## Foreclosures and the California Housing Market

Monday, May 16, 2011
State Capitol, Room 113
1:30 PM

## Background Paper

California homeowners continue to lose their homes to foreclosure in unprecedented numbers. In the first three months of 2011 alone, banks filed 68,239 notices of default on California residents, according to DataQuick Information Systems Inc. While this figure represents the lowest quarterly level in three years, explanations and future forecasts differed. A recent Los Angeles Times article stated, "The drop was an indication that the worst of the foreclosure mess is probably over and a much-feared second wave of bank-owned properties is unlikely, analysts said." [1] As cited in a Bloomberg article, however, real estate information service firm RealtyTrac Inc. explained the drop in foreclosure filings as the result of lenders working through a backlog of flawed paperwork and predicted that filings are likely to jump 20 percent this year, reaching a peak for the housing crisis.[2] Analysts cited in both articles agreed that foreclosures will probably remain a considerable part of the California market for years to come as the mortgage industry and government officials continue to sort through the aftermath of the housing bust.

The foreclosure crisis was the catalyst for the economic recession and is a significant contributor to California's on-going economic malaise, as the high number of foreclosed homes for sale has reduced home sale prices across the board and held back the homebuilding industry.

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[1] http://articles.latimes.com/2011/apr/20/business/la-fi-foreclosures-20110420.
[2] http://www.bloomberg.com/news/2011-05-09/u-s-underwater-homeowners-increase-to-28-percent-zillow-says.html.

**Purpose of the Hearing**

Given the severe impact that foreclosures have on families that lose their homes and the effect that foreclosures continue to have on the California economy, this hearing is intended to update legislators on the state of the California housing market, review what California and other states have done to address the foreclosures crisis, and discuss what more can or should be done.

**The State of the California Housing Market**

As with all other markets, the housing market reflects supply and demand. Since the housing bubble burst in California, housing construction (new supply) has plummeted, dropping from 164,000 new units in 2007 to 36,000 new units in 2009, the lowest total since records have been kept. Population growth in California, on the other hand, has decreased only slightly. So what explains this lack of demand for housing? Is demand likely to rebound any time in the near future? What will future housing demand look like?

Stephen Levy will delve into these questions during the hearing. He is the Director and Senior Economist of the Center for Continuing Study of the California Economy, a private research organization founded to provide an independent assessment of economic and demographic trends in California.

**What California Has Done to Address Foreclosures?**

In the wake of the unprecedented wave of foreclosures, California has adopted various legislative and administrative strategies to facilitate loan modifications and keep as many families in their homes as possible. The committee will hear from Corporations Commissioner Preston DuFauchard on the implementation of recent foreclosure-related legislation, from Senior Assistant Attorney General Frances Grunder on enforcement efforts, and from California Housing Finance Agency Executive Director Claudia Cappio on the agency's Keep Your Home California Program.

*Recent California Legislation*

In an effort to help those who may avoid foreclosure, the Legislature has enacted three bills over the last three years to facilitate loan modifications between lenders and homeowners prior to foreclosure.

*SB 1137 (Perata, Corbett, Machado), Chapter 69, Statutes of 2008.* This bill, among other things, requires the lender or servicer of a loan to contact the borrower, or to try with due diligence to contact the borrower, at least 30 days prior to filing a notice of default (NOD). This is intended to give the lender or servicer an opportunity to assess the borrower's financial situation and explore options that would allow the borrower to avoid foreclosure. SB 1137 also requires that lenders advise borrowers of their right to request a subsequent meeting with the lender or servicer and provide borrowers with a toll free number to find a HUD-certified housing counseling agency. These provisions of SB 1137 apply only to loans originated between January 2003 and December 2007 that are secured by owner-occupied residential real property and to situations in which the borrower has not filed for bankruptcy, surrendered the property, or contracted with an entity to extend the foreclosure process.

*SBx2 7 (Corbett), Chapter 4, Statutes of 2009, and ABx2 7 (Lieu), Chapter 5, Statutes of 2009.* Known as the California Foreclosure Prevention Act, these bills, until January 1, 2011, provided additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan servicers that have implemented a comprehensive loan modification program. Specifically, these bills added 90 days to the period of time between an NOD and a notice of sale, unless the loan servicer had received an exemption by demonstrating to the appropriate commissioner that the servicer had implemented a comprehensive loan modification program. The law required servicers desiring an exemption to apply to the departments of Corporations, Real Estate, or Financial Institutions. In order for a servicer to qualify for an exemption, its comprehensive loan modification program must:

- Endeavor to keep borrowers whose principal residences are homes located in California in those homes when the anticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis.
- Target a ratio of the borrower's housing-related debt to the borrower's gross income of 38 percent or less on an aggregate basis in the program.
- Include some combination of the following features:

    - An interest rate reduction for a fixed term of at least five years.
    - An extension of the amortization period for the loan term, to no more than 40 years from the original date of the loan.
    - Deferral of some portion of the principal amount of the unpaid principal balance until maturity of the loan.
    - Reduction of principal.
    - Compliance with a federally mandated loan modification program.
    - Other factors that the commissioner determines are appropriate, including efforts implemented in other jurisdictions that have resulted in a reduction in foreclosures.

According to the Business, Transportation and Housing Agency's latest report, over the life of the program 120 loan servicing institutions received an exemption. From June 15, 2009 through September 30, 2010, the number of modifications reported to the departments totaled over 171,000. Of those modifications, approximately 114,000 reflected monthly payment reductions to borrowers to less than the payment prior to the modification.

*Keep Your Home California Program*

Under its Hardest Hit Program, the federal government has allocated $2 billion to the California Housing Finance Agency (CalHFA) to prevent foreclosures. CalHFA has branded its program as the Keep Your Home California Program and is using the funds for the four purposes described below, three of which are intended to prevent foreclosures and keep families in their homes. The fourth program is intended to assist in relocating families whose homes cannot be saved. While families can receive assistance from more than one of the programs, no family may receive more than $50,000 worth of assistance.

- The Unemployment Mortgage Assistance Program (UMA) assists homeowners who have experienced involuntary job loss. UMA provides temporary financial assistance in the form of a mortgage payment subsidy of varying size and term to unemployed homeowners who wish to remain in their homes but are in imminent danger of foreclosure due to short-term financial problems. These funds can provide up to six months of benefits with a monthly benefit of up to $3,000 or 100% of the existing total monthly mortgage, whichever is less.

- The Mortgage Reinstatement Assistance Program (MRAP) assists homeowners who have fallen behind on their mortgage payments due to a temporary change in a household circumstance. MRAP provides limited financial assistance in the form of funds to reinstate mortgage loans that are in arrears in order to prevent potential foreclosures. These funds can provide benefits of up to $15,000 per household.

- The Principal Reduction Program (PRP) assists homeowners at risk of default because of an economic hardship coupled with a severe decline in the home's value. PRP provides capital to reduce outstanding principal balances of qualifying borrowers with negative equity and requires lenders to match the contribution with an equal principal reduction of their own. This principal reduction, most likely in conjunction with a loan modification, helps prevent avoidable foreclosures and promote sustainable homeownership.

- The transition Assistance Program (TAP) promotes community stabilization by providing homeowners with relocation assistance when it is determined that they can no longer afford their home. TAP is used in conjunction with a servicer-approved short sale or deed-in-lieu of foreclosure program in order to help homeowners transition into stable and affordable housing. Homeowners are responsible to occupy and maintain the property until the home is sold or returned to the servicer as negotiated. Funds are available on a one-time only basis.

*Enforcement Efforts*

On April 13, 2011, the Federal Reserve Bank and its sister regulators, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation, announced formal enforcement actions requiring ten banking organizations, including some of the nation's largest banks servicing at least 65% of the nation's mortgages, to address a pattern of misconduct and negligence related to deficient practices in residential mortgage loan servicing and foreclosure processing. As part of the enforcement order, the banks must, among other things, submit plans acceptable to the Federal Reserve that:

- Provide borrowers with the name of the person at the servicer who is their primary point of contact.
- Ensure that servicers do not pursue foreclosure once they have approved a mortgage for modification, unless repayments under the modified loan are not made.
- Establish robust controls and oversight over the activities of third-party vendors that provide to the servicers various residential mortgage loan servicing, loss mitigation, or foreclosure-related support, including local counsel in foreclosure or bankruptcy proceedings.
- Provide remediation to borrowers who suffered financial injury as a result of wrongful foreclosures or other deficiencies identified in a review of the foreclosure process.
- Strengthen programs to ensure compliance with state and federal laws regarding servicing, generally, and foreclosures, in particular.[3]

In addition to these federal enforcement orders, the attorneys general from all 50 states are investigating how lenders verify foreclosure documents and negotiating with lenders on a potential settlement.

**What Other States Have Done?**

In each of the last three years, at least 40 state legislatures have debated bills relating to foreclosures. The ideas vary greatly, and the enacted bills run a wide gamut. Presenting the highlights of foreclosure-related legislation from other states will be Heather Morton, the lead resource for foreclosure legislation at the National Council of State Legislatures.

**What More Can Be Done?**

After hearing about efforts to date in California and elsewhere, the committee will hear from a panel of consumer advocates and lending industry representatives on what more California can or should be doing to address the on-going wave of foreclosures. Paul Leonard of the Center for Responsible Lending and Lisa Sitkin of Housing and Economic Rights Advocates will represent consumer advocates. Kevin Gould of the California Bankers Association and Pat Zenzola of the California Mortgage Bankers Association will represent lenders.

[3] http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm.