POLICY BRIEF
California Economic Outlook: Greater Foreclosures Loom, Threaten to Delay Economic Recovery
November 2009

Executive Summary

Reckless and abusive lending practices have left California victim to a foreclosure crisis with catastrophic consequences for families, communities and the state economy. Recent assessments and reports from policy analysts, industry insiders and the media suggest that the catastrophe is over: a bottoming of the housing and stock markets, the end of the recession, and the "green shoots" of recovery are all on the horizon. But the crisis is far from over in California. And if we are to get the economy on solid footing again, **California must adequately address the mortgage crisis by preventing avoidable foreclosures and stabilizing the housing market for the long-term.**

THE SOLUTIONS

- Establish a foreclosure process that ensures that mortgage loan servicers carefully review and document the economic alternatives to foreclosures that will keep borrowers in their homes.
- Given the large numbers of borrows who are deep underwater, loan servicers should be encouraged to reduce outstanding principal balances in their loan modifications so that borrowers can begin building equity in their homes.

THE PROBLEMS

The Economy: A bleak economic outlook is part of the spiral of bad news for California. Although the housing and mortgage crisis catalyzed the recession, as the economy worsens and unemployment increases, more unemployed homeowners are unable to pay their mortgages, leading to more foreclosures. These unemployment-driven defaults are putting further downward pressure on the housing prices and preventing a more robust economic resurgence. **Preventing avoidable foreclosures is therefore at the heart of economic recovery, can put a brake on downward housing prices and prevent unnecessary community blight that arises from concentrations of vacant homes.**

Foreclosure Backlog: For the January to July 2009 period, there were 89,287 actual foreclosures, but there were nearly three times as many – a remarkable 259,993 – notices of default. The wide gap between those entering the process and actual foreclosures cannot be explained by loan modifications and self-cures alone. Instead, the gap is likely due to delays in the foreclosure process caused by understaffing and lagging foreclosure-prevention efforts. **It is likely that the majority of this backlog will result in future foreclosures, as loan modifications are preventing foreclosures in fewer than one in five seriously delinquent loans.**

The Next Wave of Foreclosures—Alt-A and Option ARM Mortgages: California is on the brink of a second wave of foreclosures in the Alt-A mortgage market. Alt-A loans were made to near-prime quality borrowers**.** California accounts for more than 30 percent of the nation's Alt-A loans originated between 2000 and 2007. Risky features of these loans included stated incomes, interest-only payments, and with Option ARMs, negative amortization. **As subprime loans begin to pass their payment reset or recast dates, Alt-A loans will enter a period of dramatic payment shocks, starting in late 2009 through 2012.**

Underwater Mortgages: Growing levels of underwater mortgages are likely to push more already financially-strapped borrowers into default and/or foreclosure, either because they are unable to refinance into more affordable mortgages, or because they choose to walk away. **According to First American CoreLogic, in California 2.9 million borrowers, or 42 percent of all properties, are under water. DeutscheBank estimates that by 2011, nearly 70 percent of California homeowners will be under water.**