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The Cost of Defaulting

Roger Bernhardt

The legal issues covered in *Holbert v Fremont Inv. & Loan* (reported at p 19) are less interesting than some of the facts that generated them. Before 2003, Holbert's house was subject to a deed of trust in the amount of \$121,250 (a fact not stated in the opinion but mentioned in Fremont's brief). In 2003, she refinanced that loan with a new loan from Ameriquest for \$144,500; in 2004, she refinanced with a loan from World Savings for \$153,750; in 2005, she refinanced with a loan from New Century for \$204,000; and then, finally (?) in 2006, she refinanced with a loan from Fremont for \$265,000. (All numbers have been rounded by me.)

Along the way, it appears that Holbert paid over \$30,000 in loan fees for those refinancings, the final charges being the foundation of her claims for Truth-in-Lending Act and Home Ownership and Equity Protection Act (HOEPA) violations (as well as Fin C §4973, unfair business practices, and elder abuse). If all of the previous refinancings had been done by one lender, their cumulative impact might well have been great enough to support those claims, but since the challenge went only to the particular charges imposed by Fremont—her last lender—the fact that that involved paying off some of her different previous lenders meant that they were not the sort of items included in a HOEPA calculation, with the result that Fremont's loan did not come under its statutory prohibitions and requirements. So, she may have paid too much, but her treatment was not predatory.

Holbert's loan history is interesting and instructive, whether or not it was predatory. If her mortgage balance started at around \$121,000 and ended at \$265,000, her debt burden ballooned by about \$144,000 during her four years of refinancing. According to the opinion, she received from these refinancings, respectively, \$18,000, \$5000, \$6000, and \$31,000—about \$60,000 in cash. (Fremont's brief says that she also had obligations to other unsecured creditors of \$32,000 that were paid off, making for a total of over \$90,000 of income to her.)

Holbert's loan fees of \$30,000-\$40,000 were surely high, but all of those fees were paid not out of her pre-loan pocketbook, but rather out of loan proceeds that came from her lenders. That amount would be too high if she herself had to pay them back, but what if she doesn't have to do so?

Holbert's brief declared that her house had a value of only \$240,000 at the time of the final refinance with Fremont, making it worth considerably less (by \$25,000) than what she then owed on that mortgage. If that number is accurate, then Holbert had no equity in the property that she will lose on foreclosure. True, Fremont may have a technical possibility of obtaining a deficiency judgment, but that is not a realistic possibility. Even assuming that a refinance eliminates the ability of a borrower to defend on §580b purchase-money antideficiency grounds (a possibility I do not consider as well-settled as most lenders hope), it is still unlikely that a rational lender would want to go through the hoops of a judicial foreclosure action and the uncertainties of a fair value hearing (especially considering that someone thought the property was worth the amount of the loan just a short while earlier) just to obtain a small money judgment against a widow with

no outside wealth and living on Social Security. So, Holbert may lose her house, but that is probably the total extent of her loss. I am not sure that this was such a bad deal for her.

Indeed, if Holbert had gone to a loan modification counselor three years earlier, she might have been advised to follow a strategy not that different from what she did end up doing—*i.e.*, pulling as much equity out of the property as possible, while she could, and then just walking away at the end. Lawyers might feel uneasy in telling debtors to do that, but we all know that such advice is often given. When there is equity in the house but insufficient income to continue servicing the mortgage, and both sales and property values are declining, no choices are very appealing.

To all this, it should be added that the opinion does not say what has been happening to Holbert's mortgage while the lawsuit has been going on. There is no mention of any foreclosure proceeding being prosecuted by the lender, and it is unlikely that Holbert has been paying her mortgage while she was litigating over it. I doubt that any loan counselor would advise Holbert to continue paying off a \$265,000 mortgage on a \$225,000 house, regardless of the predatory lending issues. Given those numbers, a debtor would be better off financially by moving out and getting into a rental (or a lower-priced purchase) that her monthly income can handle. There is, no doubt, the embarrassment and perceived immorality of not paying one's debts, but the cost of preserving a reputation may be too high.

Holbert v Fremont Inv. & Loan (2009) 179 CA4th 1067, ___ CR3d ___

In June 2006, Carolyn Holbert sued her lender, then Fremont Investment Loan, and her loan broker, Samantha Pham, owner of California Real Estate Investments & Loans, Inc. (CREIL), for violation of the federal Truth in Lending Act (TILA) (15 USC §§1601–1693r), as amended by the Home Ownership and Equity Protection Act of 1994 (HOEPA) (15 USC §§1602(aa), 1639). The trial court found that HOEPA was inapplicable and granted summary judgment for Fremont on the several claims based on HOEPA. Holbert obtained terminating sanctions against Pham and CREIL and, after entering their defaults, obtained a judgment against them. In December 2007, the trial court entered judgment of dismissal in favor of Fremont. The court of appeal affirmed in an opinion certified for publication as to Part II concerning the HOEPA claims.

Between her husband's death in 2003 and February 2005, Holbert refinanced her home loan three times to pay off the prior loans, other debts that had accrued since the last refinance, and the fees and charges of the new loan. The first refinancing was with Ameriquest in 2003; the second with World Savings in June 2004; and the third with New Century Mortgage in February 2005. Holbert's monthly payment on the New Century loan was \$943.50. In 2005, Holbert was over age 65, unemployed (though previously certified as a notary), and living on Social Security benefits of \$1137 per month. Having decided that she could not afford the monthly payment, Holbert listed her home for sale in June 2005.

On June 7, 2005, Holbert informed an employee of CREIL of her fixed income and that Holbert was interested in refinancing only if it would reduce the monthly payment pending the sale of Holbert's home. On July 1, 2005, Holbert informed Pham of Holbert's current monthly payment, fixed income, and need for a single payment including taxes and insurance. Pham assured Holbert that the Fremont loan application and documents would be consistent with the information provided to CREIL by Holbert, that the loan proceeds could be used to make

monthly payments on the loan pending sale, and that Pham would assist Holbert in selling the refinanced home. The loan application submitted by Pham listed the value of Holbert's home as \$265,000 and represented Holbert's monthly income as including \$4800 per month as a self-employed notary. The Fremont loan documents provided for a \$265,000 loan, listed the debts to be paid, including \$4528.80 owed to Wells Fargo Bank, and disclosed a \$4528.80 penalty for prepayment of the New Century Loan. The monthly payment on the Fremont loan was over \$1900, taxes and insurance were not included, and the loan included a penalty for prepayment within two years. Holbert was unsuccessful in selling the house and Pham provided no assistance. Fremont refused to waive the prepayment penalty and refused to consider a short sale. Most of the loan proceeds were used to make monthly payments to Fremont.

Holbert argued that the costs of paying the Wells Fargo loan, the New Century prepayment penalty, and the notary fee paid to Pham were finance charges associated with the Fremont loan, that those charges brought the total finance charges above the 8-percent threshold triggering application of the HOEPA disclosures, and that Fremont had failed to supply the required disclosures. The court of appeal concluded that the charges could not be included in the total costs and fees for the Fremont loan. The payment of the preexisting Wells Fargo loan could not be included because it did not constitute the creation of a new financial obligation. The prepayment penalty imposed by New Century was a charge associated with the New Century loan, not the Fremont loan. The \$300 notary fee paid to Pham could be excluded if reasonable and not paid to the lender or an affiliate. However, the facts regarding the notary fee did not need to be determined; if included, the notary fee alone would not cause the finance charges to reach the 8-percent HOEPA threshold. Therefore, the claims based on HOEPA failed.

The court also concluded that, to the extent Holbert relied on misrepresentations in agreeing to the Fremont loan, the misrepresentations were made by Pham and CREIL and not by Fremont.