



Dreams Deferred: **Impacts and Characteristics of the** **California Foreclosure Crisis**

EXECUTIVE SUMMARY

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Key Findings:

- Latino and African-American borrowers in California have experienced foreclosure rates 2.3 and 1.9 times that of non-Hispanic white borrowers. Given the high foreclosure rates for loans made in recent years and the large number of loans to Latinos in those years, almost half of all California foreclosures have been of Latino borrowers.
- The concentration and volume of California foreclosures differ dramatically by region. The Central Valley and Inland Empire have the highest concentrations of foreclosures, while the volume of foreclosures is highest in major cities, such as Los Angeles.
- Contrary to some claims, most foreclosures have not been on sprawling “McMansions” but rather on modest properties that were typically valued significantly below area median values at origination.

I. INTRODUCTION

California and the United States are in the midst of the worst foreclosure crisis since the Great Depression. Across the country, foreclosures have hit an all-time high, with nearly one in ten homes with a mortgage currently in some stage of foreclosure. In the Golden State, nearly one in eight—or approximately 702,000—homes is currently in foreclosure, the economy is in ruins and unemployment stands at 12 percent. The now three-year-old crisis has tarnished California’s once-golden reputation. This report aims to paint a picture of the foreclosure crisis in California by examining the who, the where and the why of foreclosures in the Golden State and discussing what we must do to prevent as many avoidable foreclosures as possible.

Background

The foreclosure crisis had its genesis in the abusive practices of the subprime and “Alt-A” mortgage markets, where risky mortgage products and lax underwriting standards were the norm. During the heyday of these markets, loan products commonly had such features as low initial “teaser” rates that exploded upward when they reset. Adding to the risky nature of these products was poor underwriting practices that did not adequately consider borrowers’ ability to repay. During this time it was routine for lenders to not document borrowers’ income or assets and use “piggy-back” second liens to originate mortgages up to, and in some cases, beyond the full value of the home. These risky loans were able to flourish, thanks in large part to Wall Street and its appetite for purchasing and securitizing these loans, which, in turn, provided the virtually unlimited capital that fueled dangerous lending practices. The combination of originators aggressively seeking to make as many loans as possible without due regard for underwriting standards and Wall Street’s conviction that risk could be adequately managed through complex financial instruments helped inflate an enormous housing

bubble in California and many other states. And as happened from California to Florida, the bursting of the bubble has brought record, devastating foreclosures.

The damages to families resulting from foreclosures is multifaceted. First, the disruption and upheaval associated with being evicted from one’s home, and the effects this displacement can have on a family’s education, health and employment, are significant. Second is the loss of homeownership and the tax benefits and wealth that historically have accompanied it. Homeownership has been the primary source of economic mobility and financial security in this country, as home equity is often tapped to start a new business, pay for higher education and secure retirement. In addition, home equity provides a financial cushion against unexpected financial hardships, such as job loss, divorce or medical expenses. Homeownership is also the primary means by which wealth is transferred to future generations. The foreclosure crisis therefore threatens the financial stability and mobility of families across the country, not just now but also into the future. Further, in addition to the individuals and families who lose their homes to foreclosure, nearby homeowners are affected when they experience depreciated home values, as are communities which suffer the financial and non-financial consequences of abandoned properties and neighborhood blight.

It is therefore critical to understand not just the number of foreclosures that have and will occur, but the distribution of foreclosures among various regions and populations. In this report, we shed light on which demographic groups have been hit hardest by the foreclosure crisis in California, describe the geographic distribution of foreclosures, and provide details on the profile of homes being foreclosed.

KEY FINDINGS

A. Latino and African-American borrowers in California have experienced foreclosure rates 2.3 and 1.9 times that of non-Hispanic white borrowers. Given the high foreclosure rates for loans made in recent years and the large number of loans to Latinos in those years, almost half of all California foreclosures have been of Latino borrowers.

In Table 1 below, we see that almost half of foreclosures (48.2 percent) were of Latino borrowers, far greater than their 36.6 percent share of the California population, and more than double their 21.7 percent share of California homeowners.

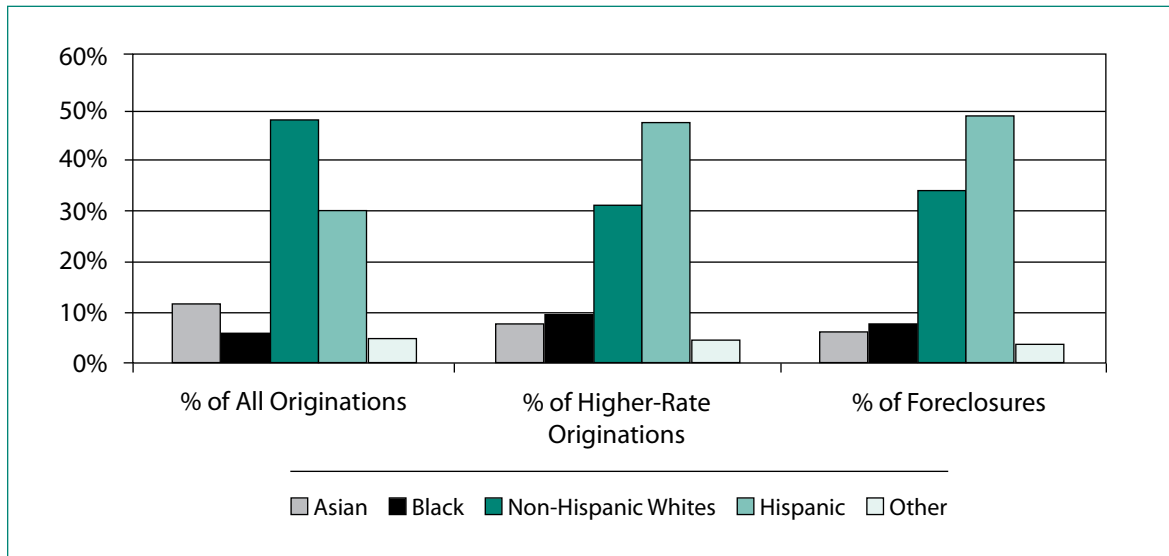
Table 1: Foreclosures by Borrowers’ Race and Ethnicity, All Loan Cohorts.

Race/Ethnicity of Borrower	No. of Foreclosures in Dataset	Share of Total Foreclosures
Asian	39,718	6.4%
Black or African-American	47,337	7.6%
White, Non-Latino	216,037	34.6%
Latino	301,086	48.2%
Other/Unknown	21,178	3.4%

Source: CRL calculations of October 2006-November 2009 foreclosure data from Foreclosure Radar combined with Catalist demographic data

Latino foreclosures are also disproportionate compared to their share of loan originations. In Figure 1 below, between 2004 and 2008, Latinos received 29.9 percent of all loans originated, much lower than their 48.7 percent share of foreclosures for these same loan cohorts. However, the Latino share of foreclosures is much more reflective of this population’s share of the subprime market during this time period. Latinos received 47.1 percent of all higher-rate loans (typically subprime) originated between 2004 and 2008 in California.

Figure 1: Racial and Ethnic Compositions of Originations and Foreclosures, (2004-2008 Cohorts Only)



Source: CRL Calculations of HMDA, Foreclosure Radar and Catalist Data

Importantly, this basic pattern holds regardless of loan amount. In other words, when we group loans into categories based on the loan amount, the Latino share of foreclosures is disproportionate compared to their originations. The population’s share of foreclosures, however, is nearly identical to their share of higher-rate loan originations, likely reflecting the prominent role played by higher-rate loans in the foreclosure crisis to date.

While representing a much smaller share of the mortgage market, African-American borrowers also suffered disproportionately large shares of foreclosures. African-American borrowers accounted for 5.7 percent of all loan originations, but 7.6 percent of all foreclosures.

B. The concentration and volume of California foreclosures differ dramatically by region. The Central Valley and Inland Empire have the highest concentrations of foreclosures, while the volume of foreclosures is highest in major cities, such as Los Angeles.

The geographic distribution of foreclosures in California is a two-part story.

First, the *density of foreclosures* (that is, the number of foreclosures as a proportion of all housing units) is highest in the Central Valley and Inland Empire, areas that were becoming exurbs of the San Francisco Bay Area and Los Angeles.

Second, the **highest numbers of foreclosures** have occurred in the major cities of both Northern and Southern California. Both of these trends pose significant spillover risk: small communities with high foreclosure densities are sensitive to the macro-level impacts of foreclosure; in densely-populated cities, the effects of high volumes of foreclosure can have micro-level impacts on larger numbers of families.

Table 2: Top Ten California MSAs by Foreclosure Density, September 2006-November 2009

MSA	Foreclosure Density (Share of Housing Units Experiencing Foreclosure)
Modesto, CA	16.1%
Merced, CA	16.0%
Stockton, CA	15.8%
Riverside-San Bernardino-Ontario, CA	15.6%
Bakersfield, CA	11.4%
Yuba City, CA	11.1%
Madera-Chowchilla, CA	11.0%
Vallejo-Fairfield, CA	10.7%
Sacramento--Arden-Arcade--Roseville, CA	9.7%
El Centro, CA	9.3%

Source: Foreclosure Radar and US Census

Table 3: Top Ten California MSAs by Total Foreclosures, September 2006-November 2009

MSA	Foreclosure Total
Los Angeles-Long Beach-Santa Ana, CA	206,048
Riverside-San Bernardino-Ontario, CA	184,475
San Francisco-Oakland-Fremont, CA	69,851
Sacramento--Arden-Arcade--Roseville, CA	69,146
San Diego-Carlsbad-San Marcos, CA	63,488
Stockton, CA	29,832
Bakersfield, CA	26,494
San Jose-Sunnyvale-Santa Clara, CA	25,681
Modesto, CA	24,294
Fresno, CA	19,428

Source: Foreclosure Radar and US Census

C. Contrary to some claims, most foreclosures have not been on sprawling “McMansions” but rather on fairly modest properties that were valued below area median values at origination.

A common perception is that California foreclosures have been caused by middle-class families overextending to purchase opulent homes. However, the facts tell quite another story. Specifically, foreclosed homes in California have been relatively modest in terms of size and value, and half of loans that resulted in foreclosure were used to refinance, not purchase, properties.

First, half (50.3 percent) of foreclosures resulted from refinance loans, challenging the notion that foreclosures are simply the result of people purchasing properties they could not afford.

Second, the median size of a foreclosed home in California is 1,494, square feet and two-thirds (67 percent) of these homes have three or fewer bedrooms. This information further undermines the notion that foreclosures are simply the result of people buying extravagant homes.

Finally, foreclosed properties were likely to be relatively modest value, in comparison to other area properties. On average, the estimated property value at origination for foreclosed borrowers was \$396,531, compared to a weighted area median property value of \$485,906. We also found that a large majority of borrowers—76.4 percent—had property values estimated to be less than the area median value at the time of loan origination.

Table 4: California Foreclosures: Estimated Property Characteristics

All Origination Cohorts		Share of Foreclosures
Number of Bedrooms	0-1	8.9%
	2-3	58.6%
	4+	32.5%
Square Feet	Median = 1,494	
	Average = 1,704	
2004-2008 Originations Only:		
Estimated Average Home Value at Origination	\$396,483	
Percent of Homes with Estimated Home Values below Median at Origination	76.4%	

Source: CRL Calculations of LPS and Foreclosure Radar Data

POLICY RECOMMENDATIONS

These findings give us a clearer picture of the foreclosures in California. The magnitude and nature of the crisis suggest three areas where policy changes are needed. In the near-term, preventing avoidable foreclosures is critical— from Sacramento to San Diego, and for homeowners of every color. Second, steps must be taken to ameliorate the consequences of foreclosures for families and for neighborhoods that are directly affected. Third, policies should be put in place to help avert a similar crisis in the future.

Preventing Avoidable Foreclosures

In recently released data, CoreLogic reports that 34 percent of California mortgages, compared with 24 percent nationwide, are in a state of negative equity, where borrowers owe more than the home is worth. Specifically, the report finds that three of the top four MSAs in the United States by percentage of mortgages in negative equity are in California's Central Valley.

Many of the foreclosures detailed in this paper may be avoidable. Given the magnitude of the crisis documented here and elsewhere, and the effect of foreclosures on the communities least able to absorb losses, policymakers should redouble their efforts to ensure that homeowners in trouble are adequately supported and incented to stay in their homes.

A. Require servicers to complete the review of any loan modification application before beginning the foreclosure process or referring the loan file to a foreclosure attorney.

Homeowners denied a modification should be notified of the reason for modification and given a chance to correct any errors before the foreclosure commences. As this report is going to press, the California State Legislature is considering measures similar to those outlined in this section.

B. Incorporate principal reduction into loan modification programs, especially where housing prices have contributed to lack of affordability. Changes have recently been made to the primary federal program aimed at forestalling foreclosures, the Home Affordable Modification Program (HAMP), to encourage servicers to incorporate principal reduction into modifications for borrowers whose loans are sufficiently “underwater.” However, principal reduction remains an option within voluntary programs and policymakers should be prepared to take additional steps if necessary.

C. Lift the ban on modification of principal residence mortgages by bankruptcy judges. Judicial modification of loans is available for owners of commercial real estate and yachts, as well as for subprime lenders like New Century, but denied to families whose most important asset is the home in which they live. Judicial modifications carry no cost to the U.S. taxpayer and would address the main obstacles to current voluntary programs, including second liens, investor concerns, underwater loans and high consumer debt.

D. Expand funding and capacity of housing counseling agencies and legal aid providers, particularly those with Spanish and other non-English language capacity. Mounting evidence demonstrates that homeowners who receive assistance from someone experienced with the loan modification process have much better outcomes than those who attempt to save their home on their own.

Addressing Consequences of Foreclosures

In addition to averting impending new foreclosures, policymakers have a responsibility to invest in the stabilization of neighborhoods already harmed by completed foreclosures. These efforts should address both the maintenance and preservation of the foreclosed homes and the families displaced by foreclosure. Policymakers can help to revitalize neighborhoods blighted by foreclosure by supporting and expanding funding for Neighborhood Preservation efforts; enforce tenant protections for renters of foreclosed properties and providing funding to connect families displaced by foreclosure to supportive services in their communities.

Promoting Access to Fair and Responsible Credit

Going forward, for communities and families to flourish, home mortgage lending standards must be improved. This is especially important in traditionally underserved communities, where responsible home lending must play a formative, and not merely ancillary role.

The recent enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act was a major step forward in protecting consumers from predatory lending practices. The Act includes both substantive mortgage standards and creates a Consumer Financial Protection Bureau that will monitor the financial marketplace and act to rein in irresponsible lending practices. The creation of the Bureau and the regulatory rules implementing the Act's substantive provisions will all be important going forward to ensure that the tough legislative standards are given full effect.

As the country begins to address a potential restructuring of the entire housing finance system, it is crucial to focus on the need for access to responsible credit for communities of color and lower-income communities.

Finally, to increase fairness and transparency, documents and disclosures related to mortgages or other loan products, as well as appropriate advice and counseling on these products, should be available in non-English languages.

DATA

Our data come primarily from three sources. The foreclosure data was purchased from Foreclosure Radar, a private vendor of foreclosure filings based on county records and notices of trustee sale auctions and actual foreclosure sales from every county in California.

Our demographic data comes from Catalist, an aggregator and provider of data and related software and services. Catalist's data comes from a combination of voter registrations records and other government and commercial data sources. In addition to providing data, Catalist matched the foreclosure records from Foreclosure Radar to its database of demographic information.

Although the Foreclosure Radar data alone and the sample of combined Foreclosure Radar/Catalist data give us extensive information on the property, geographic and demographic compositions of California foreclosures, these databases provide little information on the loan terms of foreclosed properties. Therefore, we also rely on a sample of California foreclosures from Lender Processing Services (LPS), a database containing information on individual loans collected from mortgage servicers. While LPS does not have the universal foreclosure coverage of Foreclosure Radar or the demographic information of Catalist, it contains rich information on loan characteristics such as loan purpose, borrower credit score, loan-to-value ratio (LTV), documentation level and origination channel, as well as loan performance.

Finally, in addition to the Foreclosure Radar, Catalist and LPS data, we use a limited amount of data from the Home Mortgage Disclosure Act (HMDA), Mortgage Bankers Association National Delinquency Survey and the American Community Survey.

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