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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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

![Line graph showing completed foreclosures and notices of default in California from 3Q 2006 to 2Q 2008. The data is sourced from DataQuick (www.dqnews.com).]
Fewer Borrowers Escaping Foreclosure

Source: DataQuick (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

http://www.responsiblelending.org
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

http://www.responsiblelending.org
LA Foreclosure Concentrations Intensify, April 2008

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

Legend
- Less than half a percent
- .5 to 1.4 percent
- 1.4 to 2.8 percent
- 2.8 to 4.2 percent
- More than 4.2 percent
- Insufficient Data

Source: McDash Analytics, LLC and FRBSF calculations

http://www.responsiblelending.org
California Housing Market Increasingly Dominated By Foreclosure Sales

Source: DataQuick (www.dqnews.com).
Foreclosures: More to Come

CA Subprime ARM Reset Volume

Dollar Volume ($ billions)

July 07, August 07, September 07, October 07, November 07, December 07, January 08, February 08, March 08, April 08, May 08, June 08, July 08, August 08, September 08, October 08, November 08, December 08
2nd 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

Source: Credit Suisse, as reported in Business Week, 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

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

Source: FirstAmerican CoreLogic, LoanPerformance Data provided by NY Fed (June 2008) (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

The Effects of Foreclosures: A Drain on California Homeownership

Net Loss of 175,000 CA Homes

http://www.responsiblelending.org
II. Loan Modification Efforts
Modifications Are Not Keeping Pace with Foreclosure Activity

Sources: DataQuick (www.dqnews.com); DoC reported data (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)
California DoC Data on Loan Mods

- 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
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