be implemented by DeMarco (FHFA).

If $10 billion was not sufficient on the national basis; the final $12 billion received by AG Harris for California sounds like a significant improvement in settlement terms for the people of California. ***However, we must note that this figure includes "principal reduction and short sale relief" for California homeowners. How much will go to principal reduction, which keeps homeowners in their home, compared to short sale relief which moves homeowners out of their home?***

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Can principal reductions with this create strategic default problems?

Strategic default problems are already here. If there are an estimated 11,300,000 loans with Negative

Equity (First American CoreLogic), default and strategic default will continue to materialize; especially as prices continue to decline and there is no housing recovery in sight. In this context, the question is whether principal reductions can be used to shift incentives to “stay and pay.” The answer is simple: yes, if the borrower is offered a payment within a range of his true ability to pay, and equity is visible or realizable to the borrower within certain time parameters. Principal reductions and forgiveness can be a viable solution if all interested parties are incentivized therefrom. SAMs would be a key element of the success of such a solution. Recently, Sen. Robert Menendez (D-New Jersey) introduced a bill entitled, Preserving American Homeownership Act which would have banks write down principal to 95 percent of the new fair market value. This reduction would take place over a three-year period upon the borrower continuing to make timely payments. In this proposal, the bank would get a fixed claw-back, not to exceed 50% of the appreciation at 1st transfer, and the percentage would be equal to the percentage of reduced principal (i.e.: 20% for 20%).

Principal Reduction/Forgiveness Examples:

In this context, the question is whether principal reductions can be used to shift incentives to “stay and pay.” If $900 billion of principal is underwater, 25% of Forgiven Principal (or $187,500,000,000) could result in 33% claw-back for each participant (or $187,500,000,000 to lender and $187,500,000,000 to investor/insurer, and same to borrower).

Principal Writedowns

Total Underwater Principal $900,000,000,000

Government Cost (in $900b) $150,000,000,000

Private Cost/Exposure $750,000,000,000

Savings to Lenders / Investors

Example 1 - 25% Forgiven Principal - 33% Shared Appreciation

The following example assumes that 25% of the principal is forgiven and the remaining portion might be regained in future appreciation of properties and as such is held in quarantine to be shared equally by the lender, borrower and an Insurer/Investor. Under this scenario the Lender/Investors would save $187 billion using QBSam™.

Assume 25% Forgiven Principal - 33% Shared Appreciation

Forgiven Principal – Loss/Outset 25% $187,500,000,000

Quarantined (Deferred) Principal /

Remaining Negative Equity / 75% $562,500,000,000

Potential Shared Appreciation /

Reduced Loss Write-off Amounts at Outset

QBSam™ Clawback Allocations / Reduced Loss Write-off Amounts at Outset

Borrower share of clawback 33.3% $187,500,000,000

Lender/Investor share of clawback 33.3% $187,500,000,000

Insurer/Investor (Govt; Private) share of clawback 33.3% $187,500,000,000

Another solution would be the solution that Richard Rydstrom discussed with Wilbur Ross at the DC Executive Leadership Summit in June of 2008; which is as follows:

Public – Private Guarantee Solution: (Wilbur Ross and Richard Rydstrom June 2008)

- Set up an insurance guarantee program.
- The government would guarantee 50% of the mortgage that had been reduced to true net value after selling commissions, etc.
- The guaranteed amount (50% government amount) could be separately sold by holder/lender at a much lower yield than the mortgage itself.
- Enable the holder/lender to pay a 2 ½% per year Insurance Fee to the government.
- At first sale, share proceeds of appreciation as follows:

1/3rd to Government 1/3rd to Lender/Holder 1/3rd to Borrower (Homeowner)

- Making it transferrable/assumable will lessen the need for new replacement mortgage.
- The 50% can come over to the next owner from the government guarantee at low rates and supply liquidity to the original lender.