



Foreclosures in California: Causes and Solutions

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**Paul Leonard
California Office Director
(510) 379-5500**

Center for Responsible Lending



Promoting policies and practices that encourage fair access to credit for low-wealth families

Durham, NC Washington, DC Oakland, CA

Self-Help



Creating and protecting ownership and economic opportunity for people of color, women, rural residents and low-wealth families and communities

Summary Points

- California is Ground Zero for America's Foreclosure Crisis

- How did we get into this mess?

- What should we do?
 - Industry
 - State Policy
 - Federal



I. California is Ground Zero for Foreclosures

What is Subprime Lending?

Higher-Cost Loans to Borrowers

- With Imperfect Credit
- Borrowing More Than They Could Otherwise Afford

Record and Growing Levels of Foreclosures



- CRL's Losing Ground, December 2006
 - 2.2 million foreclosures nationwide, nearly 500,000 in CA
 - One out of 5 borrowers.
- Record Levels of CA Foreclosures:
 - DataQuick: Roughly 100K in 2007
- Central Valley, Inland Empire Lead Nation
 - Stockton #2
 - Modesto #3
 - Merced #4
 - Riverside-San Bernardino #5
 - Bakersfield #7
 - Vallejo-Fairfield #8
 - Sacramento #9

Source DataQuick; RealtyTrac

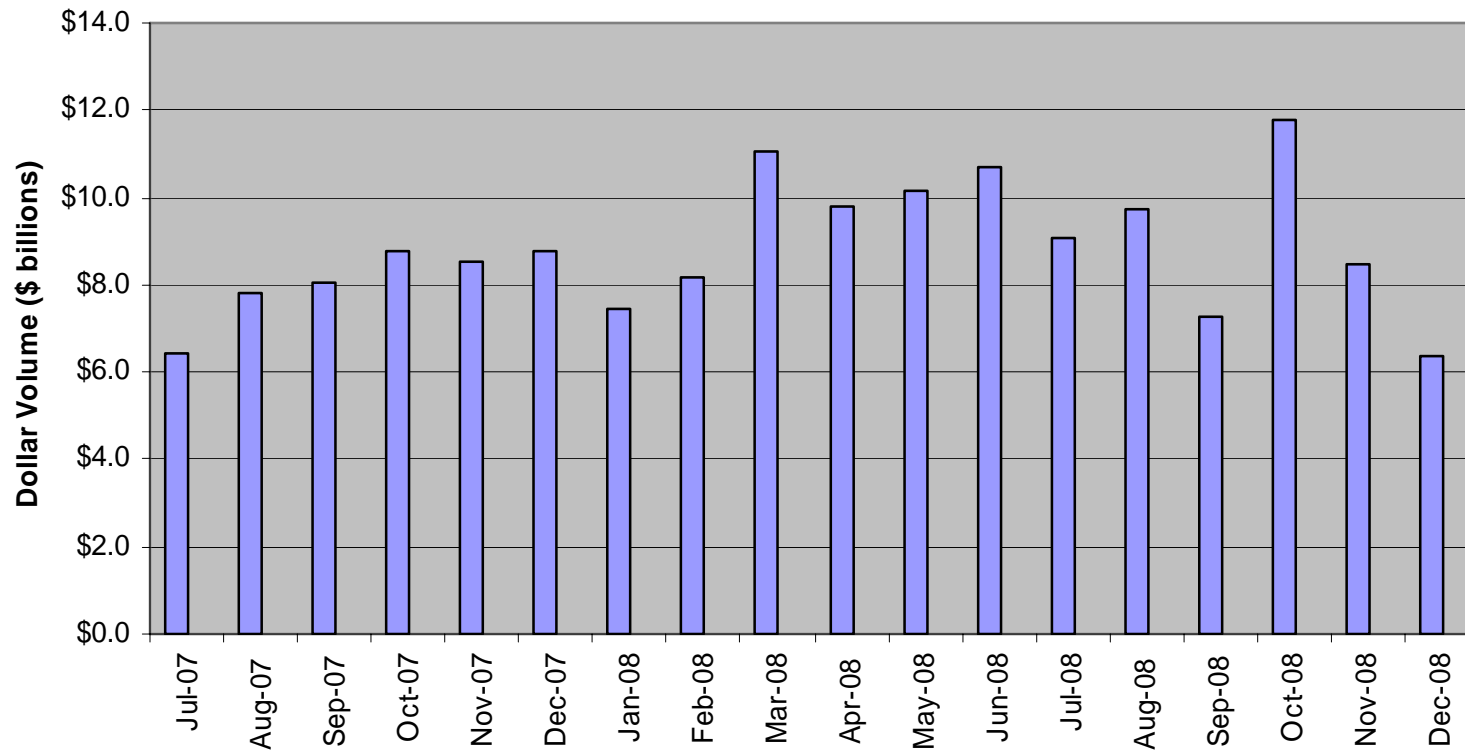
Subprime Foreclosure Spillover Effects



- **355,682** metro homes with subprime loans expected to be lost in 08-09
- Spillover: Neighbors Homes Devalued
 - **7.5 million** homes experiencing value declines as a result of nearby foreclosures
 - **\$107 billion** in loss of home value
 - \$14,300 average loss

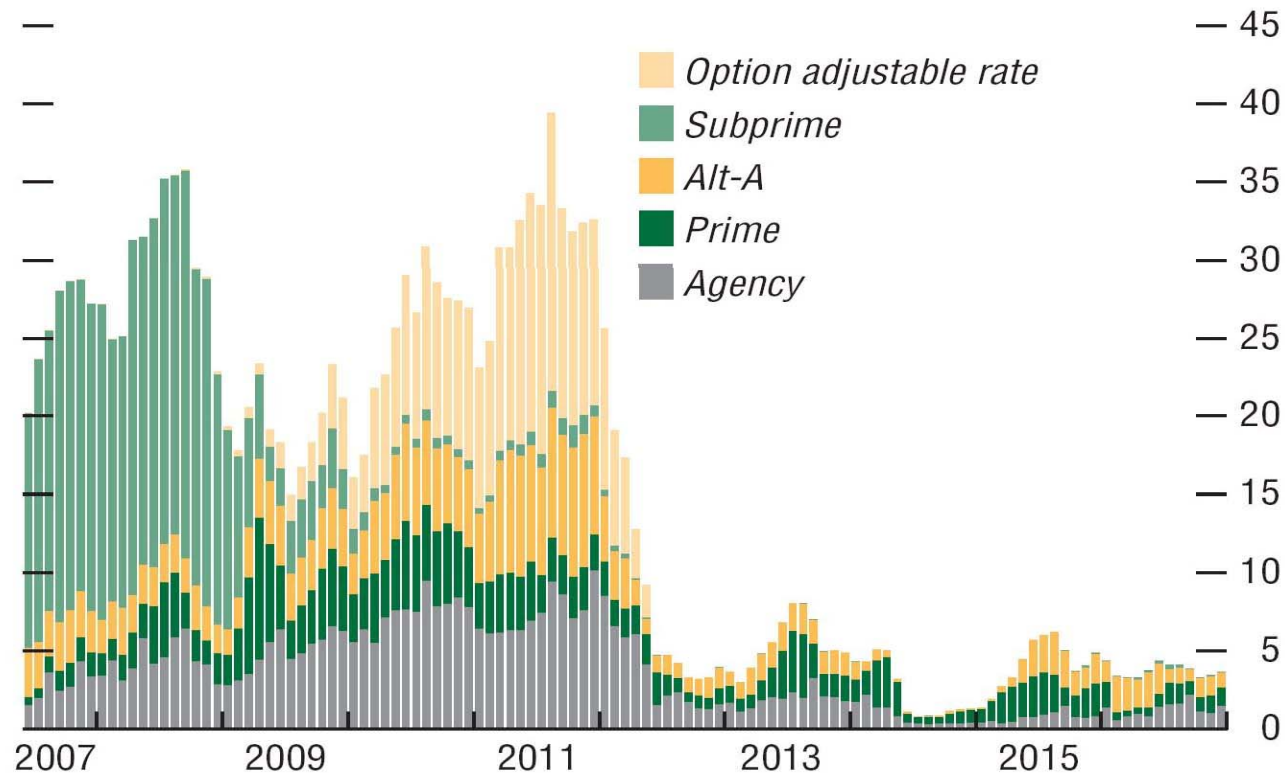
The Crisis Will Worsen

CA Subprime ARM Reset Volume



2nd Wave of Alt-A & Option ARMs in 2010 - 2012

Figure 1.7. Monthly Mortgage Rate Resets
(First reset in billions of U.S. dollars)



Source: Credit Suisse.



II. How did we get into this mess?

My Mother's Mortgage Market



- **Products:** Mostly 30-year fixed; Limited ARMs
- **Underwriting:** Manual, Labor-Intensive, Lengthy
- **Lenders:** Banks and S&Ls; Hold in Portfolio
- **Profits:** Interest Spread
- **Underserved:** Redlining, high denial rates and lower homeownership rates for minorities and those with imperfect credit

21st Century Subprime Mortgage Market



- **Products:** Many options, multiple features, risk layering.
- **Underwriting:** Automated, instantaneous, heavy reliance on credit scores
- **Lenders:** Mostly non-depositories, most originated by brokers, sell loans to Wall Street
- **Profits:** Volume = Transaction fees and sales to secondary markets
- **Underserved:** “If you can fog a mirror ...,” Prepayment Penalties, Flipping

Three Core Problems

- Lax and declining underwriting standards
- Misaligned incentives hurt borrowers
- Lack of accountability

I. Lax Underwriting: Risky Borrowers Get the Riskiest Loans



2006 CA Subprime Loans

- Exploding ARMs: 98%
- Stated incomes: 56%
- No escrows: 75%
- Piggybacks: 80%
- Prepayment penalties: 80%
- Other Key Facts
 - Refinance: 50%, only 10% for new homeowners
 - Broker-Originated: 80%
 - State/HUD-Regulated Lender: 60%

California's Communities of Color Most Likely to Get High-Rate Loans



	<u>Number</u>	<u>%</u>
■ African-American	47,559	44.3%
■ Latino	241,087	42.1%
■ White	149,678	19.4%

(2006 HMDA data)

Even after controlling for credit risk, African-American and Latino borrowers more than 30 percent more likely to receive a higher-rate loan than white borrowers with the same qualifications. (CRL, *Unfair Lending*, 2006)

II. Financial Incentives Reward Risky Loans



- Broker Kickbacks for Higher Rate Loans, aka “Yield Spread Premiums”
- Prepayment Penalties
- Steering: 20-60% of subprime borrowers appear to have prime credit statistics

III. Current Market Structure Lacks Accountability



- Brokers
- Lenders
- Wall Street
- Ratings Agencies
- Investors
- Servicers



III. What Should We Do?

Industry: Empty Promises So Far



- Voluntary modifications are best answer
- Limited success to date
- Obstacles have been insurmountable:
 - Inadequate Servicer Capacity
 - Servicer Incentives
 - Threat of lawsuits
 - 2nd Liens

State Policy Reform: Helping Current Borrowers



- Servicer Data Reporting: AB 69 (Lieu)
- Foreclosure Process Reform: SB 1137
 - Requires meeting between servicer and borrower
 - Extended tenant notification before eviction
 - Fines for failure to maintain properties

Preventing Future Problems: Comprehensive Predatory Lending Reform



- Package of Bills Originating in the Assembly
 - AB 1830 (Lieu): Underwriting and Incentives
 - AB 2880 (Wolk): Brokers
 - AB 2740 (Brownley): Servicers
 - AB 2359 (Jones): Assignee Liability
 - AB 512 (Lieber): Document Translation

Federal Policy



- Federal Bankruptcy Reform:
 - 600,000 homes saved (as many as 89,000 in California)
 - Same protections already provided for family farms, commercial properties, and other debts
 - No impact on cost of credit
- Federal Predatory Lending Reform: Dodd S. 2452 offers strongest measure w/o state pre-emption
- Frank/Dodd: Broad FHA Refinance Tool

Contact



Paul Leonard

California Director

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Paul.Leonard@responsiblelending.org

510-379-5500

www.responsiblelending.org