DEPARTMENT OF CORPORATIONS
California's Investment and Financing Authority

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Since the end of last year, the Department of Corporations has collected data from various mortgage loan servicers relating to loan modifications, forbearance plans, and foreclosures. We provided the information for the first three quarters of 2007 at the end of the year. The data that accompanies this memorandum include: (1) updated data for the calendar year 2007, and (2) January 2008 data.

Loan Modifications Increased In Last Quarter But Have Leveled; Forbearance Arrangements Have Increased

Modifications and forbearance plans are the primary programs designed for borrowers who seek to keep their homes. For the last quarter of 2007, lenders increasingly made loan modifications available to borrowers. The monthly number of modifications almost doubled beginning in the third quarter, with November reflecting a high water mark, which saw 8,061 modifications. The overall number of modifications has leveled off since November. For December and January the numbers are 5,780 and 5,630 respectively. However, the combined number of modifications and forbearance plans has remained in a constant range, between 8,000 and 10,000 per month, since October

2007, indicating the lenders are making greater use of forbearance arrangements. This represents an increase of roughly 50% in home retention efforts since the third quarter.

There appear to be at least two reasons for modification numbers leveling off in December and January. First, after modification plans designed to help avoid defaults arising from interest rate resets were announced in November, the Federal Reserve significantly reduced interest rates; the prime rate is now the lowest it has been since June 2005. Six-month LIBOR has also been reduced since November 2007. One lender reports that over fifty percent of the people who would have been eligible for a modification prior to the November agreement are now not eligible because they can tolerate the rate resets. So, in the streamlined process to determine whether borrowers can tolerate the reset, there are now fewer borrowers eligible for modifications. Second, the estimated number of resetting loans decreased approximately fourteen percent in January and is not expected to reach another spike until March 2008.[1]

The Number of Foreclosures Continues to Increase

The number of foreclosures in California has increased from roughly 6,500 per month for the last quarter of 2007 to over 10,000 in January 2008. There appear to be at least three principal reasons for this. One is that speculators continue to exit the market and, in light of evaporating appreciation potential, abandon the houses they bought for investment. Another concerns the recognition that some borrowers stretched too far at the outset and could not afford their initial mortgages, either because they took out too large of a loan at refinancing in the hope of further appreciation or expected to refinance after a couple of years but cannot in the current credit environment. (The fact that most of the modifications in January were made at interest rates below the starter rate support this.)

Third, a troubling new phenomenon is currently at work. Increasing numbers of borrowers, especially those who paid very little or nothing down or who refinanced out all their equity, and who live in areas of steep home price declines, have seen

[1] Banc of America estimates of reset schedule for hybrid ARMs across various sectors. July 18, 2007

appreciation potential evaporate and, instead of working with lenders to modify loans, are walking away from their homes[2]. No precise data exist yet to track this trend, but it has received much media attention[3], and lenders have expressed sufficient concern to conclude it is real, and not necessarily marginal.

No Silver Bullets, But Strategies Add Value

We have always stated that no single step would provide a silver bullet in the mortgage crisis. In addition to the state and federal loan modification agreements, critical strategies include counseling and outreach to borrowers to help and encourage them to work with lenders and the expansion of safe and lower cost credit to the California housing market, such as the very welcome recent expansion of federal conforming loan limits to accommodate CA housing prices. Nevertheless, servicers have stated that without these modification agreements there would be even fewer modifications and more foreclosures. In fact, we have seen increases in the number of modifications being done by virtually all the servicers since the time we began collecting data. But no single step can solve the foreclosure problem.

Efforts to get lenders engaged must increasingly be complemented by efforts to get borrowers engaged, and to keep them engaged in the homeownership process. We are troubled by evidence[4] that borrowers who are actively engaged in addressing credit card and auto loan obligations are not taking similar steps to address mortgage obligations. The State has engaged in outreach efforts that are showing promise in terms of getting borrowers to meet with housing counselors and lenders[5]. As these

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[2] The social stigma formerly attached to foreclosure appears to have dissipated. Consumers increasingly view foreclosure as a simple economic decision, as evidenced by the emergence of a service that counsels consumers on how to minimize the economic impact of foreclosure on borrowers.

[3] "Facing Default, Some Walk Out on New Homes", New York Times, February 29, 2008

[4] "Experian Subprime Lending Study Shows Consumers Are More Likely to Pay Bankcard Debt Before Mortgage Debt," *Experian Press Release,* 6/20/07

[5] Over 3,000 homeowners have attended the state's consumer education and counseling events. The Governor has launched a $1.2M public awareness campaign featuring real California families telling their foreclosure stories and urging others to call the HOPE Hotline for help. Additionally, CalHFA has been awarded $8M to fund consumer counseling.

efforts continue, we hope they show up more meaningfully, in updated data we will provide in the coming months. We will continue to push both lenders and borrowers to keep more people in homes and reduce pressure on foreclosures.