



Dreams Deferred:

Impacts and Characteristics of the California Foreclosure Crisis

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Key Findings:

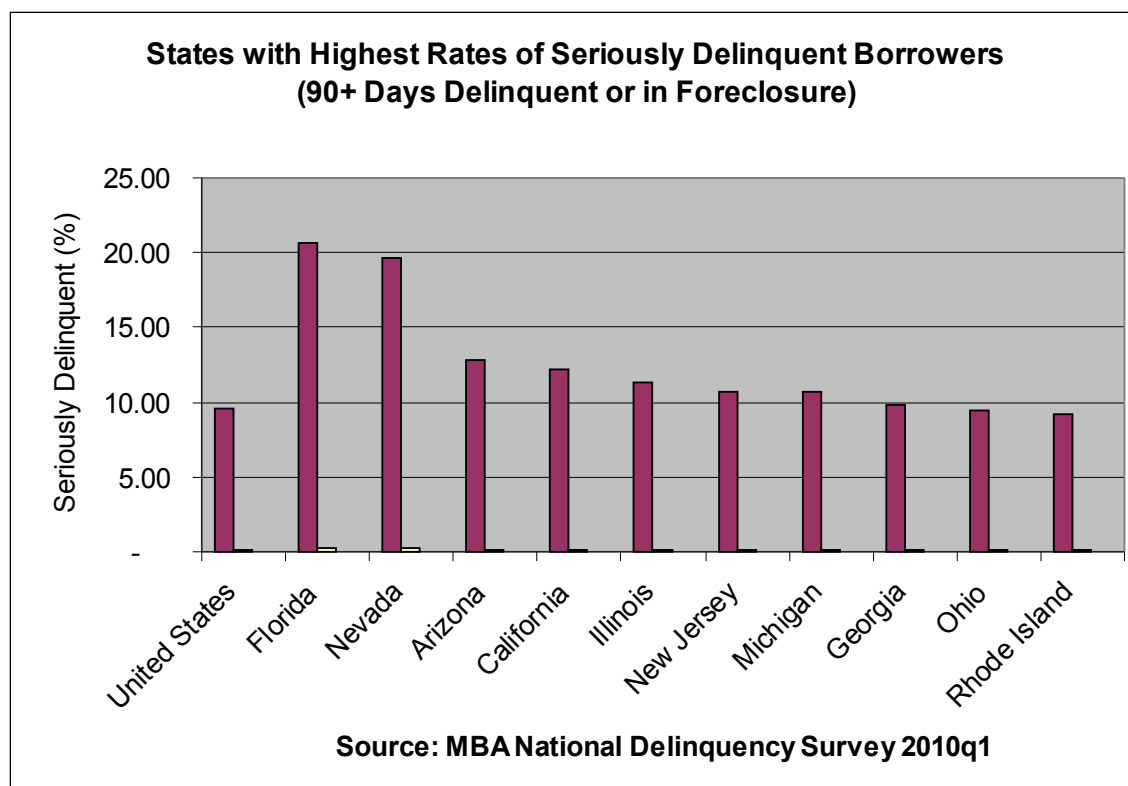
- The concentration and volume of California foreclosures differ dramatically by region. California's Central Valley and Inland Empire have the highest concentrations of foreclosures, while the volume of foreclosures is highest in major cities.
- Latino and African-American borrowers in California have 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 Latino loans in those years, almost half (48%) of all California foreclosures have been of Latinos.
- 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.

SECTION 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.¹ In California the situation is even grimmer, with nearly one in eight—or approximately 702,000—homes currently in foreclosure.² California ranks 4th in the United States in mortgages that are seriously delinquent, defined as 90 days or more delinquent or in foreclosure, behind Florida, Nevada, and Arizona.³

California's foreclosure crisis shows little sign of abating. The state's housing crisis has devastated the economy and its unemployment rate now stands at 12.3 percent.⁴ The high level of unemployment only serves to increase mortgage defaults, thereby contributing to a negative cycle where unemployment exacerbates the foreclosure epidemic, which, in turn, exerts downward pressure on the economy and elevates unemployment. Furthermore, California's mortgage market accounted for more than 30 percent of the nation's Alt-A loans between 2000 and 2007.⁵ Though these loans have already experienced steep increases in defaults, the expiration of low introductory payments on these will continue through 2012 and the resulting payment shocks threaten to worsen the crisis.⁶

Figure 1: States with Highest Rates of Seriously Delinquent Borrowers



Background on the Foreclosure Crisis

The foreclosure crisis had its genesis in abusive lending practices that were concentrated in the subprime and Alt-A mortgage markets,⁷ where risky mortgage products and lax underwriting standards were common. During the height of these markets, loan products typically had features such as initial “teaser” rates (that were often higher already than prime rates) that exploded to much higher rates when they reset. While these features challenged borrowers who were sold products unsuitable to their situation, the unsustainability of these products was ultimately driven by poor underwriting practices, such as failing to adequately consider borrowers’ ability to repay. Examples of poor underwriting abound. During this time it was routine not to document borrowers’ income or assets, to use “piggy-back” second liens to originate mortgages up to and (in some cases) beyond the full value of the home, and even to ignore built-in payment increases when evaluating a borrower’s ability to repay a loan.⁸

Loans made under these conditions were never sustainable in the long run, but during the period of rapid housing appreciation that marked the first part of this decade, borrowers were often able to refinance or sell their home when their mortgage payments reset to higher amounts. Indeed, many lenders used this phenomenon to assure borrowers who doubted their ability to repay future amounts that they would be able to avoid higher

payments by refinancing. Lenders also profited from the serial refinancing of borrowers' mortgages, while stripping equity from the borrowers themselves. The assumption of never-ending housing appreciation was also held by Wall Street, which provided virtually unlimited capital for this type of lending.⁹ However, once housing prices leveled off, and then began to fall, borrowers lost their escape routes from unaffordable payments. Millions of borrowers defaulted on their mortgages, leading to the virtual collapse of the subprime market. At the same time, it became clear that the financial derivative products that were based on these loans had been enormously mispriced and mismanaged, further undermining the mortgage market, the financial system, and rippling throughout the broader economy. The consequential rise in unemployment only added to the woes of the housing market, spreading the foreclosure crisis far beyond the subprime and Alt-A markets into the prime market as well, devastating families and communities across the country.

The damage resulting from foreclosures is multifaceted. First, there are the immediate and direct impacts on families associated with the disruption and upheaval of eviction. The detrimental consequences that forced displacement can have on children's education and a family's health and employment are significant.¹⁰ Second, there is the loss of wealth that homeownership typically provides. Homeownership has been the primary source of economic mobility and financial security in this country. 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 in the future.

Finally, in addition to the devastation caused to individuals and families who directly lose their homes, foreclosures have broader negative impacts on communities. Homeowners who live near foreclosed properties experience depreciated home values.¹¹ Moreover, communities with high concentrations of foreclosures lose tax revenue while incurring the financial and non-financial costs of abandoned properties and neighborhood blight.¹²

The Geographic and Demographic Dimensions of Foreclosures

The Geographic Distribution of Foreclosures

People often refer to the "California housing collapse" or state-level foreclosure statistics as if the state's housing market were a single entity. Of course, every state has multiple housing markets that are affected by a host of dynamics such as the local lending environment and unemployment. This is particularly true in California, which represents 13 percent of outstanding loans in the U.S.¹³ This large market share is spread out over 35 different metropolitan areas, in addition to the substantial share of non-metropolitan rural areas in the state. From the agricultural and exurban mix of the Central Valley and

Inland Empire, to the larger, densely-populated cities of San Diego, Los Angeles, San Jose, San Francisco, and Sacramento, to the rural lands of the eastern and northernmost parts of the state, California's housing market is extremely diverse. Therefore, understanding how the foreclosure crisis has affected different parts of California is critical as both state and Federal policy makers craft housing policies moving forward.

The Demographics of Foreclosures

It is well documented that African-American and Latino families disproportionately received the most expensive and dangerous types of loans during the heyday of the subprime market. According to analyses of the Home Mortgage Disclosure Act data, higher-rate conventional mortgages were disproportionately distributed to borrowers of color between 2004 and 2008. For example, in 2006, among consumers who received conventional mortgages for single-family homes, roughly half of African-American (53.7 percent) and Hispanic borrowers (46.5 percent) received a higher-rate mortgage compared to about one-fifth of non-Hispanic white borrowers (17.7 percent).¹⁴

In addition, a CRL study showed that African-American and Latino borrowers were more likely to receive higher-rate subprime loans than white borrowers with similar risk profiles, while another study provided evidence that loans in minority communities were more likely to carry prepayment penalties than loans in white communities, even after controlling for other factors.¹⁵

Risky loan products—especially subprime products—have been shown to be more likely to default.¹⁶ It therefore stands to reason that borrowers of color, which were targeted by subprime lenders and steered into the most abusive products, would be disproportionately bearing the brunt of this foreclosure crisis. Anecdotal evidence from around the country of African-American and Latino communities being devastated by the crisis, combined with a recent report by the National Community Reinvestment Coalition on foreclosures in Washington D.C. and a CRL study that estimates the demographic distribution of foreclosures, suggest that this is in fact, the case.¹⁷

However, the degree to which communities of color have been impacted in any given state is difficult to know, as demographic data on foreclosed borrowers is not generally available. Furthermore, the specific dynamics at play in the California market—its unusual composition of prime and non-prime loans and the particularly large size of its housing collapse—suggest that national demographic trends may not be generalizable to California.

In this report, we look to see which geographic areas and demographic groups have been hit hardest by the foreclosure crisis in California. Since developing effective policy responses to the foreclosure crisis necessitates understanding not just the number of foreclosures that have and will occur, but also the distribution of foreclosures among various communities and populations, we hope this report will help policymakers as they seek to allocate resources in effective and efficient ways. Section II of our paper outlines the data and methods that we use to analyze the geographic and demographic

compositions recent California foreclosures. Section III presents our findings and Section IV provides policy recommendations and concluding remarks.

SECTION II: DATA & METHODS

Our data come primarily from three sources. Foreclosure data were purchased from Foreclosure Radar, a private vendor of foreclosure filings. Foreclosure Radar collects notices of default, notices of trustee sale, and actual foreclosure sales from every county in California.¹⁸ We purchased data covering 1,218,230 foreclosure filings from the period September 2006 to November 2009. Each record included the property address, borrower name, and loan amount. There is also limited information on the physical characteristics of the property, including number of bedrooms and square footage.

Because multiple foreclosure actions can be filed for a single property (e.g., a notice of default and a completed foreclosure sale would each be filed separately), we reduced the dataset to 877,173 unique properties, keeping only one foreclosure record per property. We consider this dataset to substantially cover the universe of properties with foreclosure activity from the fourth quarter of 2006 through October of 2009.¹⁹

To get information on the race and ethnicity of foreclosed borrowers, we combine the Foreclosure Radar data with demographic data from Catalist, an aggregator and provider of data and related software and services. Catalist's data come from a combination of voter registrations records and other government and commercial data sources.²⁰ In addition to providing data, Catalist matched the foreclosure records from Foreclosure Radar to its database of demographic information.

CRL sent all 1,218,230 original foreclosure filings to Catalist to be matched to their database of voters.²¹ Prior to matching, Catalist spliced foreclosure filings with more than one owner into multiple records. Therefore, Catalist actually evaluated 1,535,070 records to be matched against their database. Of these, 996,742 records were matched,²² producing a match rate of 64.9%. After matching borrowers and de-duplicating properties, we had a sample of 625,356 unique foreclosed properties.²³

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 do not provide information on the purpose of the loan or the value of the foreclosed properties at origination. These are critical pieces of information for evaluating the validity of the claim that the foreclosure crisis is due to borrowers buying large, expensive homes. Therefore, we rely on a sample of California foreclosures from Lender Processing Services (LPS), a database containing information on individual loans collected from mortgage servicers,²⁴ to estimate the origination value of foreclosed homes. Specifically, for each ZIP code in California, we used LPS to calculate the average loan-to-value ratio (LTV) for each of four loan amount ranges for loans originated in each year between

2004 and 2008 and foreclosed in our timeframe.²⁵ We then applied these average LTVs to corresponding loans in our Foreclosure Radar database to estimate property values at origination. We also use LPS to analyze the loan purpose of foreclosed properties.

In addition to the Foreclosure Radar, Catalist and LPS data, we used a limited amount of data from the Home Mortgage Disclosure Act (HMDA), Mortgage Bankers Association National Delinquency Survey and the American Community Survey. Explanations of how these data were used are included in Sections III and IV.

Finally, while our analysis by location looks at foreclosures that occurred between September 2006 and November 2009, parts of our analysis are limited to loans originated between 2004 and 2008, since these are the years for which we have relevant HMDA and American Community Survey data. All analyses and tables which rely on specific subsets of data are labeled as such.

SECTION III: FINDINGS

As shown in Table 1, the vast majority of recent California foreclosures were on loans originated between 2004 and 2007. This is not surprising for two reasons. First, most borrowers who received their loans prior to 2004 likely would have built up enough equity during the housing boom to avoid foreclosure when the bubble burst. This equity would have allowed these borrowers to sell or refinance into another loan if and when they faced economic hardship or payment shocks. On the other hand, borrowers who received their loans closer to when housing prices peaked in 2006 built up little or no equity when prices fell and, therefore, were far less likely to have this option.

Table 1. Distribution of California Foreclosures between September 2006 and November 2009, by Origination Year

<i>Origination Year</i>	<i>Number of Foreclosures</i>	<i>Share of Total</i>
Before 2004	23,577	2.7%
2004	50,851	5.8%
2005	246,483	28.1%
2006	364,330	41.5%
2007	172,439	19.7%
2008	19,488	2.2%

Source: CRL analysis of Foreclosure Radar data

The second reason that we would expect foreclosures to be concentrated in the 2004-2007 cohorts is that this was the period during which the high-risk and weakly-underwritten subprime and Alt-A products were most aggressively structured, marketed and sold. Table 2 below shows U.S. subprime and Alt-A market share. While not all loans in these categories were problematic, recent experience shows that a great many were. During the peak period of 2004-2006, higher-cost subprime loans comprised 19.6 percent of total originations nationwide (by volume) while Alt-A loans made up another 23.8 percent—a total of more than 40 percent of all originations.²⁶

The density of foreclosures ... is highest in the Central Valley and Inland Empire, areas that became exurbs of the San Francisco Bay Area and Los Angeles.

The highest numbers of foreclosures occur in the major cities of both Northern and Southern California.

Table 2. Recent Subprime and Alt-A National Market Share of Total Volume

<i>Cohort</i>	<i>Total Volume (in billions)</i>	<i>Subprime Share</i>	<i>Alt-A Share</i>
2000-2003	\$10,093	7.6%	NA
2004	\$2,920	18.5%	12.5%
2005	\$3,120	20.0%	26.4%
2006	\$2,980	20.1%	32.1%
2007	\$2,430	7.9%	28.8%
2008	\$1,485	1.5%	6.9%

Source: Inside Mortgage Finance

In the next section, we discuss the disparate ways California's regions have been affected by the foreclosure crisis followed by the demographic composition of foreclosed borrowers. Finally, we discuss characteristics of foreclosed properties.

<p>The concentration and volume of foreclosures differ dramatically by region. California's Central Valley and Inland Empire have the highest concentrations of foreclosures, while the volume of foreclosures is highest in major cities.</p>

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 became exurbs of the San Francisco Bay Area and Los Angeles. Second, the highest numbers of foreclosures occur in the major cities of both Northern and Southern California.

Both of these trends have significant implications for homeowners. In the Central Valley and Inland Empire, the high concentration of foreclosures are devastating entire communities. In the larger cities of California, the sheer number of foreclosures affect a

greater number of families, both those who are directly losing their homes and those whose housing values drop with each foreclosure in their vicinity.

Areas with the Highest Foreclosure Concentrations

California's Central Valley is comprised of the Sacramento Valley in Northern California and the San Joaquin Valley in Southern California. Traditionally, the Central Valley is an agricultural center, but in recent years, has also become a bedroom community of the growing San Francisco Bay and Los Angeles metropolitan areas, serving the high exurban growth in California over the past ten years.²⁷

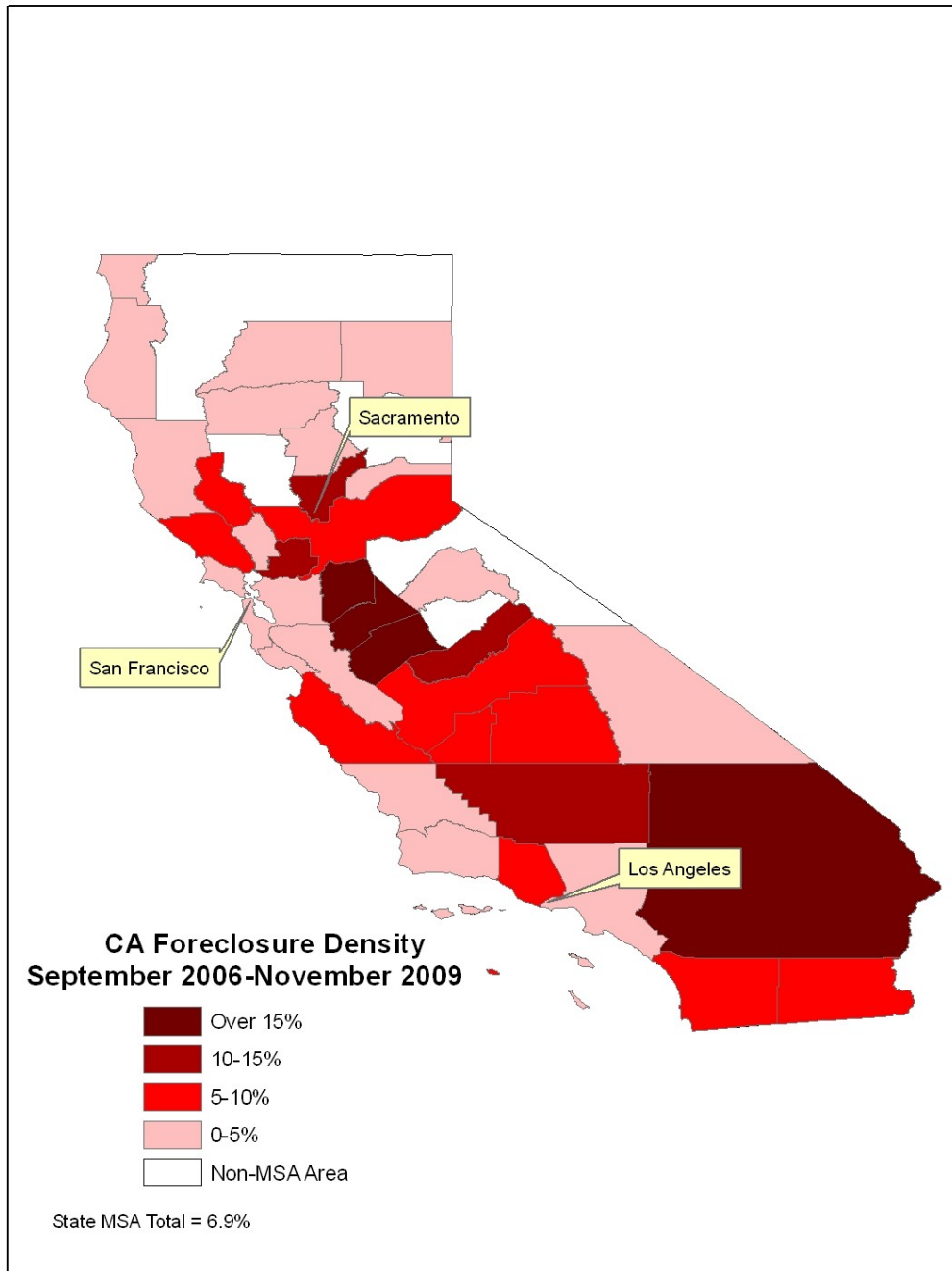
Below in Table 5, six of the top ten California Metropolitan Statistical Areas by foreclosure density, including the three highest, are located in the Central Valley. Since the fourth quarter of 2006, no California community has experienced a higher percentage of housing units entering foreclosure than Modesto, Merced, and Stockton. One of Los Angeles' bedroom communities, the Inland Empire of Riverside and San Bernardino counties, has both a high concentration and a high volume of foreclosures.

Table 3: 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%

Sources: Foreclosure Radar and U.S. Census

Figure 2: Foreclosure Density (foreclosures as a share of all housing units) of California MSAs September 2006-November 2009



Sources: Foreclosure Radar and U.S. Census

As an example of how fast the housing bubble grew in this part of California, Table 6 shows the ratio of median home price to area median income. Between 2000 and 2005, the price of the median home compared to the median income more than doubled in each of the four MSAs in the Central Valley. This may have been both an important factor in the increased incentive for borrowers to enter into a risky mortgage loan, and in the resulting volume of overextended borrowers entering foreclosure. The chart below also shows that these hardest hit MSAs also have high concentrations of Latino borrowers, offering yet another explanation for the disproportionate impact of California's foreclosure crisis on this community.

Table 4: Area Median Home Price-to-Area Median Income Ratios (select MSAs)

MSA	Median Home Price-to-AMI Ratio			Proportion of Population Comprised by Latinos		
	2000	2005	2008	2000	2005	2008
Modesto	3.09	7.30	5.48	45.3%	37.8%	39.6%
Merced	3.12	7.58	5.67	31.7%	51.5%	52.9%
Stockton	3.30	7.69	5.67	30.5%	34.8%	37.0%
Riverside-SB	3.14	6.86	5.85	37.8%	43.2%	45.7%

Source: CRL Calculations of American Community Survey Data, full chart available at Appendix A

Whatever the specific causes of the high concentrations of foreclosures in these areas, the declining economic conditions in the regions' agricultural centers have depressed communities and crushed surrounding property values. This, along with the threat of further foreclosures of subprime and Alt-A mortgages, poses serious adverse risks to California's economy, threatening both working-class and middle-class residents of a state already in economic distress.

Areas with the Highest Numbers of Foreclosures

While the map in Figure 2, which shows foreclosure densities, might suggest that the major cities of California—such as Los Angeles, San Francisco, and San Jose—have not been strongly impacted by the foreclosure crisis, this is not so. A different metric tells the second half of the California foreclosure story.

Foreclosures have an especially strong negative impact in densely-populated areas, where the spillover effects of neighborhoods in foreclosure can be widespread.²⁸ Los Angeles and its Inland Empire suburbs, followed by the cities of Sacramento, San Diego, and San Francisco, have the highest number of foreclosures among California MSAs. Although foreclosure concentrations are higher in several other MSAs, most in the Central Valley,

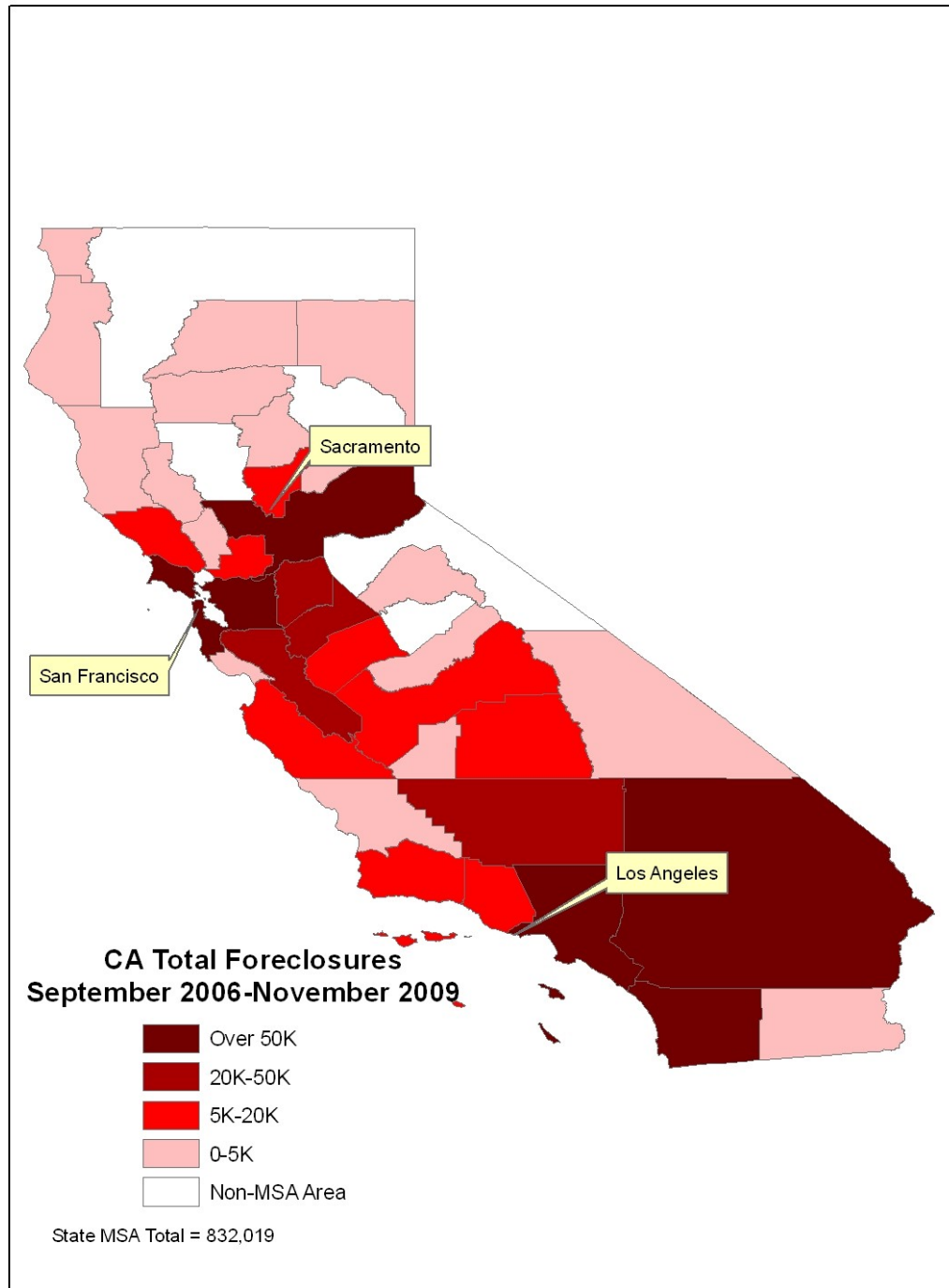
the sheer volume of foreclosures in California's major metropolitan areas is cause for concern. In fact, shown below, the top 10 MSAs in California by total number of foreclosures are home to the 20 most-populous cities in the state.

Table 5: Top 10 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

Sources: Foreclosure Radar and U.S. Census

Figure 3: Total Foreclosures in California MSAs, September 2006-November 2009



Source: Foreclosure Radar and U.S. Census

Because of the high housing density of these large cities, the spillover impact—that is the indirect impact on nearby homeowners and communities—is quite high. For example, in the Los Angeles-Riverside and San Francisco MSAs, there were 167 and 360 housing units per square mile in 2000, compared to 101 in Modesto and 36 in Merced.²⁹ Therefore, though the share of foreclosures as a proportion of all housing units is lower in these large cities, for every foreclosure there are more homeowners who lose home value as a result of living in closer proximity to a foreclose property.

Both of these effects—the deep damage caused by high concentrations of foreclosures in lower-population regions, and the broad impact of foreclosures in densely-populated cities—deserve immediate attention. In areas like Stockton, Modesto, and in the Inland Empire suburbs of Los Angeles, where foreclosures have been both dense and numerous, the need is most acute.

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 Latino loans in those years, almost half (48%) of all California foreclosures have been of Latinos.

In Table 6 below, we see that Latino borrowers comprise almost half of foreclosures (48.2 percent), which is far greater than their 32.1 percent share of the California population 18 or older, and more than double their 21.7 percent share of California homeowners.³⁰

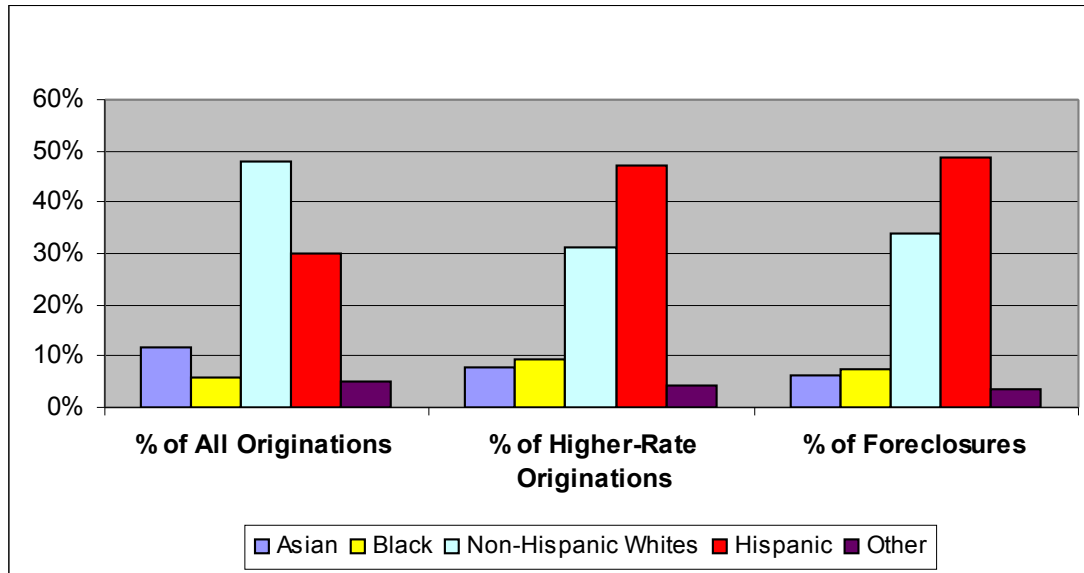
Table 6. California Foreclosures by Borrowers' Race and Ethnicity, All Loan Cohorts.

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

Source: CRL analysis of merged Foreclosure Radar/Catalist data sample of September 2006-November 2009 foreclosure filings

Latino foreclosures are also disproportionate compared to their share of loan originations. Figure 4 below shows that between 2004 and 2008, Latinos received 29.9 percent of all loans originated but accounted for 48.7 percent of foreclosures for these same loan cohorts. Notably, the Latino share of foreclosures is much closer to 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.³¹ African Americans have also disproportionately experienced foreclosure, with 7.6% of foreclosures on 5.7% of loans.

Figure 4: Racial and Ethnic Compositions of Originations and Foreclosures, (2004-2008 Loan Originations Only)



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

Importantly, this basic pattern holds even when controlling for loan amount; that is, when we group loans into categories based on the loan amount, the African-American and Latino share of foreclosures remains disproportionate compared to their originations. Table 7 below shows Latino and African-American borrowers' disproportionate foreclosure rate relative to White, non-Hispanic borrowers by loan amount category. For example, among all loans, Latinos and African-Americans experienced foreclosure rates 2.3 and 1.9 times that of non-Hispanic white borrowers.

For Latinos, their foreclosure share is nearly identical to their share of higher-rate loan originations within every loan amount category. Since higher loan amounts are generally associated with higher incomes, this analysis also suggests that income at origination was not leading to the foreclosure disparities. Rather, the calculations reflect the prominent role played by higher-rate loans in the foreclosure crisis to date. Reid and Laderman, researchers with the Federal Reserve Bank of San Francisco, have also found that borrowers who received a subprime loan in California had a greater chance of entering default even after controlling for differences in credit score, equity position and changes in housing prices.³²

Table 7. Originations vs Foreclosures by Loan Size (2004-2008 Loan Originations Only)

<i>Race/Ethnicity of Borrower³³</i>	<i>Share of Originations (%)</i>	<i>Share of Higher-Rate Originations (%)</i>	<i>Share of Foreclosures (%)</i>	<i>Disproportionate Foreclosure Rate Relative to White, Non-Hispanic Borrowers*</i>
<i>All Loans</i>				
Asian	11.5	7.9	6.3	0.8
Black	5.7	9.5	7.6	1.9
White, Non-Hispanic	47.7	31.1	34.0	1.0
Latino	29.9	47.1	48.7	2.3
<i>Loans <= \$250K</i>				
Asian	8.0	6.7	3.8	0.6
Black	6.1	8.8	7.4	1.5
White, Non-Hispanic	45.1	31.2	35.4	1.0
Latino	35.3	49.0	51.1	1.8
<i>Loans \$250-\$500K</i>				
Asian	13.2	8.0	6.1	0.7
Black	6.0	10.8	7.9	2.0
White, Non-Hispanic	46.5	28.9	31.1	1.0
Latino	29.4	48.1	51.9	2.6
<i>Loans \$500-750K</i>				
Asian	19.0	16.0	10.0	0.8
Black	4.0	8.9	6.8	2.4
White, Non-Hispanic	55.5	36.1	38.6	1.0
Latino	16.7	34.0	39.7	3.4
<i>Loans \$750+</i>				
Asian	15.2	16.4	10.0	0.8
Black	2.1	6.3	5.3	3.2
White, Non-Hispanic	72.6	58.9	57.9	1.0
Latino	5.9	14.0	18.8	4.0

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

** Share of foreclosures for a given racial or ethnic group divided by that group's share of loan originations, relative to same calculation for white borrowers. A score of one means no relative difference.*

Therefore, the patterns that we predicted—that is, that racial and ethnic patterns of foreclosures would mirror patterns in where nonprime loans were targeted—seems to hold true in California. Furthermore, the higher rates of unemployment and lower levels of wealth of African Americans and Latinos, relative to whites, is likely exacerbating the foreclosure rates in these communities.

Contrary to some claims, most foreclosures haven't occurred on sprawling "McMansions" but rather on fairly modest properties valued below area median values at origination.

A common misperception is that California foreclosures were caused by moderate- and middle-income families overextending their finances to purchase opulent homes. However, the facts tell a different story: foreclosed homes in California have been relatively modest in terms of both size and value. In addition, half of loans that resulted in foreclosure were used to refinance, not purchase, properties.

Loan Purpose

Selecting loans from LPS that were in foreclosure during the same time frame as our Foreclosure Radar data and examining the distribution of loan purpose, over 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.

Foreclosed homes in California have been relatively modest in terms of both size and value.

Half of all loans that resulted in foreclosure were used to refinance, not purchase, properties.

Foreclosed Properties

Foreclosure Radar data includes information about the physical property of the loan, including the square footage and number of bedrooms. Based on this data, the median size of a foreclosed home in California is 1,494 square feet, with two-thirds (67 percent) of these homes having three or fewer bedrooms.

In addition to property size, the empirical evidence suggests that foreclosed properties were of relatively modest value in comparison to other California properties. On average, the estimated property value at origination for foreclosed borrowers was only \$396,531, compared to a weighted area median property value of \$485,906. We 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. Foreclosed properties were particularly modest for Latino borrowers (see Appendix B).

Table 8: CA Foreclosures: Estimated Property Characteristics

<i>All Origination Cohorts</i>		
Number of Bedrooms	0-1	8.9%
	2-3	58.6%
	4+	32.5%
Square Feet	Median= 1,494	
	Average= 1,704	
Loan Purpose	50.3% Refinance	
	49.7% Purchase	
<i>2004-2008 Originations Only:</i>		
Estimated Average Home Value at Origination for Foreclosed Properties	\$396,531	
Area Median Property Value (Weighted to Reflect Foreclosures by Year of Origination and Geography)	\$485,906	
Percent of Homes with Estimated Home Values below Median at Origination	76.4%	

Source: CRL Analysis of LPS and Foreclosure Radar Data

SECTION IV: CONCLUSION & POLICY RECOMMENDATIONS

These findings give us a clearer picture of the foreclosure crisis in California. They also highlight troubling social dimensions of the event. The magnitude and nature of the crisis suggest three areas where policy changes are needed. First, 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 directly affected. Third, policies should be put in place to help avert a similar crisis in the future.

Prevent Avoidable Foreclosures

While an alarming number of California homeowners are in trouble, many foreclosures may be avoidable. Given the depth of the crisis documented here and elsewhere, and the effects of foreclosures on the communities least able to absorb losses, policymakers should redouble their efforts to keep homeowners in their homes.

Current mortgage servicer efforts to avoid foreclosures by providing affordable and sustainable loan modifications are inadequate. For example, the primary national program aimed at forestalling foreclosures is the federal Home Affordable Modification Program (HAMP). Yet HAMP, which requires servicers to reduce borrower mortgage and tax payments to 31 percent of income on qualified loans, has only produced 85,814 modifications in California from its inception in March 2009 through June 2010 while hundreds of thousands of Californians are currently at risk of losing their homes.

What's more, a July 2010 survey of 53 California housing counselors (representing approximately one-half of HUD-approved housing counseling organizations in the state and a caseload of more than 14,000 California homeowners) reveals continuing widespread problems with HAMP compliance and failure to provide proper evaluation and transparent processes for loan modification programs to homeowners throughout California.³⁴

We propose that the following steps be taken to prevent foreclosures more effectively:

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 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 here.

B. Incorporate principal reduction into loan modification programs, especially where housing prices have contributed to lack of affordability. In recently released data, CoreLogic reports that 34 percent of California mortgages are underwater, meaning that borrowers owe more on their mortgage than the home is worth, compared with 24 percent nationwide. 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.³⁵ Changes have recently been made to HAMP to encourage servicers to incorporate principal reduction into modifications for some borrowers, yet those reductions are optional rather than mandatory (within a program that itself is voluntary). Similarly, the FHA just released details of its new program designed to provide "short refinancing" for underwater homeowners who are not behind on their mortgages. These programs must be monitored carefully and if principal reductions do not begin to occur in significant numbers very quickly, policymakers should consider making such reductions mandatory.

C. Lift the ban on the 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 or investment banks like Lehman Brothers, but is denied to families whose most important asset is their home. Permitting judges to modify mortgages on principal residences, which carries *no cost to the U.S. taxpayer*, would address the main obstacles to the current voluntary programs

such as HAMP, 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.

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.³⁶

Address Consequences of Foreclosures

In addition to averting impending new foreclosures, policymakers could help strengthen the economy and communities by investing 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; enforcing tenant protections for renters of foreclosed properties; and providing funding to connect families displaced by foreclosure to local supportive services.

Promote 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 just a 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 lending marketplace and 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 nation begins to address a potential restructuring of the entire housing finance system, it is crucial to focus on the need for access to 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.

APPENDICES

Appendix A: Full AMI-to-Housing Price Ratio Chart

MSA	Latino Adult Pop.			AMI			Median Home Price			Median Home Price-to-AMI Ratio		
	2000	2005	2008	2000	2005	2008	2000	2005	2008	2000	2005	2008
Modesto	27.2%	33.5%	34.5%	\$40,101	\$47,525	\$50,359	\$123,900	\$347,100	\$276,100	3.09	7.30	5.48
Merced	40.5%	47.1%	48.0%	\$35,532	\$40,281	\$42,303	\$110,900	\$305,300	\$239,800	3.12	7.58	5.67
Stockton	27.0%	31.3%	32.7%	\$42,404	\$49,391	\$54,882	\$139,800	\$379,600	\$311,300	3.30	7.69	5.67
Riverside-SB	32.9%	38.8%	40.7%	\$41,282	\$50,756	\$56,472	\$129,700	\$348,200	\$330,400	3.14	6.86	5.85

Sources: American Community Survey, Census

Appendix B: Foreclosed Property Characteristics for White, Latino, African-American Borrowers

	<i>White</i>	<i>Latino</i>	<i>African-American</i>
Square Feet	Median=1,584 Average=1,786	Median=1,388 Average=1,554	Median=1,525 Average=1,712
Estimated Average Home Value at Origination for Foreclosed Properties	\$427,256	\$362,468	\$373,947
Area Median Property Value (Weighted to Reflect Foreclosures by Year of Origination and Geography)	\$479,821	\$494,804	\$505,525
Percent of Homes with Estimated Home Values below Median at Origination	68.0%	84.7%	80.7%

Notes:

- (a) This table is limited to properties in the merged Foreclosure Radar/Catalist sample, whereas Table 8 is based on the full Foreclosure Radar dataset.
- (b) The square footage calculations are based on all foreclosures of properties with loans from all cohorts, whereas all other calculations are limited to 2004-2008 originations due to the availability of metropolitan area median property values.

NOTES

¹ Mortgage Bankers Association National Delinquency Survey 1st Quarter 2010, May 26, 2010.

² Id.

³ Id.

⁴ Bureau of Labor Statistics, Regional and State Employment and Unemployment Report, July 20, 2010. Available at <http://www.bls.gov/news.release/laus.nr0.htm>.

⁵ Government Accountability Office, Characteristics and Performance of Nonprime Mortgages, July 28, 2009. Available at <http://www.gao.gov/new.items/d09848r.pdf>.

⁶ SNL Interactive analysis of CreditSuisse and Loan Performance data. Available at <http://www.snl.com/interactivex/article.aspx?CDID=A-10770380-12086>.

⁷ Broadly, Alt-A loans are provided to borrowers with prime or near-prime credit scores, but include one or more risky features commonly found in subprime loans, such as limited income documentation and interest-only periods.

⁸ *Report to Congress on the Root Causes of the Foreclosure Crisis*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, (January 2010), available at http://www.huduser.org/Publications/PDF/Foreclosure_09.pdf.

⁹ The inability to appropriately discern and price risk for these complex derivative instruments that were backed by these loans caused a huge demand for these instruments, that fueled and even encouraged dangerous lending practices and put upwards pressure on housing prices. Compounding the problem was an outdated regulatory system, which failed to recognize the changing structure of the mortgage market, the increased complexity of mortgage products and the consequences that these changes had on the vulnerability of consumers to predatory practices. This combination helped fuel an enormous housing bubble in California and many other states that lasted for the better part of this decade. For a rich discussion of the role of regulatory failure in the subprime crisis, see page 32 of *Report to Congress on the Root Causes of the Foreclosure Crisis* at http://www.huduser.org/portal/publications/hsgfin/foreclosure_09.html.

¹⁰ See Bowdler, Quercia and Smith, *The Foreclosure Generation: The Long-Term Impact of the Housing Crisis on Latino Children and Families*, National Council of La Raza (February 2010) available at <http://www.nclr.org/content/publications/detail/61725>. Also see Kingsley, Smith and Price. *The Impacts of Foreclosure on Families and Communities*. The Urban Institute (May 2009) available at http://www.urban.org/UploadedPDF/411909_impact_of_foreclosures.pdf.

¹¹ Homeowners living in close proximity to foreclosures suffer depreciated home values—last year, CRL estimated that, by 2012, surrounding property owners would lose \$1.86 trillion in home equity. See *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors \$502 Billion in 2009 Alone*, Center for Responsible Lending (May 2009), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf>.

¹² A recent report by the Urban Institute estimated the financial costs to local governments of a single foreclosure at \$19,229, available at http://www.urban.org/UploadedPDF/411909_impact_of_foreclosures.pdf, page 21. Also see Daniel Immergluck and Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, Housing Policy Debate (17:1) Fannie Mae Foundation (2006).

¹³ Mortgage Bankers Association National Delinquency Survey 1st Quarter 2010, May 26, 2010.

¹⁴ R.B. Avery, K.P. Brevoort, and G.B. Canner, “The 2006 HMDA Data” Federal Reserve Bulletin (available at <http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf>) Table 11, page A96. (December 2007)

¹⁵ See Debbie Gruenstein Bocian, Keith Ernst and Wei Li, “Race, Ethnicity and Subprime Loan Pricing,” *Journal of Economics and Business*, Vol. 60, Issues 1-2, January-February 2008, at 110-124; see also Debbie Gruenstein Bocian and Richard Zhai, “Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,” January 2005, available at http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf

¹⁶ A report published by the University of North Carolina showed that risky loan products, such as those with adjustable rates and prepayment penalties, are what drive loan defaults, not risky borrowers. See Ding, Quercia, Li and Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models* (May 2010) available at http://www.ccc.unc.edu/documents/Risky_Disaggreg_5.17.10.pdf.

¹⁷ See Debbie Gruenstein Bocian, Wei Li, Keith S. Ernst, *Foreclosures by Race and Ethnicity: Demographics of a Crisis*, June 2010 at <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf> and Tamara Jayasundera, Joshua Silver, Katrin Anacker and Denitza Mantcheva, *Foreclosure in the Nation’s Capital: How Unfair and Reckless Lending Undermines Homeownership*, National Community Reinvestment Coalition, April 28, 2010 at http://www.ncrc.org/images/stories/pdf/research/ncrc_foreclosure_paper_final.pdf.

¹⁸ Specifically, we purchased records associated with properties that were sold at foreclosure auction to either a lender or a third party within the time period of September 1, 2006 – November 1, 2009, Notices of Default filed between December 1, 2008 and November 1, 2009 and notices of trustee sale that were still actively scheduled for auction (have not been postponed or cancelled) as of November 1, 2009.

NOTES

¹⁹ This final analytic file of foreclosure data was very well-populated with respect to the variables of interest to us. Virtually all of the name address fields that were later in our analysis were populated, as was the field with the number of bedrooms. While it was necessary to drop some data due to values we deemed questionable (e.g. properties with square feet of less than 500 and greater than 30,000 are recoded as missing, as are loan amounts of less than \$5,000), even after removing this data, only 2.1 percent of loan amount data and 4.5 percent of square footage data were missing.

²⁰ Demographic data comes from both self-reported data from commercial sources as well as a proprietary imputation method based on name and address. Unlike many government forms of demographic data, Catalist demographic data does not break race and ethnicity into separate categories. That is, the Catalist data have only one variable that provides information as to whether the individual is Hispanic, Black, Caucasian, Asian, etc.

²¹ All of the original foreclosure filing records, rather than the “duplicated” filings, were sent to Catalist in order to maximize the the total number of record matches in case some filings had incomplete or inaccurate information.

²² Importantly, these 996,742 records did not represent unique properties, both because of the parsing of the data done by Catalist and because the original data from Foreclosure Radar were foreclosure filings and, therefore, could contain multiple filings per property. We therefore removed duplicate property listings, keeping the record with the earliest foreclosure record date and the first owner listed. When analyzing the demographic distribution of foreclosed borrowers, we are limited to this sample, which includes 625,356 unique foreclosed properties.

²³ Our merged data have almost complete information on borrower race and ethnicity, with less than one percent categorized as “unknown.” Comparisons of loan amounts, property size and geography distributions between the entire foreclosure dataset and the subset of merged Foreclosure Radar/Catalist data did not suggest any bias in the merged sample.

²⁴ By comparing LPS to HMDA originations, we estimate that LPS covers approximately 58 percent of the California market between 2004 and 2008.

²⁵ To mollify the impact of LTV outliers, for LPS loan stratification groups for which there were fewer than eight loans, we used the average LTV at the three-digit zip code level. The four loan amount categories were \$250,000 or less, \$250,000-500,000, \$500,000-\$750,000 and \$750,000 or higher.

²⁶ 2009 Mortgage Market Statistical Annual, Volume 1 Inside Mortgage Finance (2009).

²⁷ *Population Change in Central and Outlying Counties of Metropolitan Statistical Areas: 2000 to 2007*, U.S. Bureau of the Census, (June 2009), available at <http://www.census.gov/prod/2009pubs/p25-1136.pdf>.

²⁸ Dan Immergluck and Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, Housing Policy Debate (17:1) Fannie Mae Foundation (2006).

²⁹ The MSAs used in the 2000 Census for housing density differ from the ones used in the rest of our paper. Specifically, Los Angeles-Riverside-Orange County is one combined MSA, with a housing density of 167 and San Francisco-Oakland-San Jose are combined, with a density of 360. See Population, Housing Units, Area, and Density: 2000 at <http://factfinder.census.gov/>.

³⁰ U.S. Census, 2008 American Community Survey, Sept. 21, 2009. Summary available at http://www.wwwcensusgov.zuom.info/Press-Release/www/releases/archives/american_community_survey_acs/014237.html.

³¹ CRL calculations of HMDA data.

³² Carolina Reid and Elizabeth Laderman, “The Untold Costs of Subprime Lending: Examining the Links Among Higher-Priced Lending, Foreclosures and Race in California,” Federal Reserve Bank of San Francisco (revised August 6, 2009). Available at <http://iasp.brandeis.edu/pdfs/ReidPaper.pdf>.

³³ HMDA codes race and ethnicity separately. Specifically, there is one ethnicity variable that indicates whether the borrower is Hispanic or not Hispanic and five race variables, which allow borrowers to specify multiple racial identities. We considered any borrower in HMDA with any race variables coded as African-American to be black, regardless of their ethnic coding. Any non-African-American borrowers who list Latino as their ethnicity is considered to be Latino. Borrowers are only considered to be non-Hispanic white if they did not list any other racial designation in any of the five race variables.

³⁴ California Reinvestment Coalition, “Chasm Between Words and Deeds VI: HAMP Is Not Working” (July 2010), available at <http://www.calreinvest.org/system/assets/225.pdf>.

³⁵ CoreLogic, “Real Estate News and Trends,” May 10, 2010. News release available at http://www.sacbee.com/static/weblogs/real_estate/Sacramento-neg.%20equity%20Arden-Arcade-Roseville%20Real%20Estate%20News%20and%20Trends.htm.

³⁶ Neil S. Mayer, Peter A. Tatian, Kenneth Temkin, Charles A. Calhoun, “National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects,” Nov. 2, 2009. Available at <http://www.urban.org/publications/411982.html>