



# **The Mortgage Crisis Today:**

## **How Far Have We Come and Where Do We Need to Go?**

**California State Assembly Banking and  
Finance Committee Informational Hearing  
Monday, August 4, 2008**

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# Center for Responsible Lending



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

Durham, NC    Washington, DC    Oakland, CA

# Summary Points: Better or Worse?

Incremental responses pale  
compared to scope of problems

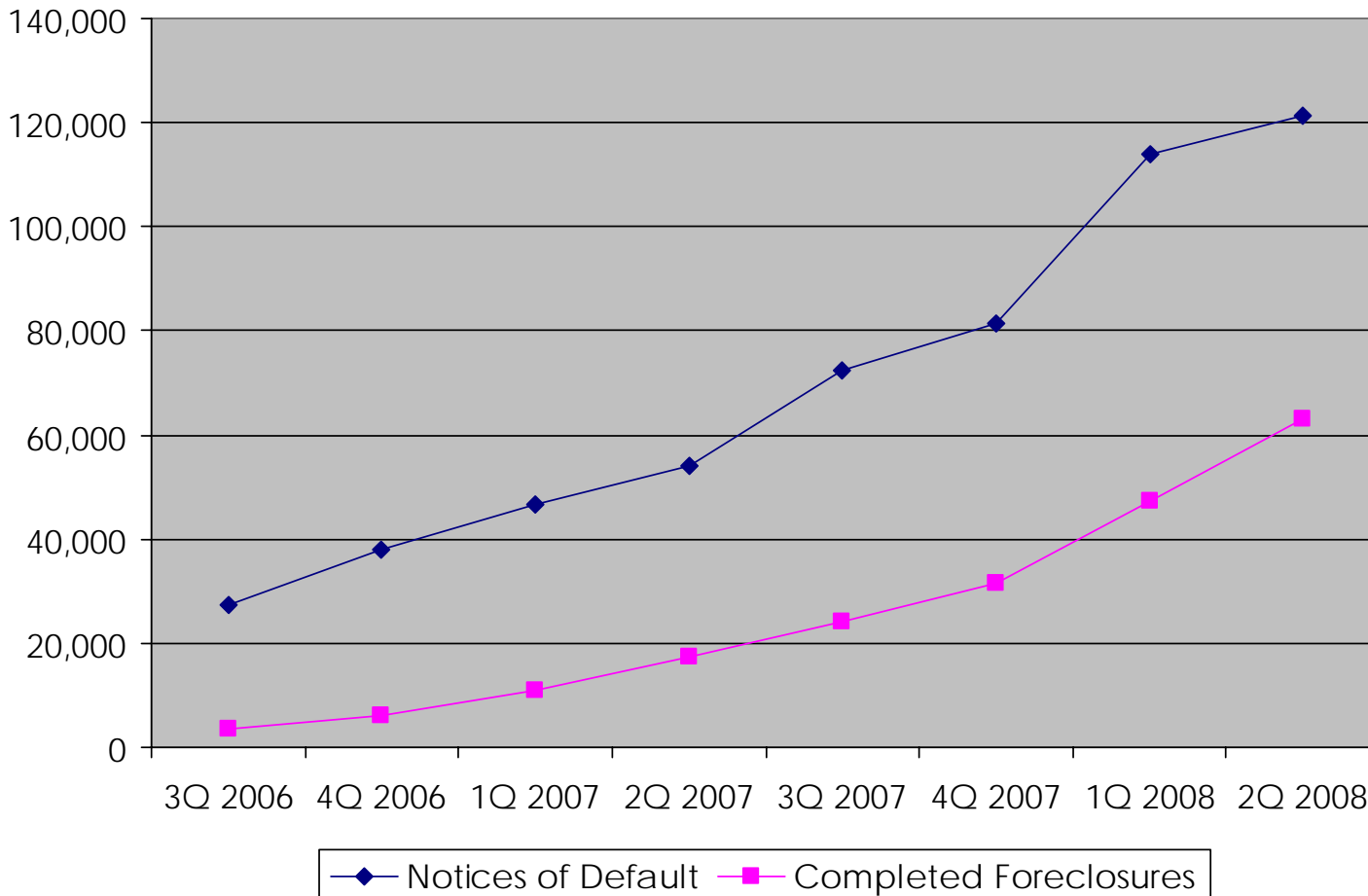


- **Foreclosures & Defaults in California:** Record-setting levels continue to worsen; more to come
- **Loan Modifications:** Some improvements, but significantly outpaced by defaults & foreclosures
- **Federal Reserve Regulation Z:** Stronger than expected; Still more to be done, focus on brokers
- **Housing Legislation:** Voluntary new program and new resources will help; More needed
- **State Action:** SB 1137 will help current borrowers; Needs to address future borrowers

**California leads in foreclosures, and should also set policy standards for reining in abuses**

# **I. California Defaults and Foreclosures Continue to Worsen and Break New Records**

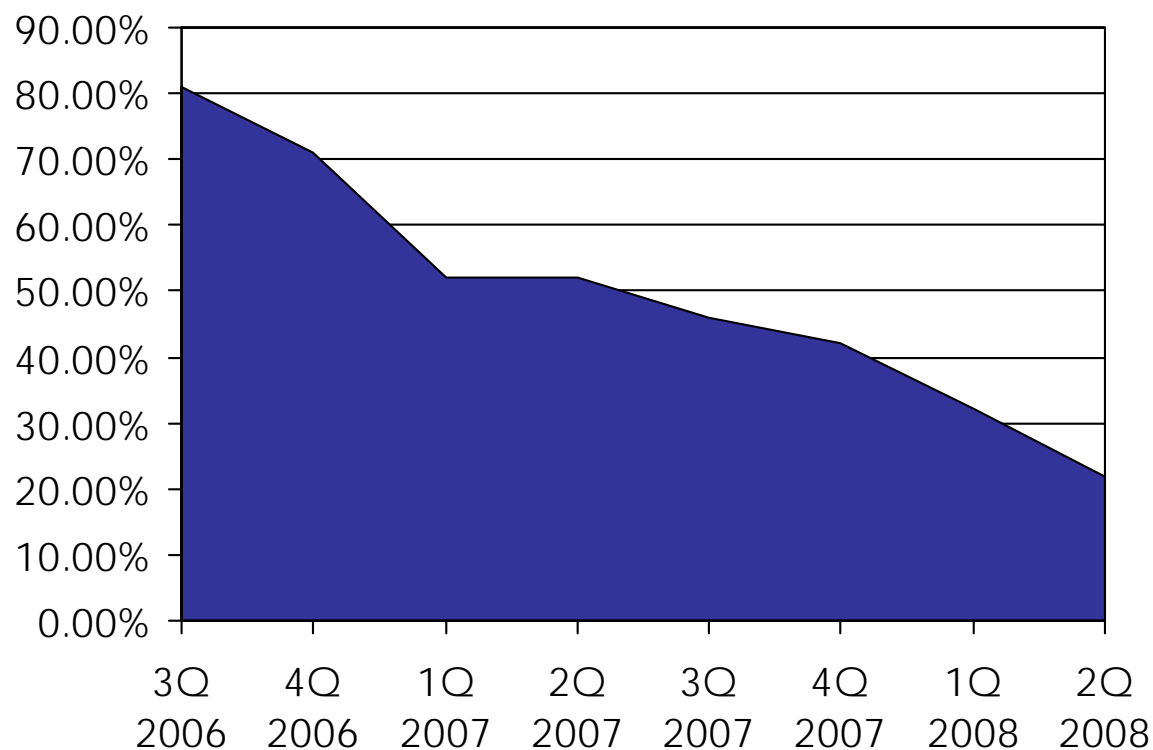
# Completed Foreclosures and Notices of Default in California



Source: DataQuick ([www.dqnews.com](http://www.dqnews.com)).

# Fewer Borrowers Escaping Foreclosure

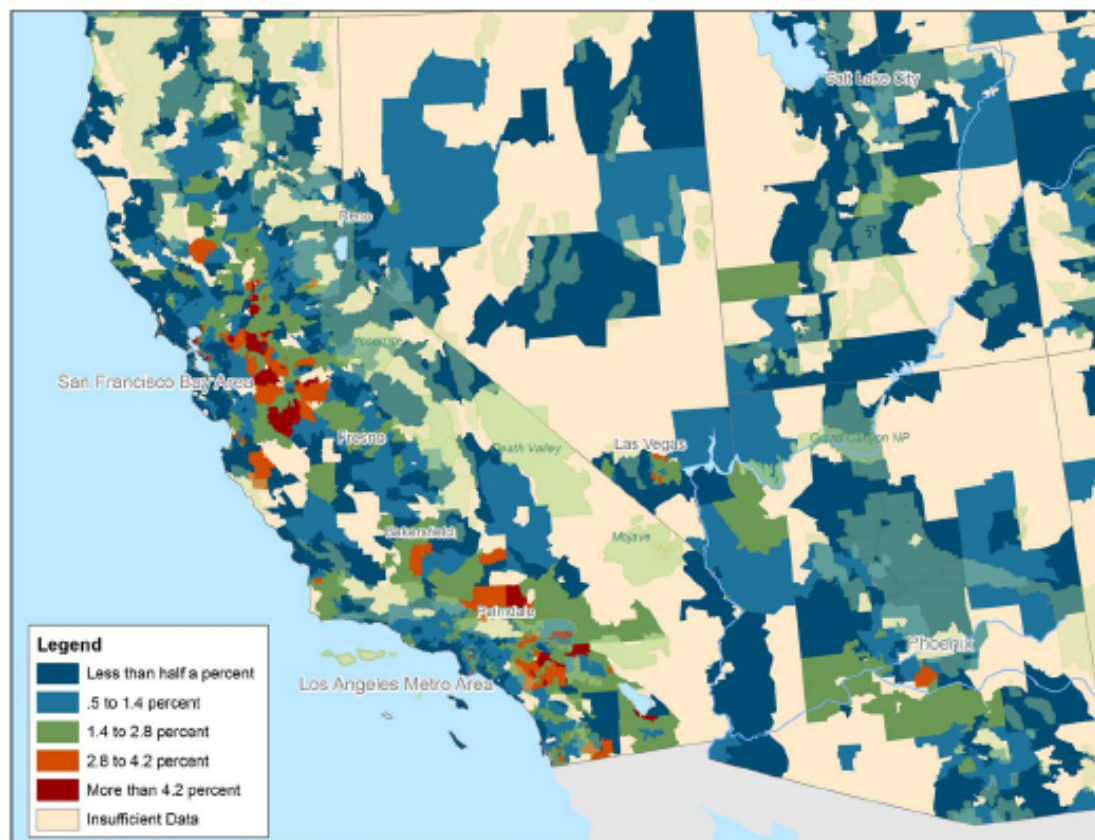
■ Percentage of California borrowers in default who emerge from foreclosure process



Source: DataQuick ([www.dqnews.com](http://www.dqnews.com)).

# Foreclosures in CA, Sept. 2007

Percent of Mortgage Loans in Foreclosure or REO (by zip code)  
September 2007

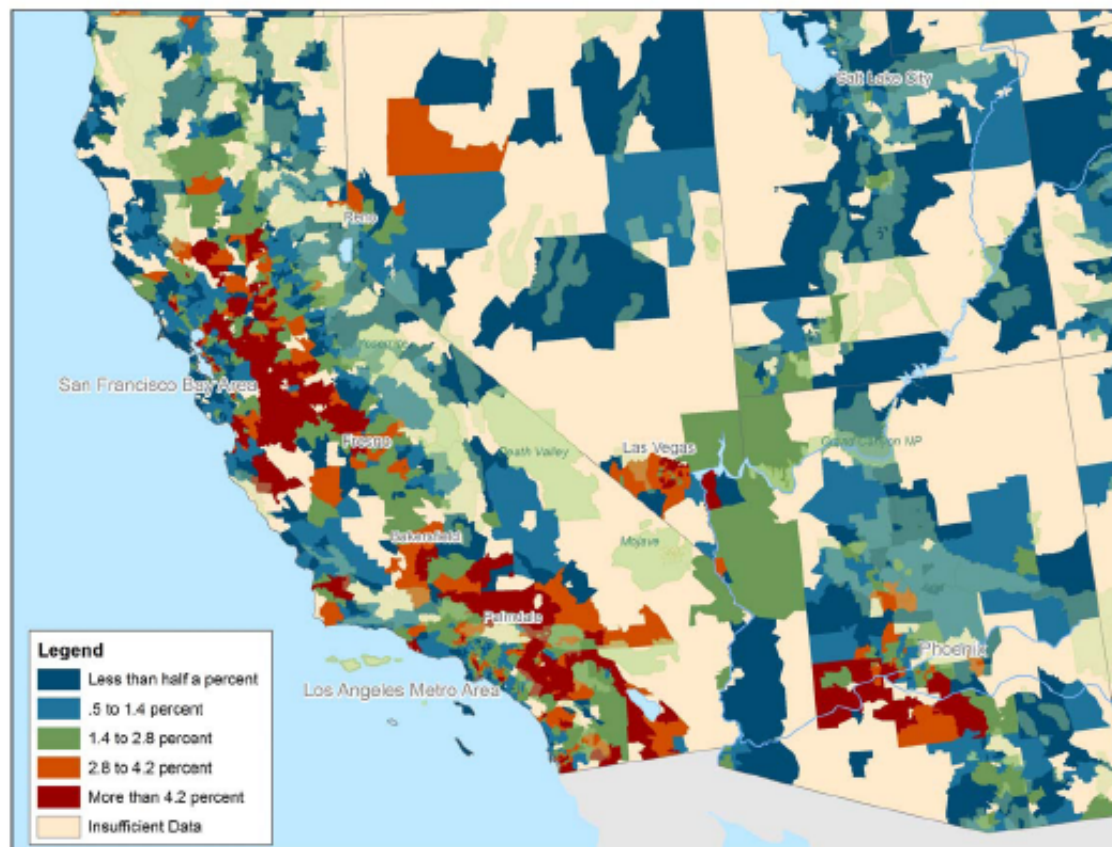


Source: McDash Analytics, LLC and FRBSF calculations



# Foreclosures in CA, April 2008

Percent of Mortgage Loans in Foreclosure or REO (by zip code)  
April 2008

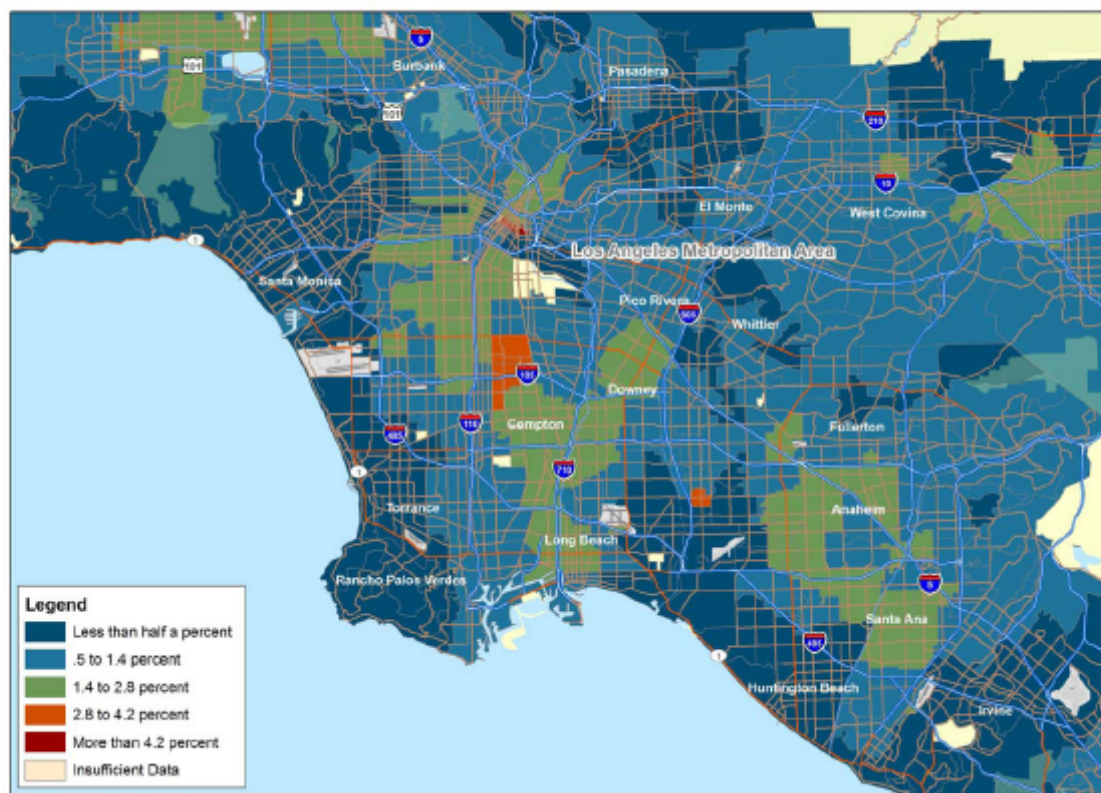


Source: McDash Analytics, LLC and FRBSF calculations



# Foreclosures in LA: Sept. 2007

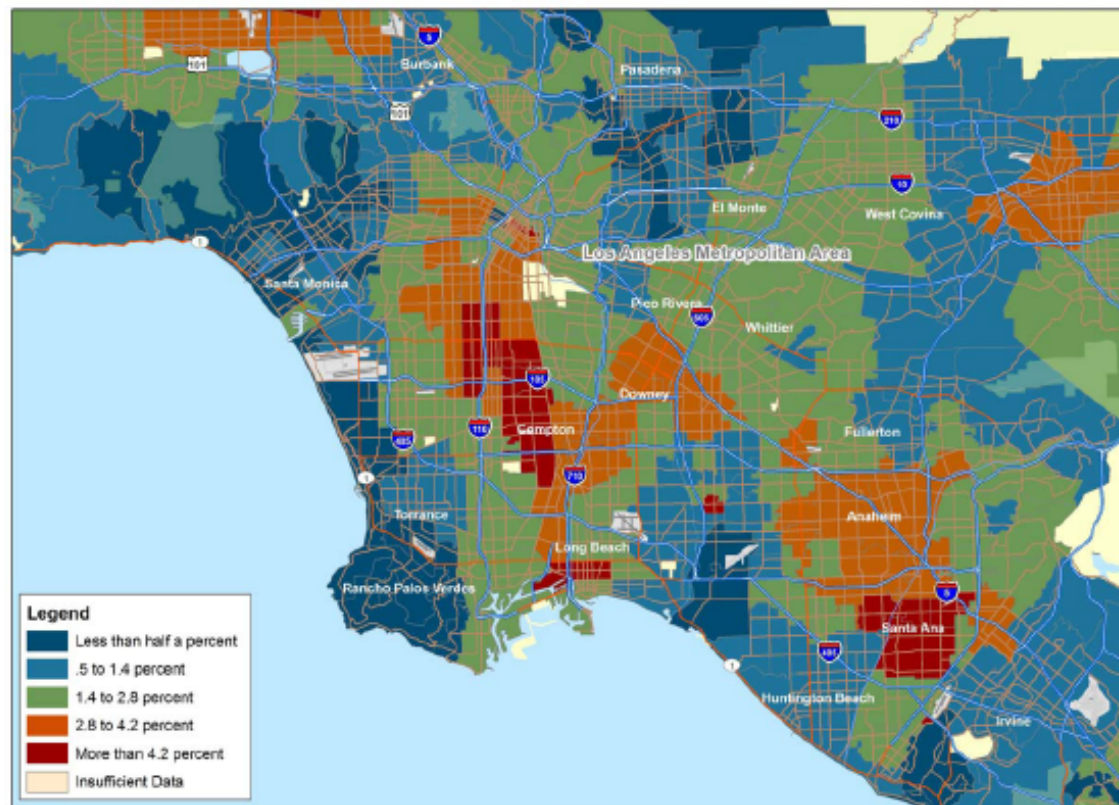
Percent of Mortgage Loans in Foreclosure or REO (by zip code)  
September 2007



Source: McDash Analytics, LLC and FRBSF calculations

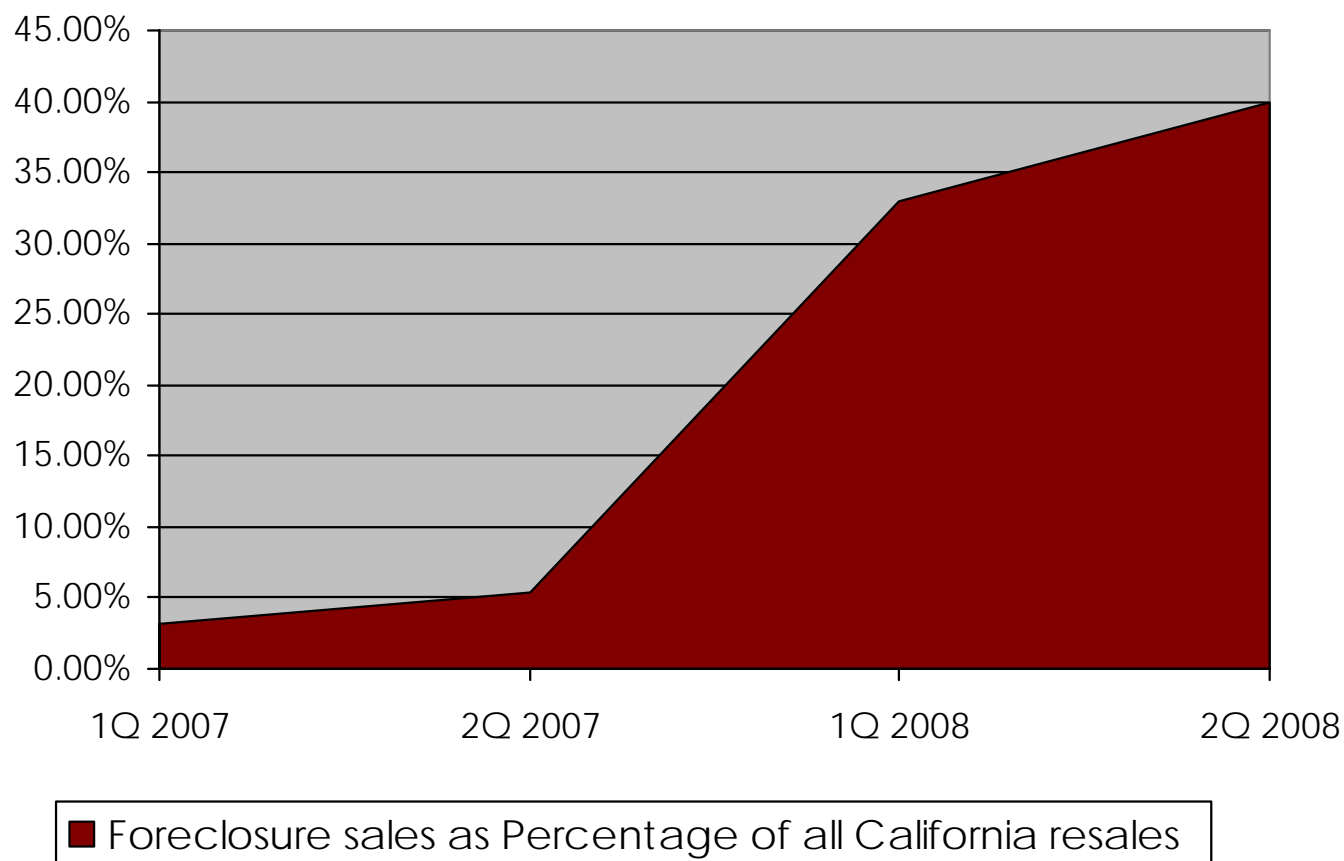
# LA Foreclosure Concentrations Intensify, April 2008

Percent of Mortgage Loans in Foreclosure or REO (by zip code)  
April 2008



Source: McDash Analytics, LLC and FRBSF calculations

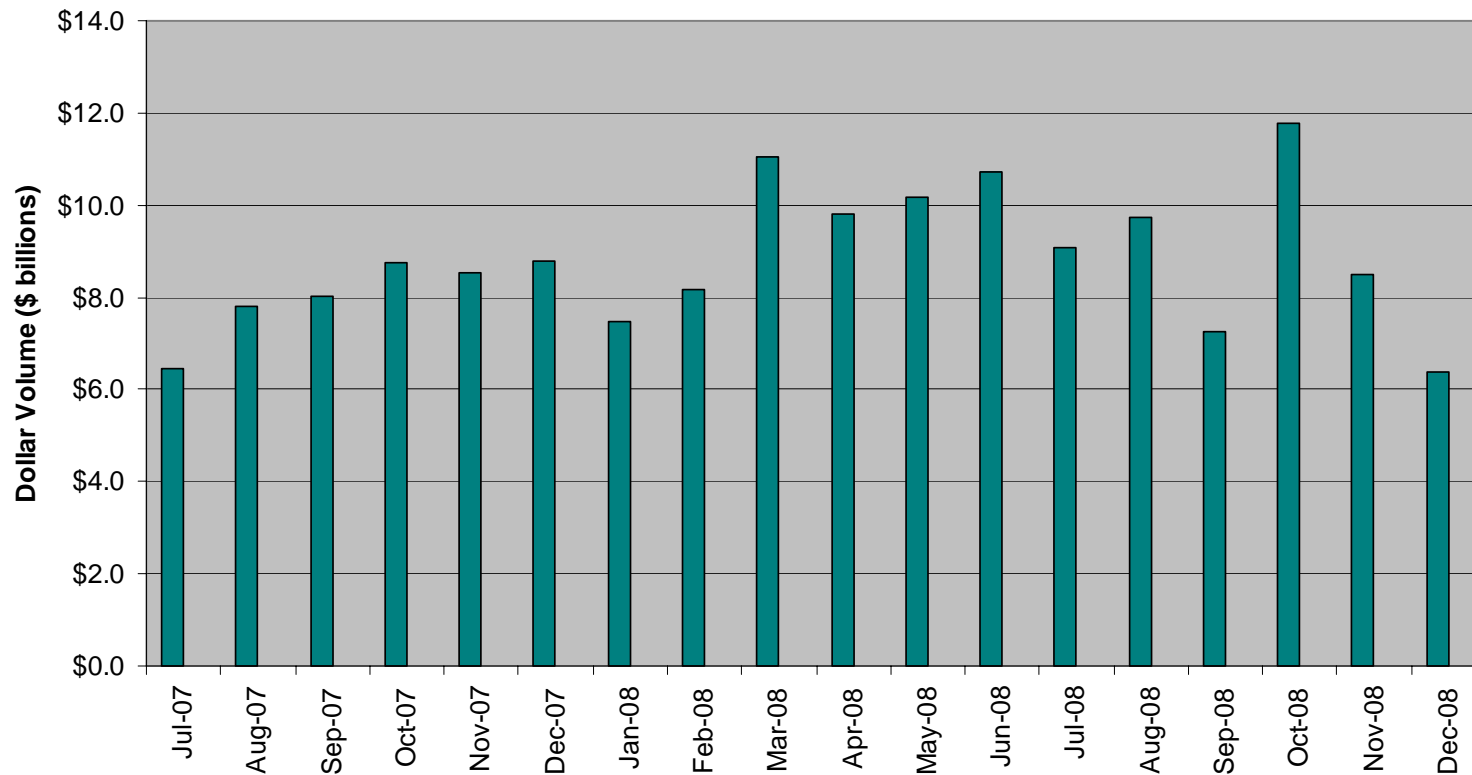
# California Housing Market Increasingly Dominated By Foreclosure Sales



Source: DataQuick ([www.dqnews.com](http://www.dqnews.com)).

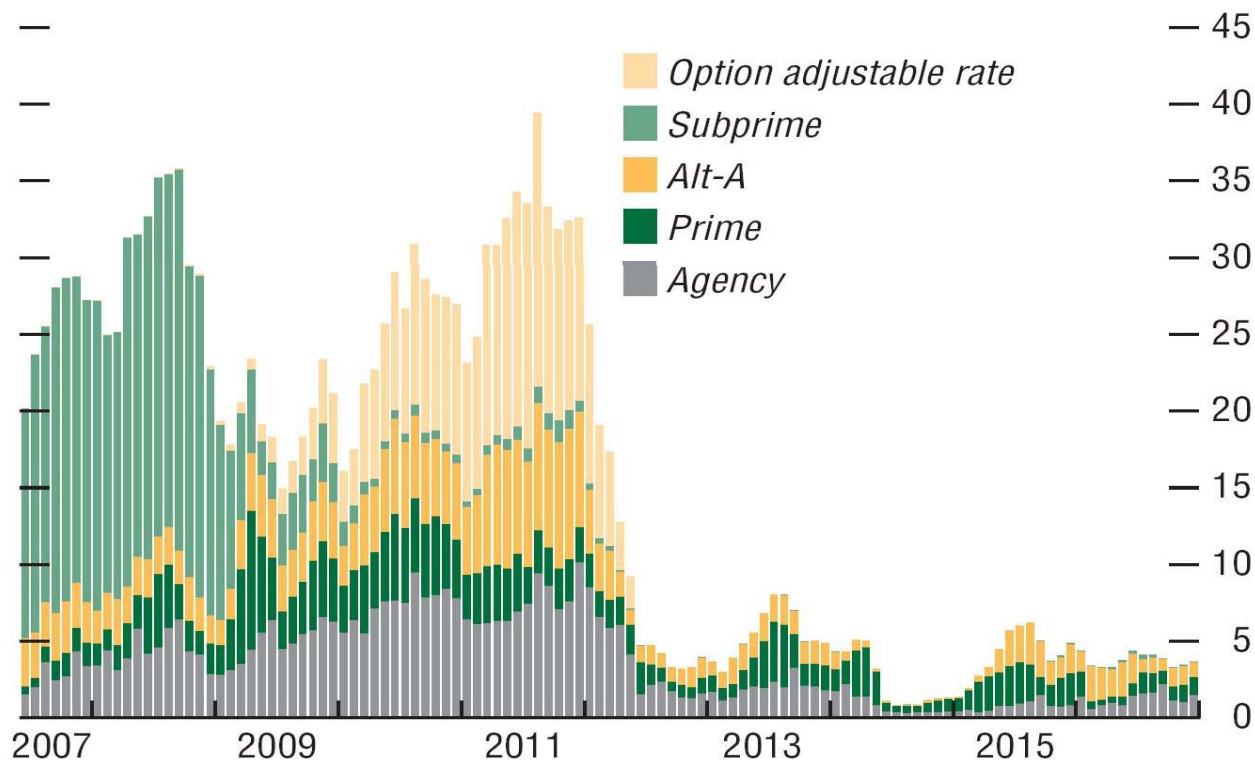
# Foreclosures: More to Come

## CA Subprime ARM Reset Volume



# 2<sup>nd</sup> Wave: Alt-A & Option ARMs

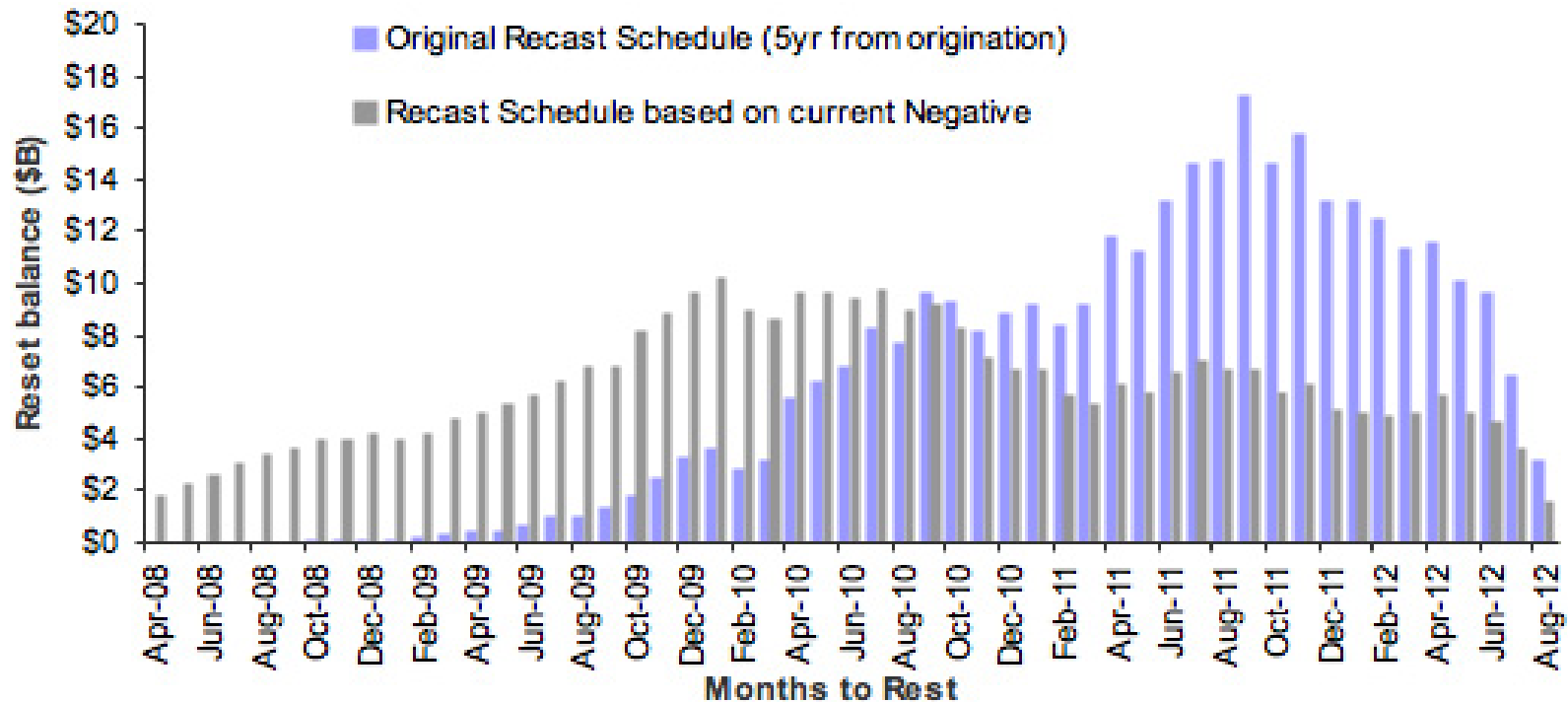
**Figure 1.7. Monthly Mortgage Rate Resets**  
(First reset in billions of U.S. dollars)



Source: Credit Suisse.

# A Closer Look: Option ARM Recasts

## Option ARM Reset Schedule



Source: Credit Suisse, as reported in *Business Week*,  
[http://www.businessweek.com/print/lifestyle/content/jun2008/bw2008065\\_526168.htm](http://www.businessweek.com/print/lifestyle/content/jun2008/bw2008065_526168.htm)

# Alt-A: The Next Foreclosure Wave Will Hit California Hard

- California: Heavy Exposure to Alt-A
  - 30% of all Alt-A loans nationwide
  - 56% all Option ARMs (NYFed data)
- Growing Delinquency & Defaults
  - 5.7% in foreclosure (up 78% in 6 mos.)
  - 27% at least one late payment in last 12 months (up 44% in 6 mos.)
- Growing Losses: 2006 & 2007 Alt-A hybrid ARMs and Option ARMs (11-15% losses, 40% loss severity)  
(S&P projections: 7/29/08)
- IndyMac and Other Alt-A Lenders experiencing huge losses



# June 2008 Data on California Subprime & Alt-A Loans

	Subprime Loans	Alt-A Loans
<b>Number</b>	465,785	688,975
<b>ARM</b>	72.6%	70%
<b>Prepayment Penalty</b>	<b>412,350 (89%)</b>	302,909 (44%)
<b>Negative Amortization</b>	379	198,385 (29%)
<b>Interest Only</b>	144,135 (31%)	252,329 (37%)
<b>Late Payment Last 12 mos.</b>	58.6%	27%
<b>Low Doc/No Doc</b>	47.0%	82.8%
<b>ARM Already Reset</b>	157,030 (34%)	187,722 (27%)
<b>Reset Next 12 months</b>	38.7%	3.5%
<b>Reset 12-23 months</b>	6.6%	5.5%
<b>Reset 24+ months</b>	5.3%	<b>42.8%</b>
<b>In Foreclosure</b>	<b>14%</b>	<b>5.8%</b>

Source: FirstAmerican CoreLogic, LoanPerformance Data provided by NY Fed (June 2008) ([www.newyorkfed.org/mortgagemaps/](http://www.newyorkfed.org/mortgagemaps/))

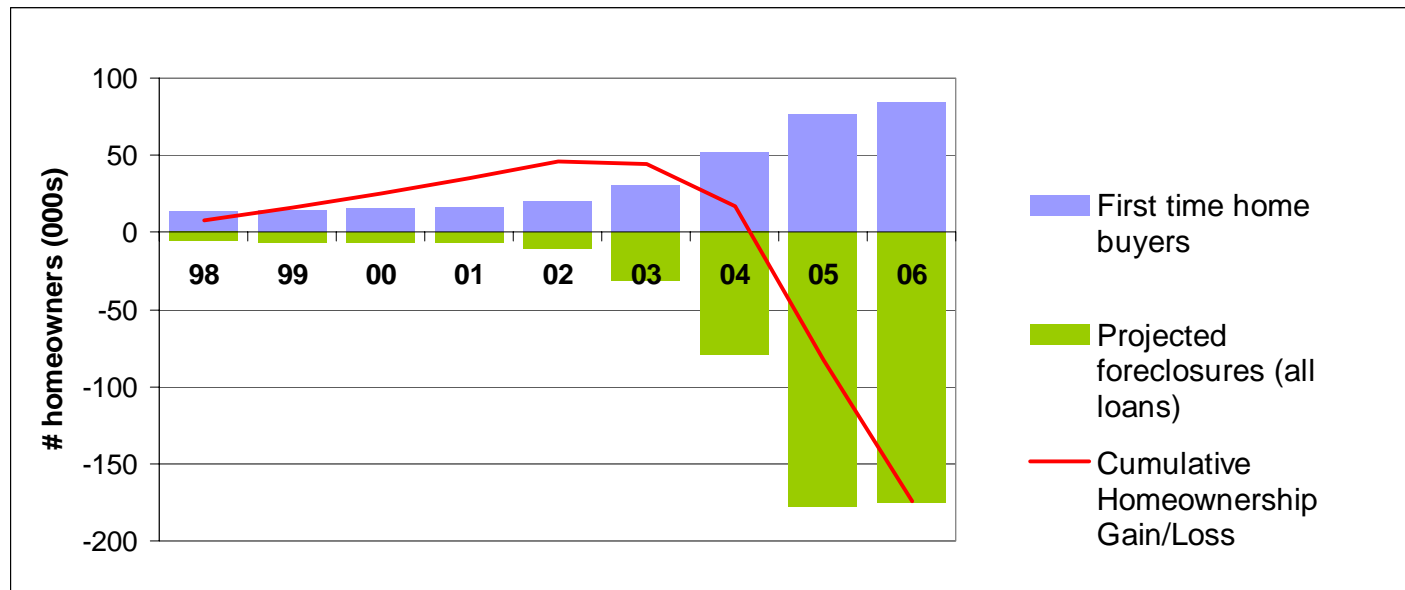
# Foreclosure Spillover Effects

- Neighbors' Homes Devalued
  - **7.5 million** homes experiencing loss of \$107 billion statewide\*
- Neighborhood Blight
- Declining local and state revenues
- Declining economy statewide and nationwide

\*Source: CRL, <http://www.responsiblelending.org/issues/mortgage/quick-references/state-by-state-analyses-of-subprime-losses.htm> |

# The Effects of Foreclosures: A Drain on California Homeownership

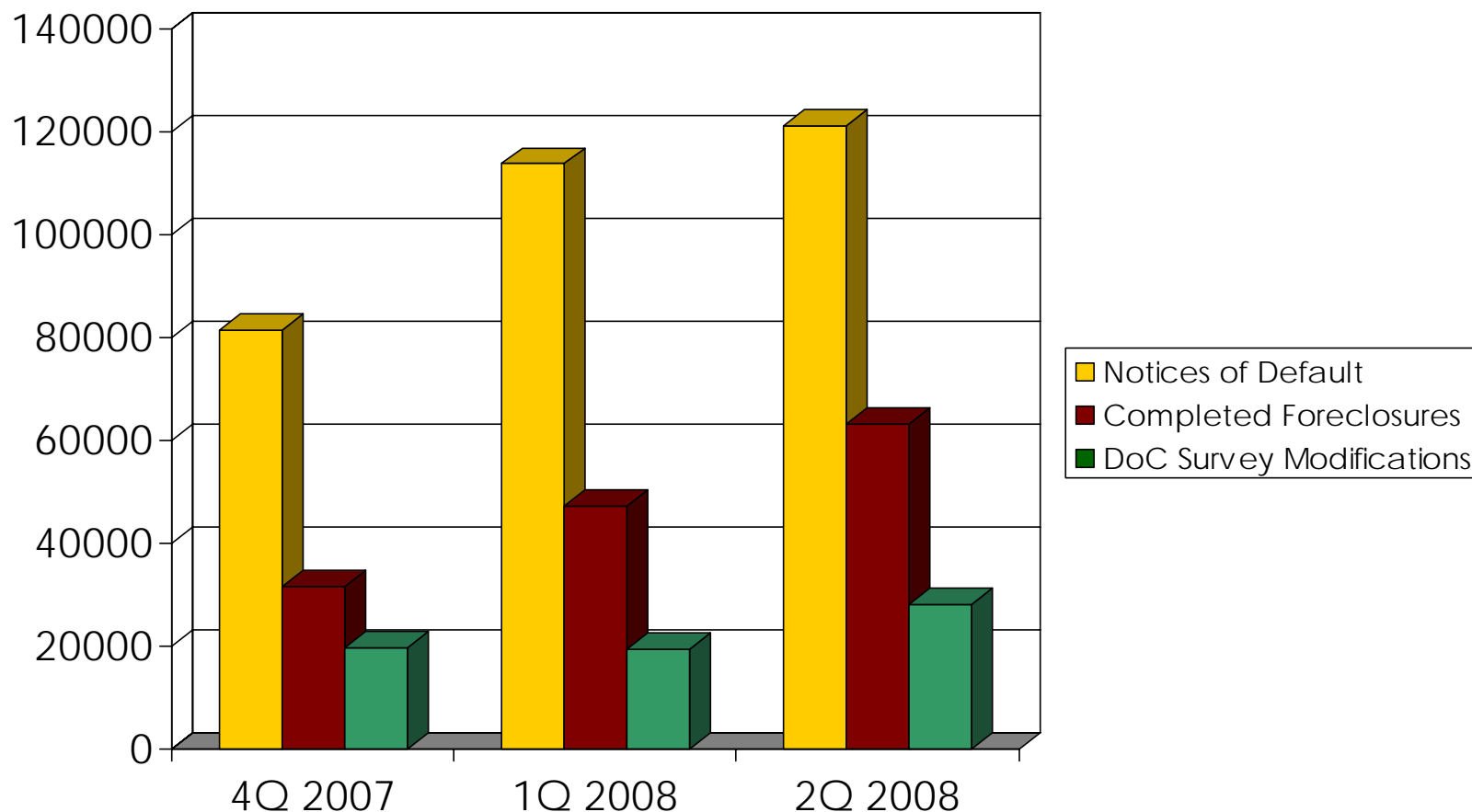
## Net Loss of 175,000 CA Homes





## **II. Loan Modification Efforts**

# Modifications Are Not Keeping Pace with Foreclosure Activity



Sources: DataQuick ([www.dqnews.com](http://www.dqnews.com)); DoC reported data ([www.corp.ca.gov](http://www.corp.ca.gov)).

June 2008 DoC data is estimated at 10,000 modifications, based on DoC report of 18,134 modifications in April and May 2008.

# Hope Now: Limited Progress

- **Hope Now Claims:** Prevented 1.9 million foreclosures since inception (July 30 press release)
- **Less Hopeful Reality:**
  - Rising foreclosures and delinquencies continue to outpace modest growth of modifications:
    - 2Q 2008: 120,000 more foreclosures than modifications
    - ARM resets Jan-June 08: only 6.1% (of 928,000) modified; 4.4% of total modified for 5yrs or more
  - 1.9 million likely overstated: repayment plans (1.2 mil (63%)) not likely to offer long-term relief.
    - 42% of loans modified in the first half of 2007 (mostly repayment plans) were 90+ days delinquent as of March 31, 2008. (Moody's)

- 1Q 2008: Foreclosure activity still dwarfing loan mods
  - ~114,000 notices of default
  - 63,000+ foreclosure sales
  - 19,391 actual loan modifications
  - April & May 2008: Welcome increase in modifications, but not enough to keep pace with foreclosures
- Are workouts long-term/sustainable?
  - Few principal reductions: ~3% of all modifications
  - Forbearance plans the 2nd most common “workout”
- Increasing backlog: number of workouts initiated greatly exceed number closed each month (3:1).



# Existing Obstacles to Voluntary Modifications

- Insufficient Servicer Staffing
- Misaligned Financial Incentives for Servicers
- Risk of Investor Lawsuits
- Limits of Pooling and Servicing Agreements
- Piggyback Seconds

# Getting to Scale: More Formulaic Modifications

- Need to get beyond case-by-case
  - Enhanced Technology
  - Pre-Approved Offers
- Will IndyMac be a Model?



## **III. Federal Action**

# Regulation Z: New Rules For All Mortgage Lenders

- **Strong and important new rules**
  - Ability to Repay & Income Verification with individual enforcement
  - Escrow Requirement
- **Better than Expected, but Not Strong Enough**
  - Bans prepayment penalties on ARMs that adjust w/in 4 yrs; 2 yr limit on other loans
  - But no general subprime ban and no cap/limit on amounts
- **Gaps and Shortcomings**
  - *Does not address non-traditional loans*
  - *Does not address yield spread premiums*
  - *Does not regulate brokers at all*
  - *Does not address other abusive practices (e.g., loan flipping, steering, language translation, negative amortization)*
  - *Effective date not until **Oct. 2009***

# HR 3221: Housing & Economic Recovery Act of 2008 (HERA)



- FHA Refinancing
  - \$4 billion for Neighborhood Preservation
  - GSE Reform & Stabilization
  - FHA Modernization
  - Affordable Housing Fund
  - \$100 million to NRC for foreclosure mitigation
  - Tax Incentives
  - New TILA mortgage disclosure requirements
  - National Licensing
- Positive step, but continues to rely on voluntary efforts to modify loans

# Implications of HERA for CA

- FHA refinancing tool is voluntary, effectiveness unknown.
  - CBO estimates 400,000 foreclosures avoided out of 6.5 million total.
  - Contingent on lenders/investors accepting short payoffs
  - Precedent of “principal balance modifications” is not encouraging.
- Large jurisdictions will get \$\$\$ to address blight caused by concentrated foreclosures
- Tax-exempt bond financing could help refinance or buyers of foreclosed properties.

# What's Still Needed At the Federal Level?

- Federal Bankruptcy Reform to give borrowers leverage
- Servicer-specific data reporting about loan modifications
- Provide temporary deferment of foreclosures until FHA program online and housing markets stabilize
- FDIC's home ownership preservation loan proposal





## **IV. State Action**

# California Legislation/Policy: Helping Current Borrowers



- **What has been done?**
  - SB 1137 provides important reforms to borrowers in trouble, tenants of foreclosed properties, and neighborhoods
  - Governor's Agreement
  - DoC Collection of Workout Data
- **What still needs to be done?**
  - Greater pressure on servicers/lenders to provide real long-term, sustainable loan *modifications*, including principal reductions
  - Servicer-specific reporting on loan modifications and outcomes

# Helping Future Borrowers: What still needs to be done?

- **California Lags Compared To Other States:**
  - **Prepayment Penalties:** 6 states ban on all home loans (AL, IA, MD, NJ, NM, VT); 4 states ban on all subprime loans (CT, MN, NY, NC)
  - **Yield Spread Premiums:** NC bans on subprime loans; MA bans when there is a conflict of interest between broker and borrower
  - **Broker Duties:** Numerous states (incl. CO, MA, ME, MN, NC, OH, WA) impose strong duties on mortgage brokers
  - **Broker Bonding:** CA one of only a handful of states that has no financial credibility requirement for independent mortgage brokers.
  - **Steering:** Numerous states include anti-steering language (incl. AR, CT, D.C., CO, ME, NY, NC, OH, WA)
  - **Anti-Flipping:** CO, IL, ME, MN, NM, NC, OH ban flipping for all loans, unlimited in time; others ban for all loans during stated time period (5 yrs: RI, MA; 42 mos.: SC; 1-yr: AK, AR, VA).

# Helping Future Borrowers: What still needs to be done?

- **Stronger protections against abusive practices**
  - Apply protections to non-traditional loans
  - Ban prepayment penalties on subprime loans
  - Ban yield spread premiums on subprime & nontraditional loans
  - Require language translation for non-English speakers
  - Impose duty of good faith & fair dealing on mortgage servicers
  - Prohibit involuntary waivers of rights

# Helping Future Borrowers: What still needs to be done?

- **Strong rules and regulations for independent mortgage brokers regarding all mortgage loans**
  - Strong fiduciary and other duties
  - Significant bonding requirement
  - Ban on steering
  - Extended ban on loan flipping
- **Widen enforcement avenues**
  - Incorporate Reg Z's into CA law
  - Allow enforcement by local law enforcement
  - Increase damages/penalties for violations
  - Allow borrowers to raise violations of the law as a defense to foreclosure, and to pursue claims against the mortgage holder

# Contact



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