July 13, 2011

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Dawn McFarland
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed a proposed constitutional amendment related to home foreclosures, mortgage loan modifications and refinancing for home or other property, and payment of property taxes and assessments (A.G. File No. 11-0014).

Background

Loans Used to Purchase Homes and Other Property. Loans to purchase residential real property, such as single-family homes or other property, are typically secured by a mortgage and are executed through contracts. Mortgage loans typically are repaid in installments over a set period of time, such as 30 years. Generally, information such as a person's credit history, income, debt, and savings are reviewed by the lender to qualify an applicant for a mortgage loan. Typically, for commercial mortgages, information such as how long a business has been established, and financial documents such as tax returns, are reviewed by lenders to qualify an applicant for a commercial property mortgage loan. This information is used to assess the risk associated with lending money and the likelihood that the lender will receive mortgage payments on time. Mortgages are used as collateral that give the lender the authority to foreclose and sell the property to pay off the debt if a borrower fails to pay back the loan.

Due to the recent recession, many property owners are having trouble making payments on their loans. Under current law, if a borrower requests a change to the loan because he or she is having trouble making loan payments, their lender may voluntarily take such actions as modifying the terms of the loan to make it easier for the borrower to continue making payments. This process may involve a review by their lender of current information about the financial circumstances of the borrower, such as recent credit reports. A lender may also meet with a borrower to discuss the terms and conditions of a possible loan modification.

Property Taxes, Other Assessments, and the Teeter Plan. The property tax is a major source of revenue for California's local government: school districts, community colleges, counties, cities, redevelopment agencies, and special districts. The property tax applies to all classes of property such as residential, commercial, industrial, agricultural, and open space and is based on the assessed value of the property. County auditors distribute property tax revenues to local agencies pursuant to various statutory formulas.

The county tax collector is responsible for preparing property tax bills. Currently, property taxes are due in two equal installments. The first installment is due on November 1 and is automatically deemed delinquent if it is not received by December 10. The second installment is due on February 1 and is delinquent if not paid by April 10. If taxes are not paid by the delinquency date, the property owner is subject to a 10 percent penalty.

Most counties in California participate in the Teeter Plan, whereby county auditors send eligible local governments the equivalent of the full amount of their share of the assessed value of the taxable property in their jurisdiction rather than the actual amount of taxes that are ultimately collected on their behalf. In exchange for these "advances," counties are authorized to collect and keep the actual amounts eventually collected from property taxpayers as well as penalties paid by delinquent taxpayers. This arrangement has the effect of generating additional revenue for the counties because the actual property tax collections, together with the penalties paid by delinquent taxpayers, ordinarily exceed the amounts the county pays to eligible local entities.

Often, property tax bills include other types of qualified special taxes or fees, such as parcel taxes. A parcel tax is a flat fee assessed on each parcel rather than on the assessed value of the property. Parcel taxes are usually adopted by local government agencies for a specified purpose, such as to provide additional funding for school programs or to build a local facility.

Proposition 98 Minimum Education Funding Requirement. Proposition 98, an initiative state constitutional amendment enacted by California voters in 1988, established a minimum funding requirement for kindergarten through twelfth grade (K-12) schools and community colleges. In the long run, under the proposition, the school funding requirement grows with the economy and student attendance. The state meets the Proposition 98 requirements through a combination of state General Fund and local property tax revenues. The state can suspend the Proposition 98 requirement for one year with a two-thirds vote of both houses of the Legislature.

State and Federal Regulation of the Mortgage Loan Industry. In California, the Departments of Corporations, Financial Institutions, and Real Estate regulate different facets of the mortgage loan industry. Some financial institutions—mainly banks, and savings and loans—are regulated by the state and others are regulated by federal agencies. Financial institutions can choose to operate under a federal charter or a state charter, meaning they can decide if they want to be an institution subject to regulation by either the federal government or state government. In many cases, federal laws and regulations applying to federally chartered lenders "preempt," or override, state laws and regulations that might otherwise apply.

Federal and State Constitutions Constrain Certain Governmental Actions. The U.S. Constitution and the State Constitution prohibit the enactment of laws that interfere with or change the terms of existing contracts, such as those used to execute property loans. The U.S. Constitution and the State Constitution also require that owners of property that is taken to be fairly compensated for a loss caused by a governmental action.

Proposal

This measure enacts new provisions of the State Constitution that are intended to create a new constitutional right for Californians to purchase and own homes and real property, prohibit foreclosures on homes and other property, ensure that borrowers can obtain a loan modification or refinancing of their loans under specific conditions, and allow homeowners to avoid penalties for late payments of property taxes and other charges assessed by state and local government agencies.

Creation of New State Constitutional Right. The measure makes it a state constitutional right for every Californian to purchase and own a home and real property, and directs the state and local agencies to assist and encourage the ownership of homes and other property.

Prohibitions on Foreclosures and Requirements for Assistance and Changes to Loans. Under this measure, lenders would be prohibited from foreclosing on the personal home or other property owned by a citizen of California. If a borrower was not able to make mortgage payments on time due to financial hardship or illness lenders would have to assist borrowers. If local property values dropped by more than 10 percent, lenders would be obligated to reduce the amount of principal owed by the borrower as well as (1) reschedule payments, (2) reduce the interest rate on the loan, and/or (3) refinance the mortgage in order to bring the loan current (in other words, to restore the loan to good standing). This measure specifies that the lender could not take the credit history of the borrower into account as it complied with these various requirements.

Requirement for Refinancing of Property Loans Under Certain Circumstances. In addition to the refinancing requirements discussed above, this measure would further require lenders to refinance a mortgage or other property loan in any case in which the original borrower who has maintained the loan for at least three years makes such a request. Lenders would be required to refinance the loan within 45 days of the request without reviewing the borrower's credit history. The lender could not impose a penalty on the borrower, and the refinanced loan would be made "at minimum cost." The measure also states that all borrowers would have the right under this measure to meet in person with an agent from the lending institution who is authorized to make changes to the terms of the loan.

Requirements to Assist Homeowners With Paying Property Taxes and Other Charges. As noted above, local agencies impose various types of assessments of property taxes, fees, and other charges on property, including homes. This measure would require local governments to "make every effort possible" to assist homeowners in the payment of current or late property taxes or other assessments so that they can retain their home or other property. The measure specifies that this can, in some cases, include actions to allow for payments on a weekly or monthly schedule without the assessment of penalties or interest on late payments.

Uncertainty Whether, and to What Extent, Some Provisions of This Measure Would Apply. In some respects, this measure appears to conflict with provisions of the U.S. and State Constitutions as well as certain federal laws and regulations governing federally chartered lending institutions. In other cases, the measure does not specify how it would be implemented.

Thus, there is considerable uncertainty whether and to what extent certain provisions of this measure would go into effect.

For example, the provisions of this measure prohibiting foreclosures and requiring lenders to modify and refinance existing loans appear to conflict with provisions of the U.S. and State Constitutions that prohibit interference with existing contracts, including those used to execute mortgages and other property loans. These provisions of this measure may also conflict with provisions in the U.S. and State Constitutions requiring just compensation for the taking of private property as a result of government actions. That is because lenders could face losses as a result of the provisions of this measure requiring refinancing of property loans when property values drop by 10 percent. This measure does not provide a mechanism for lenders to be compensated for these losses. These provisions of the measure may also not apply to lenders operating under a federal charter, since federal laws and regulations preempt state laws and regulations that would otherwise apply to these lenders.

Finally, this measure does not specify how the new state constitutional right of Californians to purchase and own a home and real property would be implemented.

Fiscal Effects

This measure is likely to result in a significant loss of property tax and other types of fee and assessment revenues to local governments. The measure could also require the state to offset the loss of property tax revenues to schools, thereby increasing state costs. We discuss these and other potential fiscal effects of this measure below.

Potential Impacts of Loan Provisions on State Revenue. The provisions of this measure prohibiting foreclosures and requiring modifications and refinancing of certain loans could reduce the amount of corporation tax revenues that the state recieves. Specifically, the loan modifications, refinancings, and prohibitions on foreclosures required by this measure could potentially reduce the interest and principal payments that borrowers would otherwise make to lenders that are regulated by the state. This could result in lower profitability of these lenders and, as a result, reduce the amount of corporation taxes lenders pay to the state.

However, as noted above, provisions in the U.S. and State Constitutions and other federal laws relating to the regulation of lenders are likely to limit the effects of these provisions. Moreover, lenders that currently operate under a state charter would likely choose to operate in the future under a federal charter to avoid having to comply with the provisions of this measure. As a result of these factors, any reduction in state corporation tax revenues would likely be minimal.

Fiscal Impacts on Revenue From Property Taxes and Other Charges. This measure could significantly reduce the amount of property tax revenues and other assessments collected by various local government agencies. The provisions in this measure relating to the waiver of penalties and interest payments on property taxes and other fees and levies would likely prompt some homeowners to cease making such payments because they might no longer have to pay penalties or interest on what they owe to local agencies. Counties that currently collect property taxes on behalf of other local agencies under the Teeter Plan would lose some revenues they now collect in the form of interest and penalties for the late payment of property taxes.

The fiscal impact of these provisions is unknown and cannot be estimated at this time, but would likely be significant on a statewide basis. If these provisions resulted in a 10 percent decline in the collection of property tax revenues, for example, the collective loss of revenues to local agencies could amount to about $4.5 billion annually on a statewide basis.

The reduction in property tax collections for schools could also increase the state's costs for meeting its Proposition 98 obligations. For example, if there was a 10 percent reduction in the collection of property taxes for schools, the state might have to replace these monies with an increase of $1.4 billion in spending from the state General Fund to meet the Proposition 98 requirement unless that requirement was suspended.

Summary of Fiscal Effects

Our analysis of the fiscal effects of this measure is as follows:

- The fiscal impacts of some provisions of this measure are uncertain because of potential conflicts with provisions of the U.S. and State Constitutions and federal laws and regulations governing federally chartered lenders.
- Potential losses to local governments up to a few billion dollars annually in revenues from property taxes and other types of fees and assessments.
- Potential state costs up to the low billions of dollars annually to replace the loss of property tax revenues now used to meet the Proposition 98 education funding requirement.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance