

TESTIMONY OF
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CALIFORNIA'S BUSINESS, TRANSPORTATION AND HOUSING AGENCY, AND
CHAIR OF GOVERNOR SCHWARZENEGGER'S
INTERDEPARTMENTAL TASK FORCE ON NON-TRADITIONAL MORTGAGES

HEARING ENTITLED
"THE EFFECTS OF THE FORECLOSURE CRISIS ON
NEIGHBORHOODS IN CALIFORNIA'S CENTRAL VALLEY:
CHALLENGES AND SOLUTIONS"

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

SEPTEMBER 6, 2008

Good morning Chairman Frank and members of the Committee, my name is Heather Peters and I am the Deputy Secretary for Business Regulation and Housing at California's Business, Transportation and Housing Agency. In that role, under Secretary Dale Bonner's designation, I provide continuous oversight on his behalf of four departments that regulate mortgage lenders, brokers, real estate sales and appraisals. I also oversee the California Department of Housing and Community Development and sit on the board of the California Housing Finance Agency (CalHFA) by designation of the Secretary.

Additionally, I am the Chair of Governor Schwarzenegger's Interdepartmental Task Force on Non-Traditional Mortgages. On behalf of Governor Schwarzenegger and Secretary Bonner I thank you for the opportunity to testify here today. We appreciate the committee's interest in this important subject and your travel to Stockton, one of the hardest hit areas in the nation's foreclosure crisis.

I have been asked by the Committee to address several subjects, including the State's response to the foreclosure crisis, collaborative initiatives, future predictions, mitigation of community destabilization and benefits of the new federal housing laws.

DESCRIBE WHY STOCKTON AND OTHER CITIES IN THE CENTRAL VALLEY ARE SO HARD HIT BY FORECLOSURES AND DETAIL THE EFFORTS OF LOCAL, STATE AND FEDERAL ENTITIES TO ADDRESS THE CRISIS.

There are many factors contributing to the high instance of foreclosures in California including lack of affordable housing, deterioration of lending standards, fraud, abuse, misuse of mortgage features, unreasonably optimistic assumptions of continued price appreciation, investor speculation, lack of market absorption of increased inventory, decreased liquidity and loan servicing challenges. The effects of these have been amplified in geographic areas such as the Central Valley where there was a high concentration of new home building and subprime lending.

There is no silver bullet to solve the foreclosure crisis. It is a multifaceted problem that requires a multifaceted solution. Discussed below are a number of steps California has taken to help address various different aspects of the problem.

COLLABORATION:

- **Interdepartmental Task Force:** In early 2007, Governor Schwarzenegger's Interdepartmental Task Force on Non-traditional Mortgages was formed to ensure a comprehensive and coordinated approach to the issue raised by these loans.
- **Agreements with loan providers:** On November 20, 2007 Governor Schwarzenegger announced the first in the nation agreement with loan servicers to streamline the modification of loans to freeze interest rates for some at-risk borrowers. His staff now meets quarterly with loan servicers, consumer advocates and counselors to discuss additional methods for streamlining loan modification decisions, including setting up "servicer days" where senior staff from a servicer can meet with counselors regionally to make decisions on pending loan modification requests in bulk.

- **Governor Schwarzenegger joined the OneCalifornia Foundation to announce a bridge loan fund** for homeowners facing foreclosure in Oakland to highlight the need for private partnerships to compliment government policies.
- **Local roundtables:** Governor Schwarzenegger and his staff have traveled throughout the state to meet with local government and stakeholders to discuss the different challenges they are facing in their regions and the various sources of help available.
- **National collaboration:** Governor Schwarzenegger and I have met with many national leaders to share successes and to strategize as discussed below.

REGULATION:

- **Issued new regulations to protect borrowers:** The Departments of Real Estate and Corporations issued strict new regulations requiring lenders to consider a borrower's ability to repay at the full interest rate and to closely scrutinize risk features. A new early disclosure form requires calculation of worst case scenario payments and loan balances under all available loan programs while consumers still have time to shop around.

LEGISLATION:

- **Legislation increasing protections:** In 2007 Governor Schwarzenegger signed three bills to increase protections for Californians who own or plan to purchase homes and to expand affordable housing.
 - **SB 223** made it a crime for licensed appraisers to engage in any appraisal activity that is connected to the purchase, sale, transfer, financing or development of property if their compensation is impacted by the final price generated by the appraisal.
 - **SB 385** permitted state agencies involved with residential mortgage lending and brokering to adopt the regulations discussed above on an emergency basis.
 - **AB 929** increased the amount of affordable housing in California by raising the total debt that the California Housing Finance Agency (CalHFA) can carry by \$2 billion. CalHFA issues bonds to finance housing for low and moderate-income families.
- **Legislation addressing foreclosures:** In 2008 Governor Schwarzenegger signed SB 1137 that requires lenders to attempt to contact borrowers before they file a notice of default to explore options to foreclosure. This new law also authorizes fines against lenders if they fail to maintain foreclosed properties and requires them to give any renters in the properties 60 days notice prior to eviction.
- **Letters to congressional leadership:** Governor Schwarzenegger wrote several letters urging Congress to increase funding for counseling and to raise FHA and GSE mortgage loan limits as accomplished in the Housing and Economic Recovery Act of 2008.

EDUCATION:

- **\$1.16 million in grant funds:** In September of 2007 the Housing and Community Development Department made \$1.16 million in Community Development Block Grant Funds available for counties and cities to use for consumer mortgage counseling.
- **\$8 million federal mortgage counseling grant** was received by the California Housing Finance Agency in partnership with the Rural Community Assistance Corporation (RCAC) and with the California Reinvestment Coalition (CRC) to help California homeowners avoid foreclosures.
- **\$1.2 million public awareness campaign:** Governor Schwarzenegger launched a \$1.2 million public awareness campaign to educate home owners about ways they can avoid foreclosures including a series of foreclosure prevention town hall workshops in the hardest hit areas around California.
- **The State partnered with HOPE Now** to promote the 888-995-HOPE hotline and launch HOPE Now's national consumer outreach tour with three California events, including one in Stockton.

STIMULUS:

- **\$5.6 million from the Federal Government to help mortgage and banking industry workers laid off** as a result of the subprime crisis make career transitions to high-demand jobs in other industries.
- **\$1.06 billion in Proposition 46 and 1C funds:** Since July 19, 2007, \$1.06 billion in bond awards have been announced to help more than 23,000 California families rent or purchase affordable housing.
- **\$72 million in federal HOME Investment Partnerships Program funds:** On January 30, 2008 awards totaling more than \$72 million in federal HOME Investment Partnerships Program funds were announced. Funds will be used to provide assistance to first-time homebuyers, reduce the number of bank owned homes and increase the number of rental properties.
- **\$200+ million CalHFA Community Stabilization Home Loan Program** (discussed below) will help first time home buyers purchase foreclosed properties below market.

DESCRIBE ANY ADDITIONAL EFFORTS, PARTICULARLY COLLABORATIVE INITIATIVES, AMONG FEDERAL, STATE AND LOCAL GOVERNMENTS THAT COULD HELP IMPROVE THE FORECLOSURE SITUATION.

Dialog with the federal government and with other states has been ongoing as response strategies have been developed and implemented during this national crisis. Discussed below are a few of these collaborations.

- **Governor Schwarzenegger met with President Bush and with the Secretary of Housing and Urban Development** to discuss federal efforts needed to reinvigorate California's housing market.

- **Governor Schwarzenegger led a town hall meeting with U.S. Treasury Secretary Paulson** in Stockton to publicize help available for homeowners facing foreclosure and to discuss new agreements with loan servicers to streamline loan modifications.
- **Governor Schwarzenegger met with FDIC Chairwoman Bair and Secretaries Bonner and Marin held a roundtable with her** in Los Angeles with lenders, consumer advocates and other stakeholders to discuss minimizing impediments to loan modifications.
- **As Chair of the Task Force I have addressed two regional conferences hosted by HUD and one hosted by the FDIC** to educate local stakeholders regarding the status of the market and government responses.
- **I have met with FHA Commissioner Brian Montgomery** to discuss the reinvigoration of FHA lending in California thanks to H.R. 3221 and the challenges posed by the loss of local FHA expertise due to FHA's 98% reduction in California loan originations between 2000 and 2006.
- **I participated in a stakeholder roundtable hosted by HUD Secretary Preston and Congressman Gary Miller** in the Inland Empire to discuss implementation of new federal and state loan programs.
- **The Secretary of HUD and I appeared together to kick off HOPE Now's national series of homeowner assistance events** to bring servicers together with borrowers face to face to discuss options available to avoid foreclosure.
- **I spoke at the National Governor's Association's Foreclosure Summit in Washington, DC** to share California's innovations with other state policymakers and exchange strategies for addressing the crisis.

Collaboration will continue in October as HUD, the U.S. Treasury and the National Governor's Association are planning a summit in Washington, DC to bring together national policy leaders to coordinate the implementation of various programs established in the new federal housing laws.

WHAT ARE THE FUTURE PREDICTIONS FOR FORECLOSURE IN THE CENTRAL VALLEY, AND HOW DID YOU COME TO THIS ASSESSMENT? DO YOU EXPECT INCREASING NUMBERS OF FORECLOSURES IN THE SHORT AND LONG-TERM? IF SO, AT WHAT POINT WILL THE AREA EXPERIENCE A TURNAROUND IN THE HOUSING MARKET?

If we have learned anything from this crisis it most certainly is that the housing market is unpredictable. We are experiencing a never before seen contagion of financial distress and tightening of liquidity which may have long lasting effects on California's housing market.

With that said, we are seeing some improvement in traditional measures of housing market performance driven largely by reduction in prices. In October of 2007 the statewide median price of a single family residence dipped below \$500,000 for the first time in recent memory. It is now \$350,760 according to the California Association of Realtors (CAR).¹ Regional median

¹ See Chart 1 in attached Exhibits to this testimony. Median prices from January of 2007 through August 2007 may have skewed high due to contraction in subprime lending resulting in fewer home sales at the lower end of the market. Subsequent contraction

prices have generally fallen across California due to the onset of the credit crunch.² Fewer and fewer regions have seen growth in median prices.³

The silver lining is that reduced prices have almost steadily resulted in increased sales recently, both month to month and year over year.⁴ According to a recent survey by the California Building Industry Association, affordability in San Joaquin County has more than doubled since the last three months of 2007 with 35.5% of homes sold being affordable to families earning median incomes. This is a dramatic increase from just 9.7% in the first quarter of 2007. According to this study, the Sacramento area is now California's most affordable market at 49.7%. CAR also recently reported good news on affordability. Statewide CAR reports that 48% of households can now afford an entry-level home compared with only 24% last year.

Equally important to improving the overall health of California's housing market is the fact that the volume of housing inventory on the market has finally begun to drop.⁵ Inventory is measured by the number of months it would take to sell all homes on the market at the current rate of sales. In April of this year, existing inventory was down below the same month one year before. Current inventory statewide is down to 6.7 months from 10 months a year ago. This is a significant improvement over the recent high of 16.8 months in January of this year.

Inventory levels are the factor most often cited by housing economists when asked to predict the bottom of a real estate downturn. Other factors routinely considered are the median number of days it takes to sell a home once it is put on the market. This measure has also improved dropping below the year over year level in April.⁶ Another factor to be considered is that interest rates which have been rising slightly in recent months, but still remain historically low.⁷ In July of 2008, CAR reported an average 30-year fixed mortgage rate of 6.43% vs. 6.7% one year prior, and an average adjustable mortgage rate of 5.24% vs. 5.71% last year. The passage of the permanent loan limit increases in H.R. 3221 should help reduce interest rates on jumbo loans as the secondary market now has certainty of the loan limit levels beyond the end of this year.

in the jumbo lending market resulting in fewer home sales at the high end of the market has helped accelerate the drop in median price.

² See Charts 2-4 in the attached Exhibits. Note CAR's reporting regional data for the Central Valley stopped after August of 2007.

³ See Chart 5.

⁴ See Charts 6-8

⁵ See Chart 9

⁶ See Chart 10

⁷ See Chart 11

However, there are factors that continue to deteriorate the housing market in California. Defaults are still high across the state, though they have started to level off at approximately 37,000 per month according to DataQuick.⁸ Some counties have started to see drops in the level of defaults including Sacramento, San Joaquin and Fresno.⁹ This is due in part to the fact that fewer subprime adjustable loans have been resetting as we reach the third anniversary of the 2005 vintage loans and the second anniversary of the 2006 vintage.

It is also due in part to the success of state and federal agreements with loan servicers to streamline loan modifications when default is imminent due to reset. The California Department of Corporations has collected the following recent data under Governor Schwarzenegger's voluntary agreement with loan servicers:

“The June results show that both the total number of loan workouts initiated and the number of loan workouts closed have increased. Especially important is that the total number of loan modifications – the type of workout most beneficial to consumers – has risen significantly, from 8,686 in May to 10,261 in June. This represents an 18% increase in loan modifications over last month. Over the same period, the number of foreclosures reported remained static, actually dropping slightly in June. A further encouraging sign is that loan modifications continue to rise as a share of total workouts. In May, loan modifications were 40.67% of total workouts. In June, loan modifications now represent 47.32% of total workouts.

It should also be noted that if the monthly numbers are combined as quarterly figures, the count of loan modifications rose from 19,391 in first quarter 2008 to 28,395 in the second quarter, a 46.43% increase.”

Nevertheless, completed foreclosure sales continue to rise, with 23,685 foreclosures completed in California for the month of June 2008 according to DataQuick. Foreclosures are still particularly high in the Central Valley where the counties of Stanislaus, San Joaquin and Sacramento reported foreclosures in June of 2008 of 851, 1155 and 1640 respectively.¹⁰ San Bernardino, Riverside and Los Angeles counties were even worse reporting 2,428, 3,222 and 3,676 foreclosures in June of 2008 respectively. These numbers are not surprising as foreclosure sales follow default notices by at least 90 days and defaults are only now beginning to level off.

Looking further into the future, California's housing recovery could be negatively affected if the overall economy deteriorates and more traditional drivers of foreclosures such as unemployment continue to rise. California's Employment Development Department recently reported that the State's unemployment rate increased to 7.3% in July, up from just 5.4% last July.

⁸ See Chart 12

⁹ See Chart 13

¹⁰ See Charts 14 & 15

Additionally, just as the worst vintages of subprime loans finish resetting, new problems are emerging in “Alt-A” and “Prime” mortgage markets where even borrowers with good credit scores are defaulting at higher rates as home prices and equity fall. Finally, California is expected to be particularly hard hit by resets on “Option ARM” loans which begin in earnest in 2010 and continue throughout 2011.¹¹ According to the New York Federal Reserve Bank 53% of all Option ARMs nationally are in California. It is hoped that mortgage holders will take advantage of the new FHA Hope for Homeowners loan program created by H.R. 3221 to refinance these borrowers and others into new affordable FHA loans.

DESCRIBE THE LARGE DESTABILIZING EFFECTS THAT OCCUR IN A NEIGHBORHOOD WHEN A FORECLOSURE TAKES PLACE, AND HOW CAN THEY BE MITIGATED?

Foreclosure statistics alone can only begin to describe how foreclosures have affected California. Property values throughout a neighborhood are decreased by each foreclosure and tax revenues decrease straining local and state budgets. Vandalism and other crime increases. Quality of life is affected as lawns in front of vacant homes die and health risks increase such as the potential spread of West Nile Virus as mosquitoes breed in undrained pools.

Collaboration between government, homeowners, non-profits and the private sector, such as discussed above, is key to creating successful local solutions to stabilize neighborhoods. Additionally, the California Housing Finance Agency (CalHFA) has created an innovative program called the Community Stabilization Home Loan Program (CSHLP).

On or shortly after July 1, 2008, CalHFA introduced the \$200 million CSHLP program to help put first-time homebuyers back in foreclosed properties in targeted communities of the State that have been hardest hit by foreclosures and in areas in need of economic stimulus. This program offers 30-year below-market fixed rate loans and affordable mortgage insurance to qualifying buyers.

Participating financial institutions agreed to make these foreclosed properties available at a minimum 12% reduction off current appraised values. Putting homeowners back in these properties will help revitalize hard-hit communities, stabilize home values and help provide economic stimulus to local neighborhoods. It is estimated that the program will provide between 800 and 1000 loans to first-time homebuyers. These loans will put homeowners instead of speculators and investor/landlords in these neighborhoods.

Although CSHLP is not designed to save existing borrowers in default, it does provide a viable, effective and potentially statewide beneficial use of foreclosed properties for affordable housing purposes. Ultimately, the program will get the foreclosed properties re-distributed much quicker in many cases than if the properties were “worked off” by the financial institutions.

Originally the program was offered in four counties (San Joaquin, Merced, Stanislaus and Riverside) and in an additional ten zip codes in the Bay Area, the City of Los Angeles and parts

¹¹ See Chart 16

of Los Angeles and San Bernardino Counties. The program has since been expanded to include an additional four counties (Sacramento, Contra Costa, San Benito and Monterey) and additional zip codes in the City of Oakland.

An expansion of CSHLP to cover the entire state is now being contemplated with anticipated funding from the recently enacted H.R. 3221. This new law contains additional tax-exempt bond authority (a.k.a. “bond cap”) for housing bonds that could fund additional loans. A total of \$1.177 billion of additional bond cap is expected for California under the new law. The law also contains expanded authority for use of tax-exempt housing bonds for the purpose of refinancing subprime loans (defined in the law as “adjustable rate mortgages”) of borrowers that are in “hardship” – a term to be defined by the bond issuer. The California Debt Limit Allocation Committee, the state entity that allocates bond cap to issuers, met on September 3, 2008 and outlined a process that will result in allocation of the additional bond cap by early December 2008.

TO WHAT EXTENT WILL PROVISION OF THE NEW FEDERAL HOUSING LAWS HAVE A POSITIVE EFFECT ON THE REGION, AND WHAT STEPS SHOULD BE TAKEN TO ENSURE THAT CENTRAL VALLEY COMMUNITIES WILL BENEFIT FROM THESE INITIATIVES?

Benefits of the new federal housing laws include the Hope for Homeowners FHA loans and the availability of additional bond cap to fund CalHFA’s CSHLP program discussed above. Another significant benefit of the new law is approximately \$4 billion in funding nationwide for the “Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes” program. California’s Department of Housing and Community Development (HCD) is working closely with HUD to insure that California receives its fair share of these funds and utilizes them quickly and wisely.

California hopes to receive significant funding under this program as nationally it has 27.14% of the foreclosed homes, 13% of the subprime loans, 22% of the subprime debt and 26.67% of the homes in default or delinquency. H.R. 3221 requires funding formulas to consider these factors, however, HUD will not be announcing its funding formula until the end of this month.

Additionally, on August 11, 2008, HCD announced \$30.4 million in Community Development Block Grant awards for 36 non-entitlements in California. The Central Valley received approximately \$7.2 million of those awards.

I hope this discussion of our efforts and accomplishments has emphasized California’s commitment to aggressively address the crisis. In so doing, Governor Schwarzenegger encourages others to do the same as only multifaceted solutions reaching across local, state and federal jurisdictions, and across public and private partnerships, can begin to address this multifaceted problem. The Administration remains firmly committed to collaborating with all stakeholders and to find innovative ways to lead us out of this crisis and restore the American dream in California and across the nation.

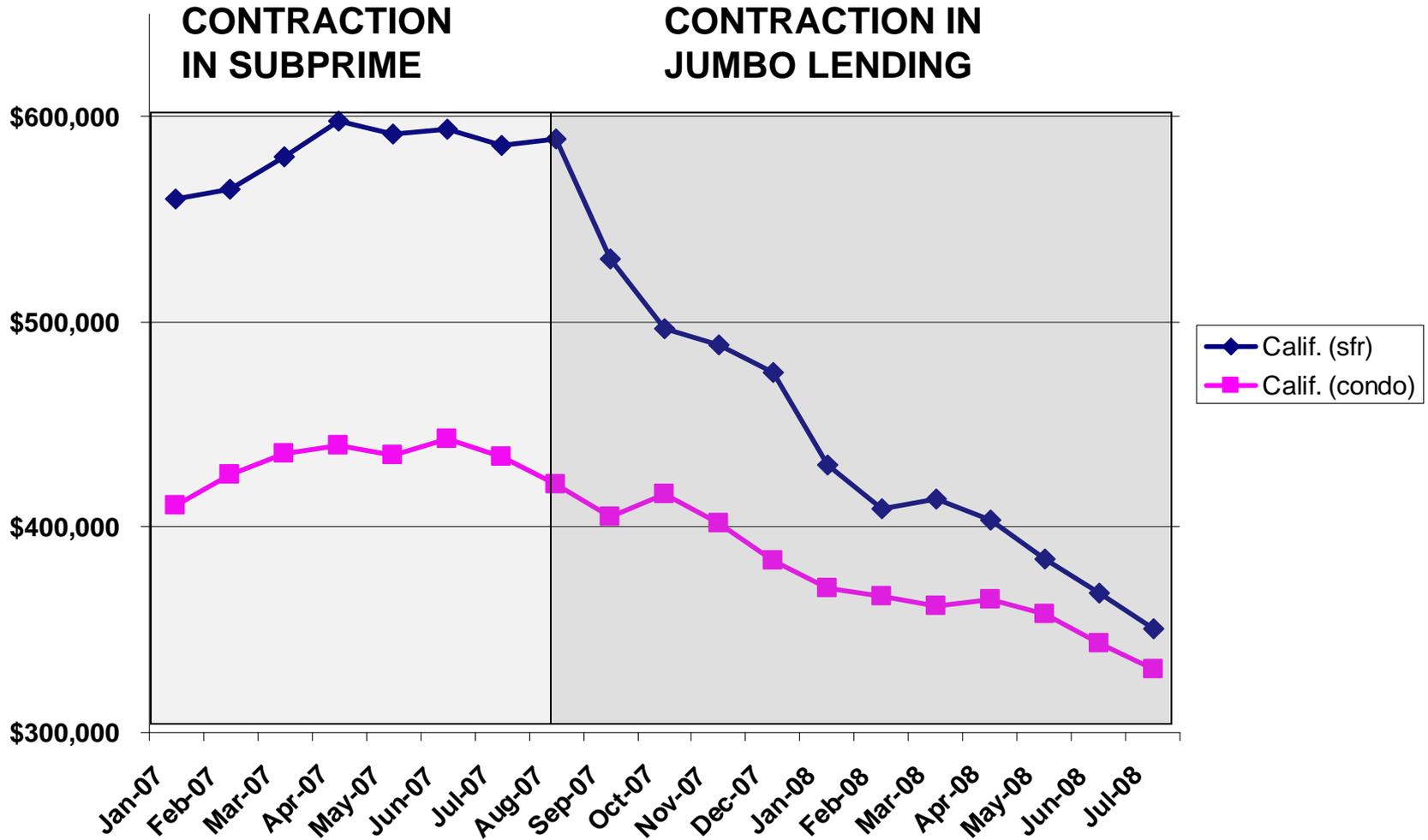
Testimony of Heather Peters

This concludes my statement. I thank the Committee for the opportunity to meet with you today to discuss this important issue. I look forward to taking any questions you may have.

**EXHIBITS TO TESTIMONY OF
HEATHER PETERS**

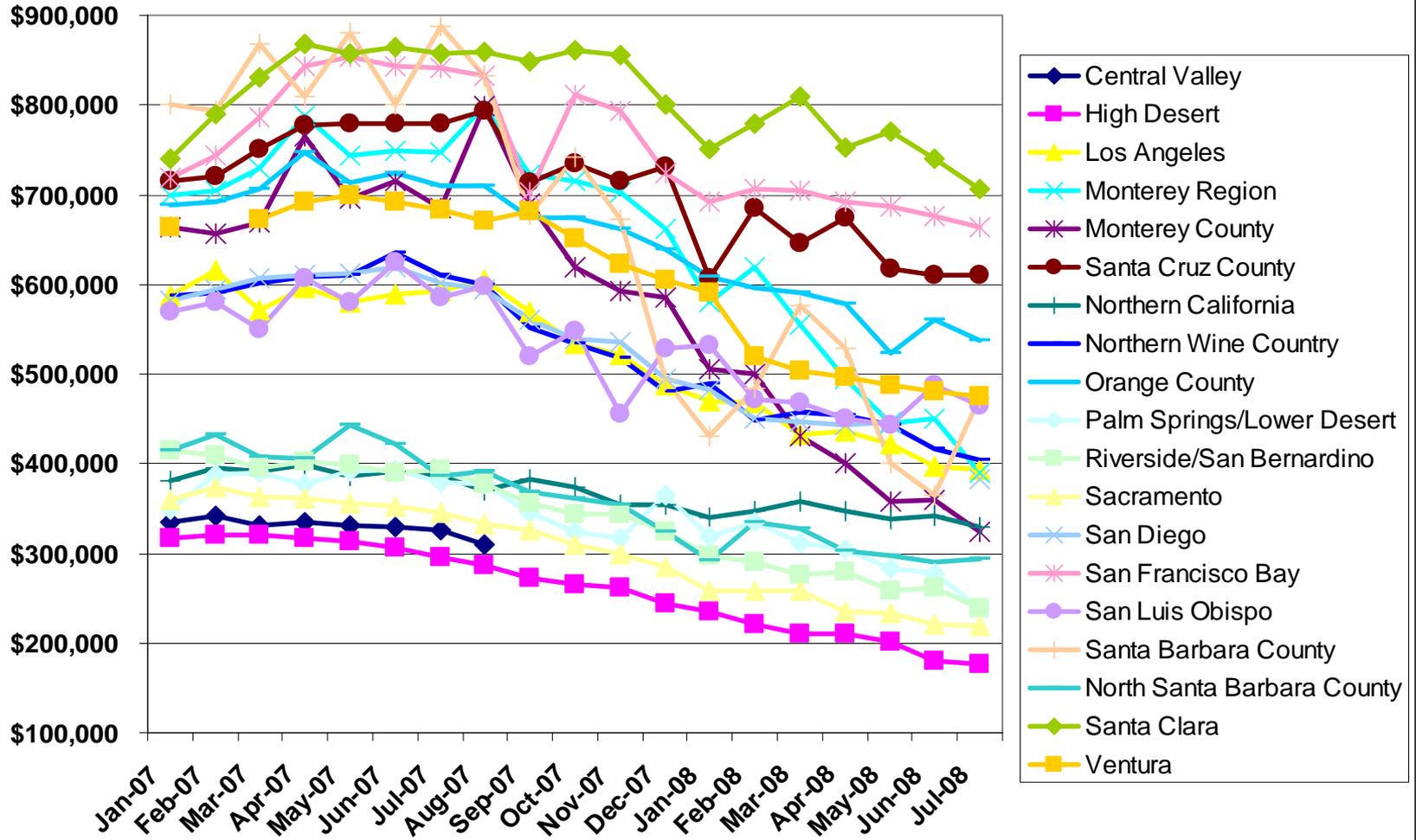
CALIFORNIA MEDIAN HOME PRICE

(Per CA Assoc. of Realtors)



REGIONAL MEDIAN PRICES

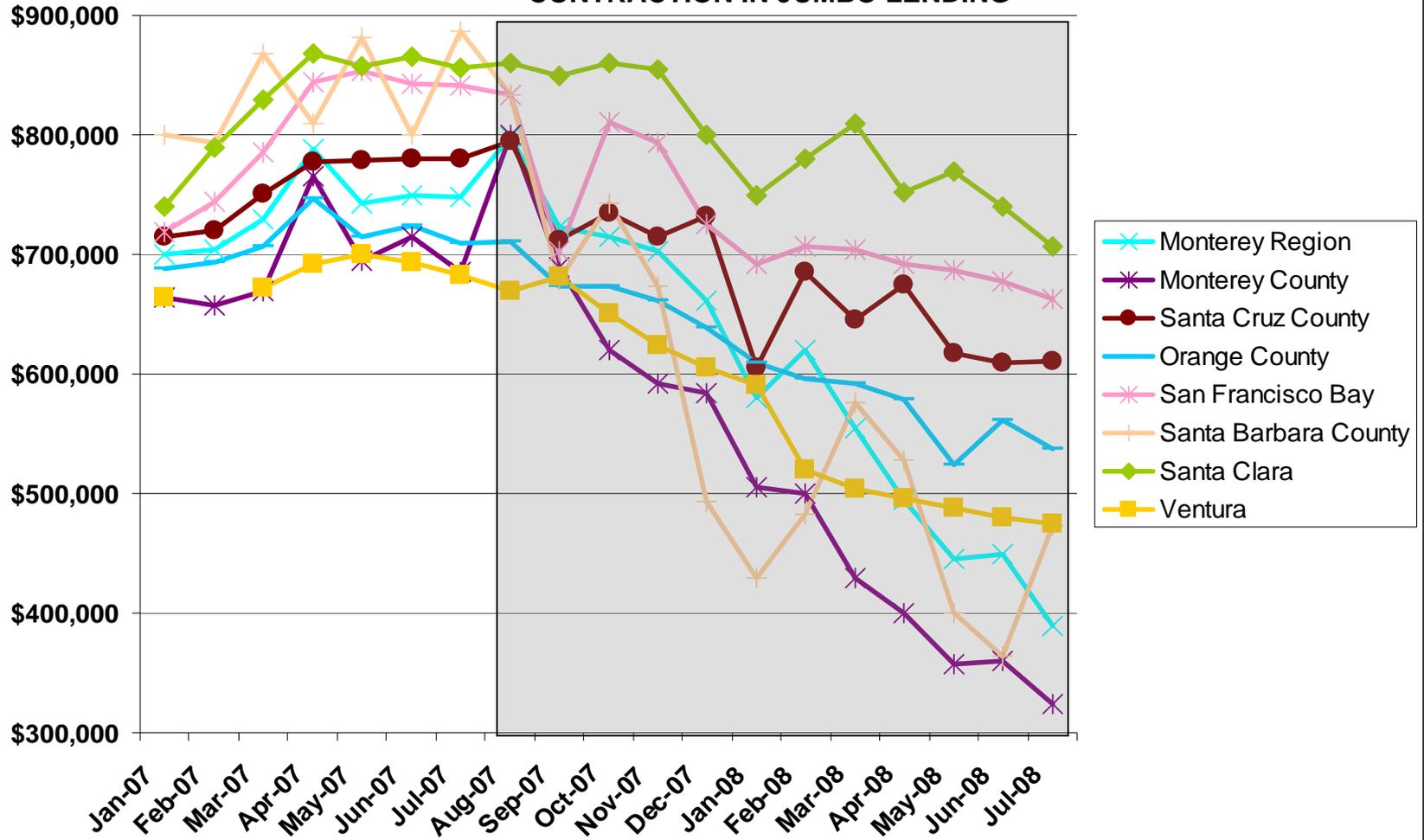
(Per CA Assoc. of Realtors)



HIGH END MARKET MEDIAN PRICES

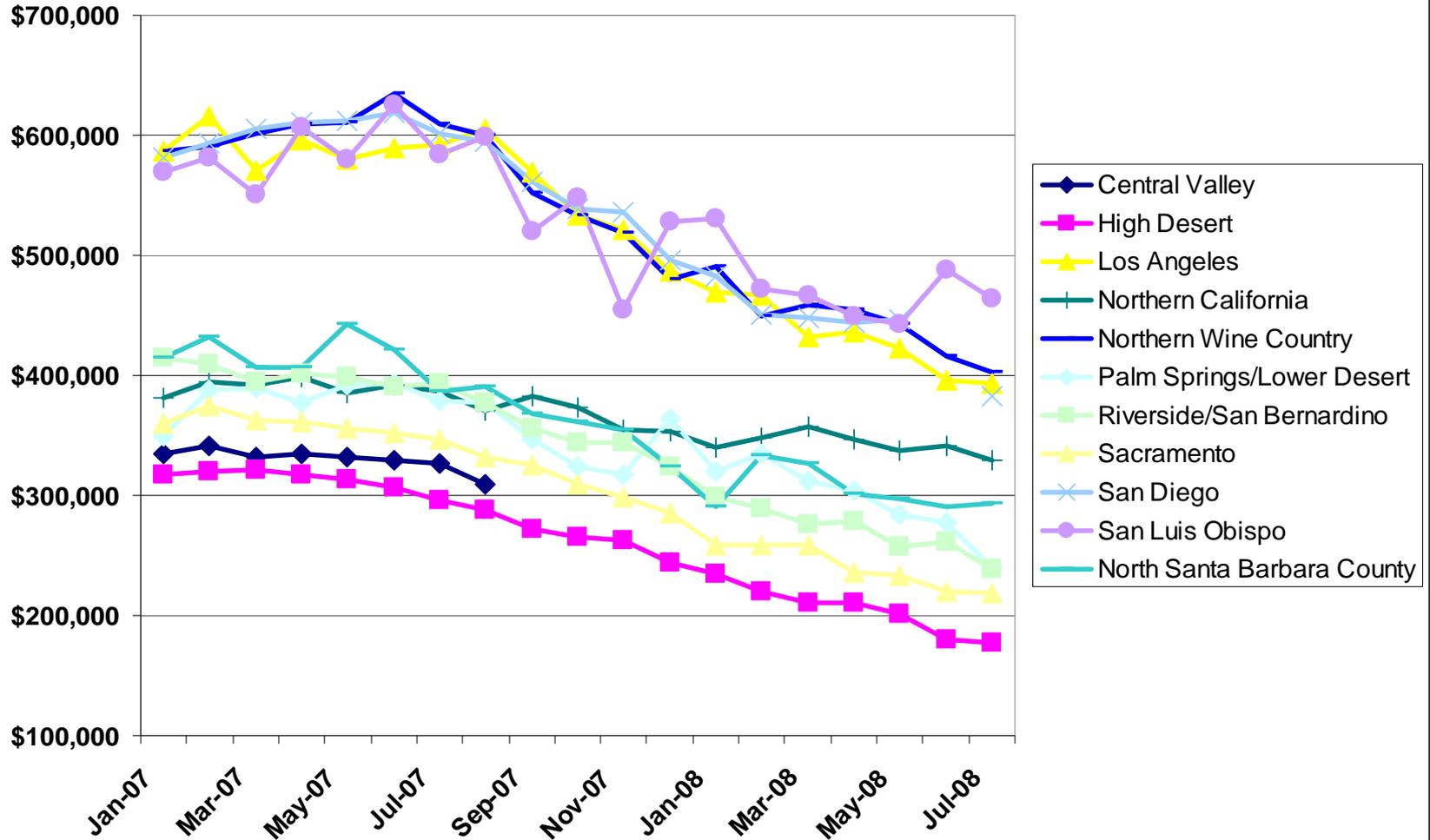
(Per CA Assoc. of Realtors)

CONTRACTION IN JUMBO LENDING

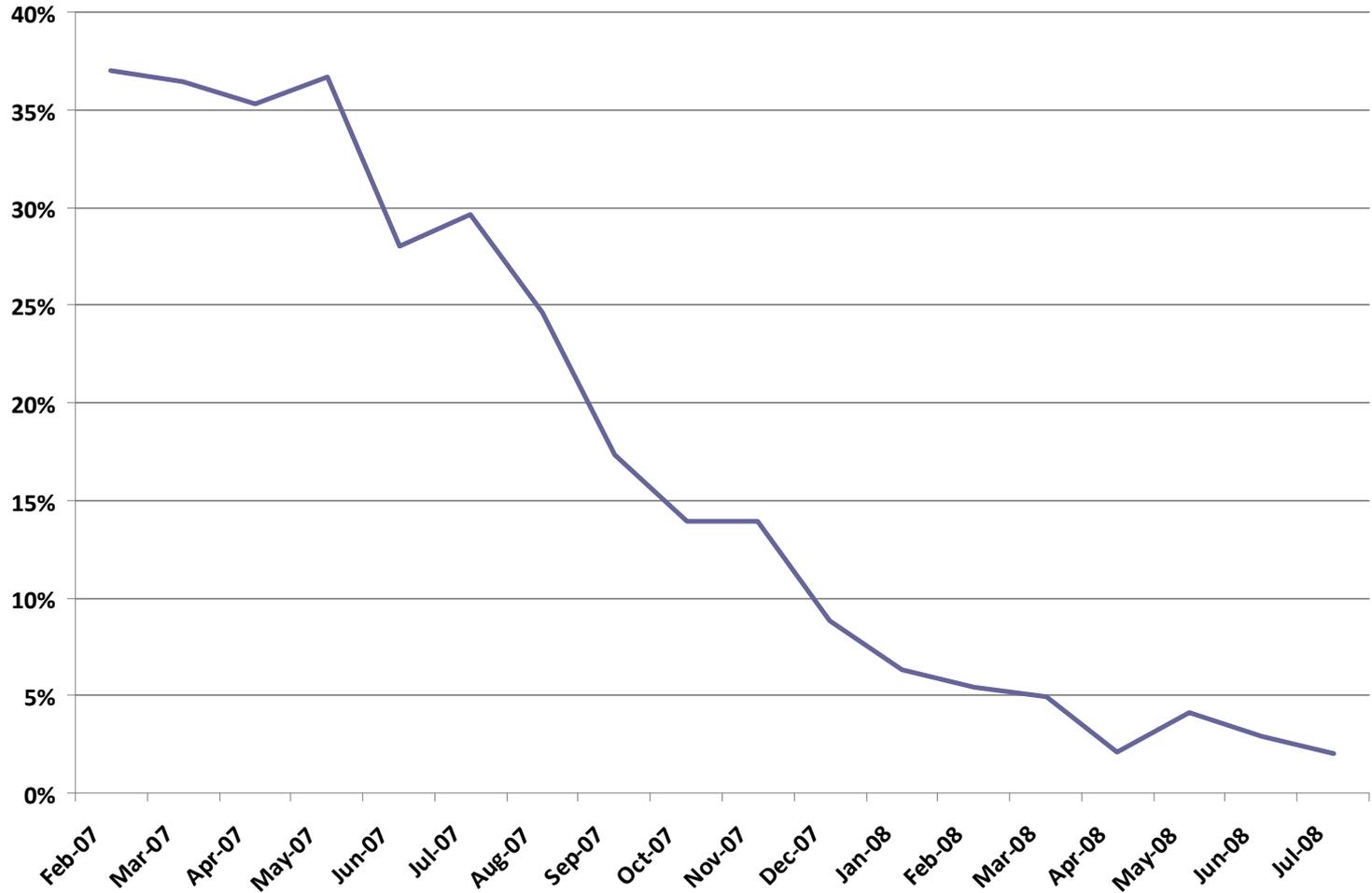


LOW AND MID-MARKET REGIONAL MEDIAN PRICES

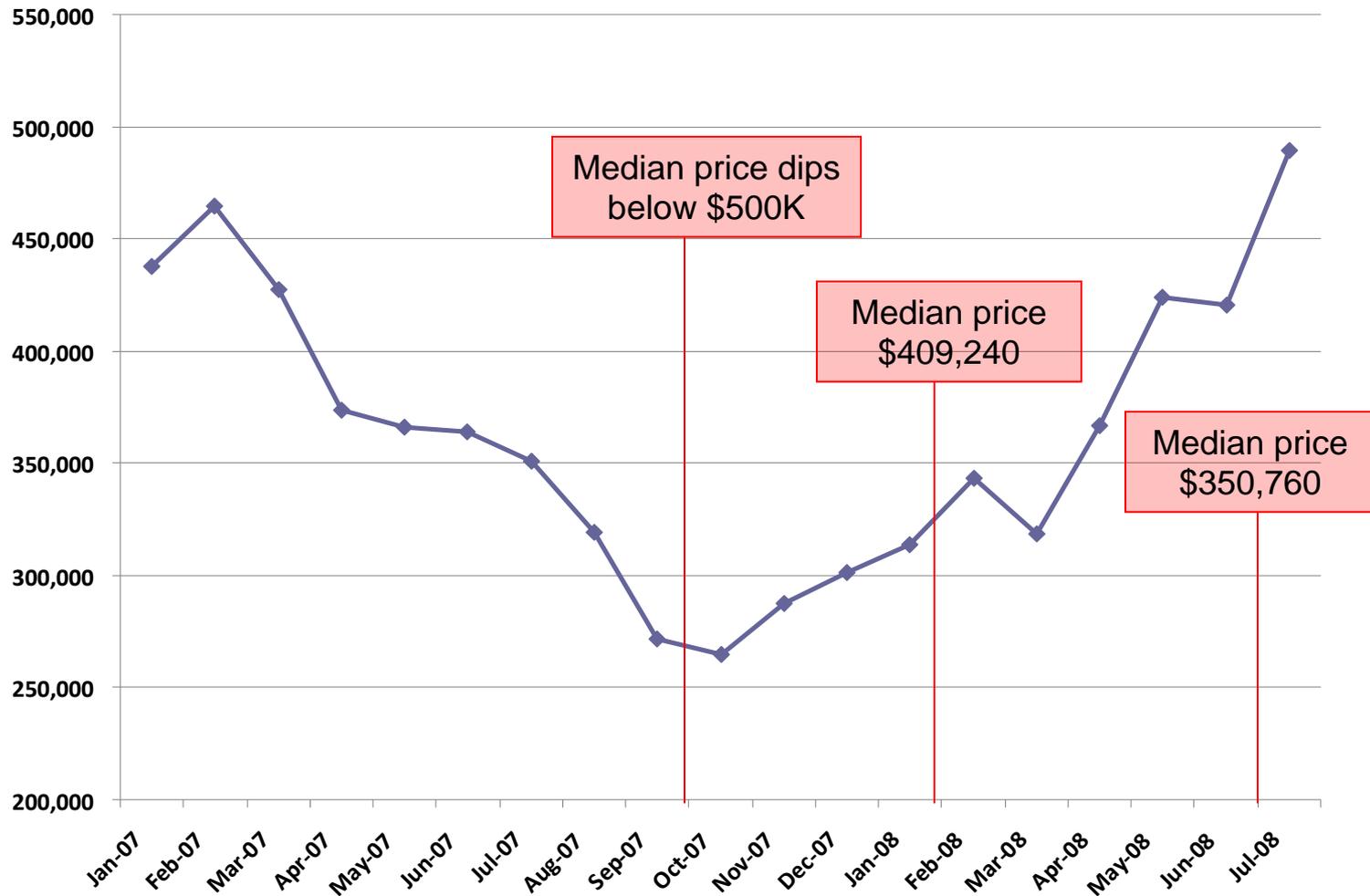
(Per CA Assoc. of Realtors)



% of CA Cities & Communities With Increased Median Price Year Over Year Per CA Assoc. of Realtors



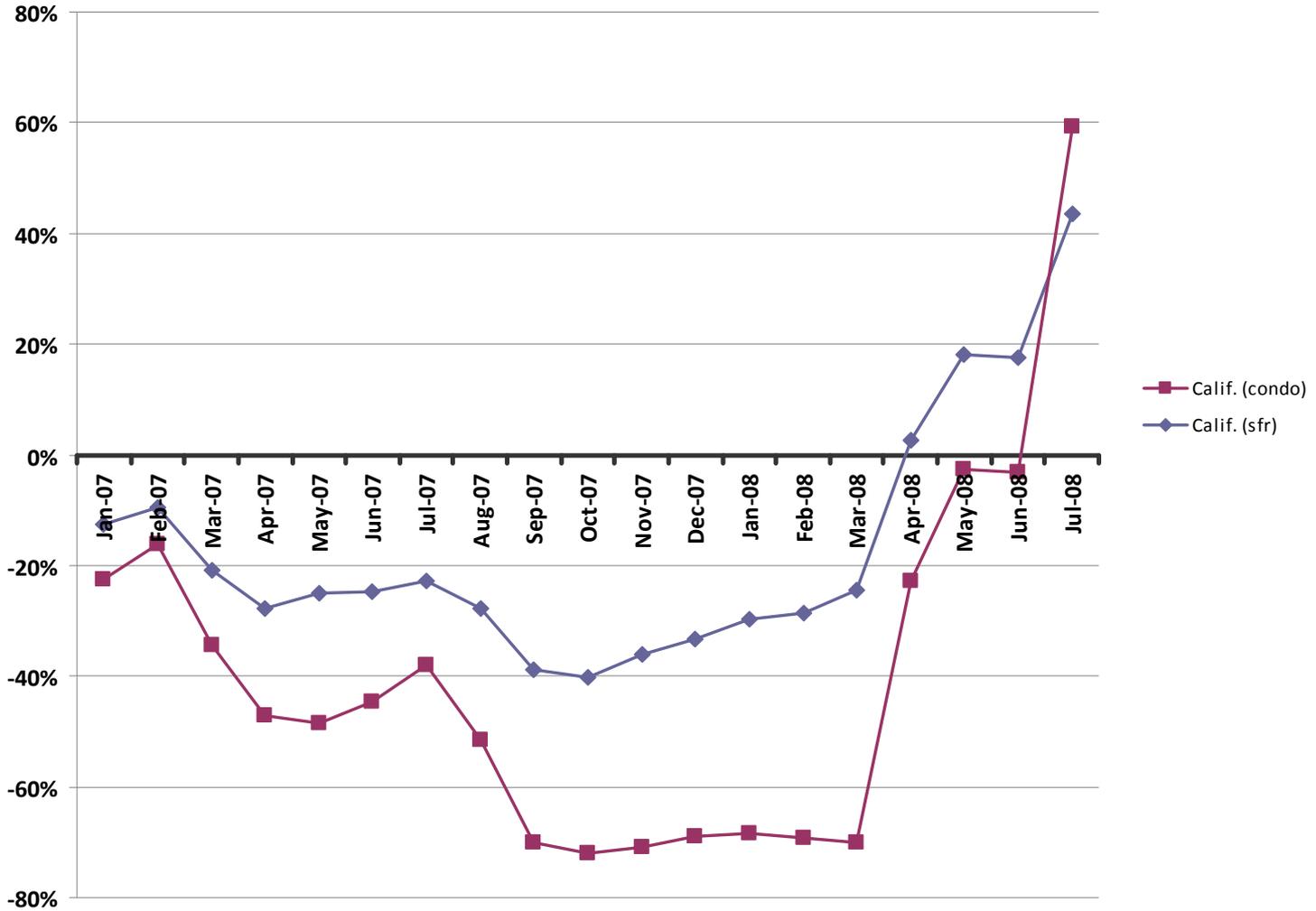
OF CLOSED SALES OF CALIFORNIA SINGLE FAMILY RESIDENCES (Per CA Assoc. of Realtors)



“Significant price declines are spurring home sales to bargain hunters and first-time buyers at the middle- and low-end of the market, especially in areas with a concentration of distressed properties.” – CAR April 2008

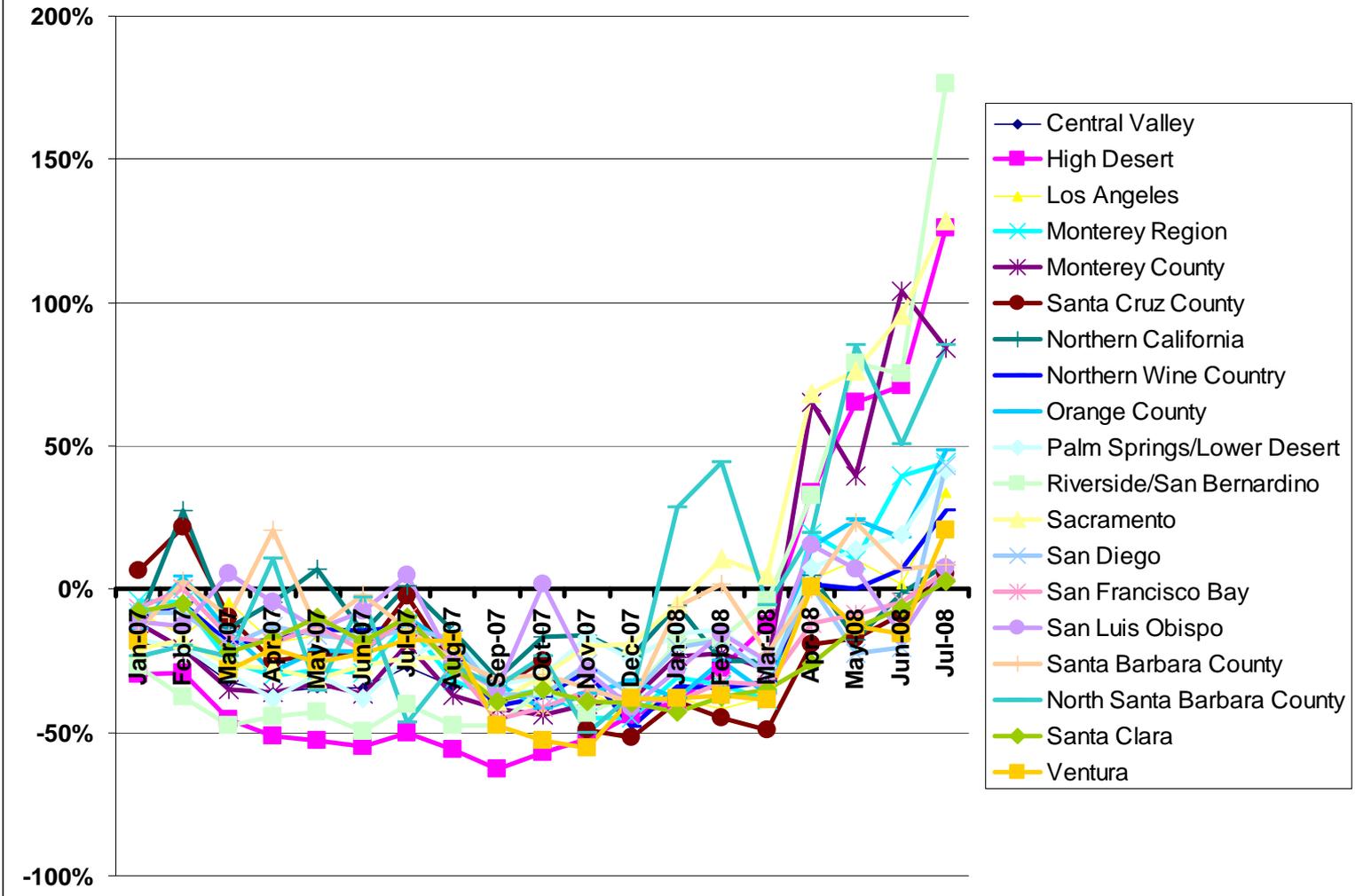
% CHANGE IN SALES FROM PRIOR YEAR

(Per CA Assoc. of Realtors)



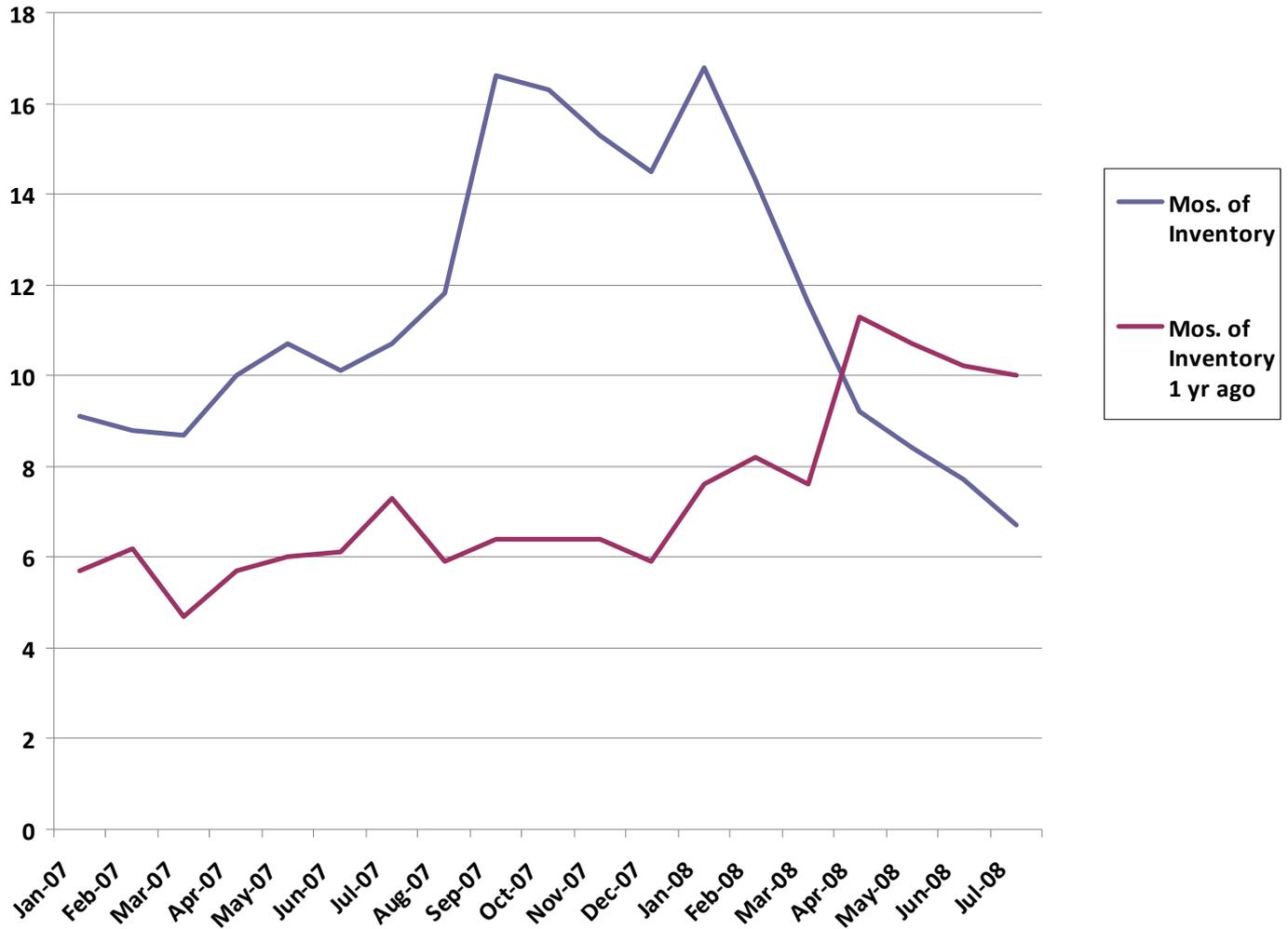
% CHANGE YEAR OVER YEAR IN SALES BY REGION

(Per CA Assoc. of Realtors)



MONTHS OF INVENTORY

(Per CA Assoc. of Realtors)



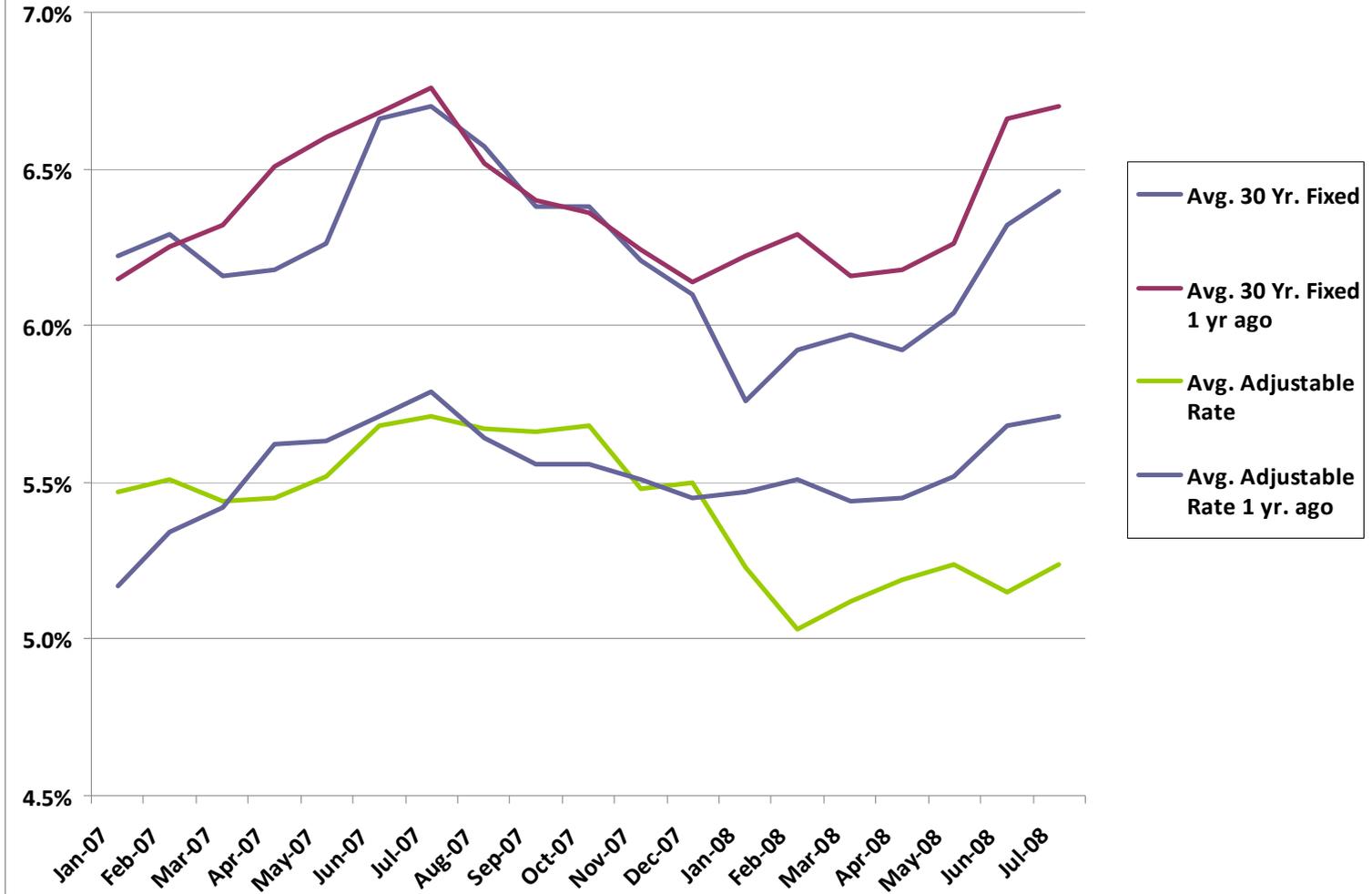
MEDIAN # OF DAYS TO SELL

(Per CA Assoc. of Realtors)



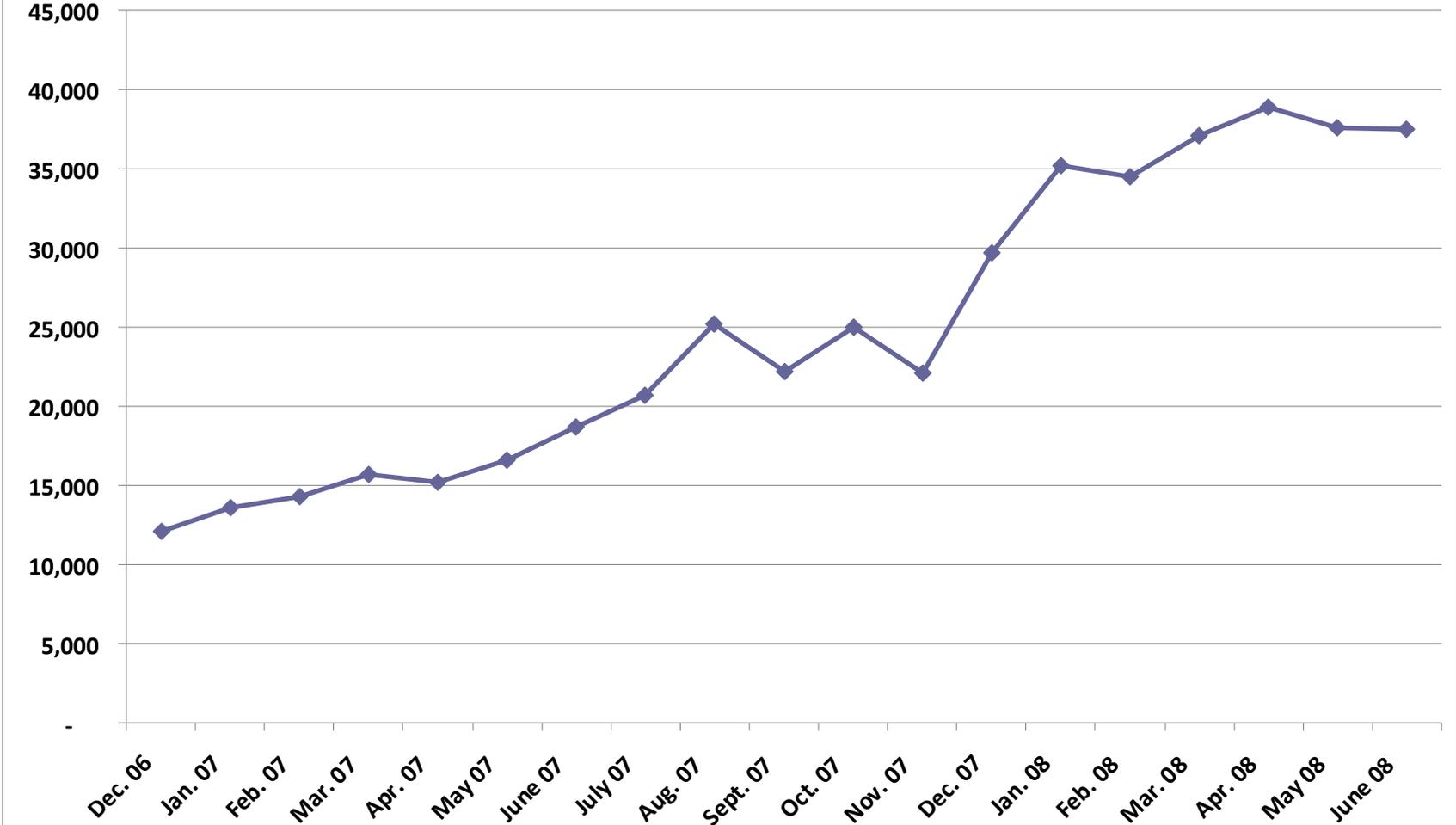
AVERAGE INTEREST RATES

(Per CA Assoc. of Realtors)



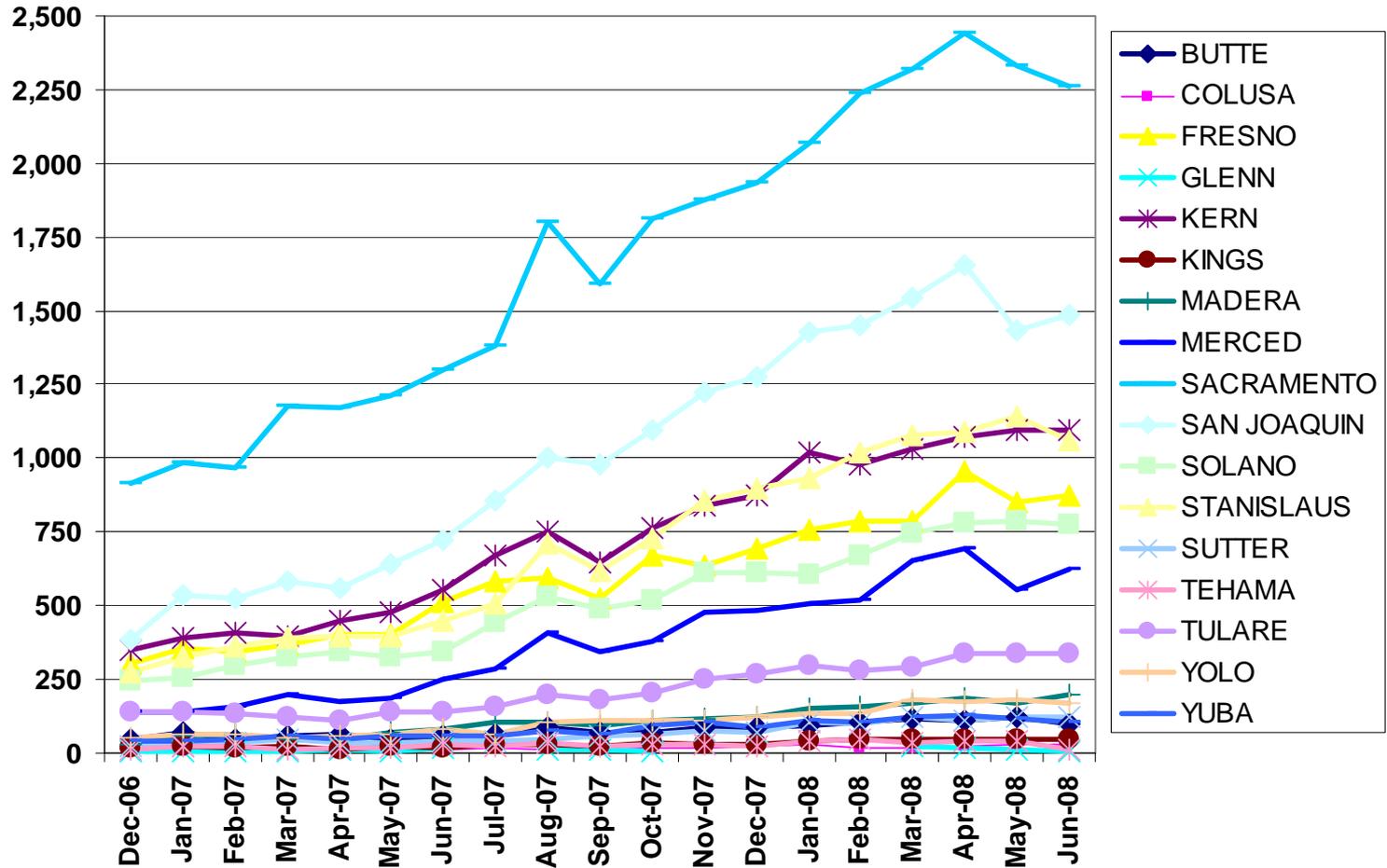
CALIFORNIA NOTICES OF DEFAULT

(Per Data Quick)



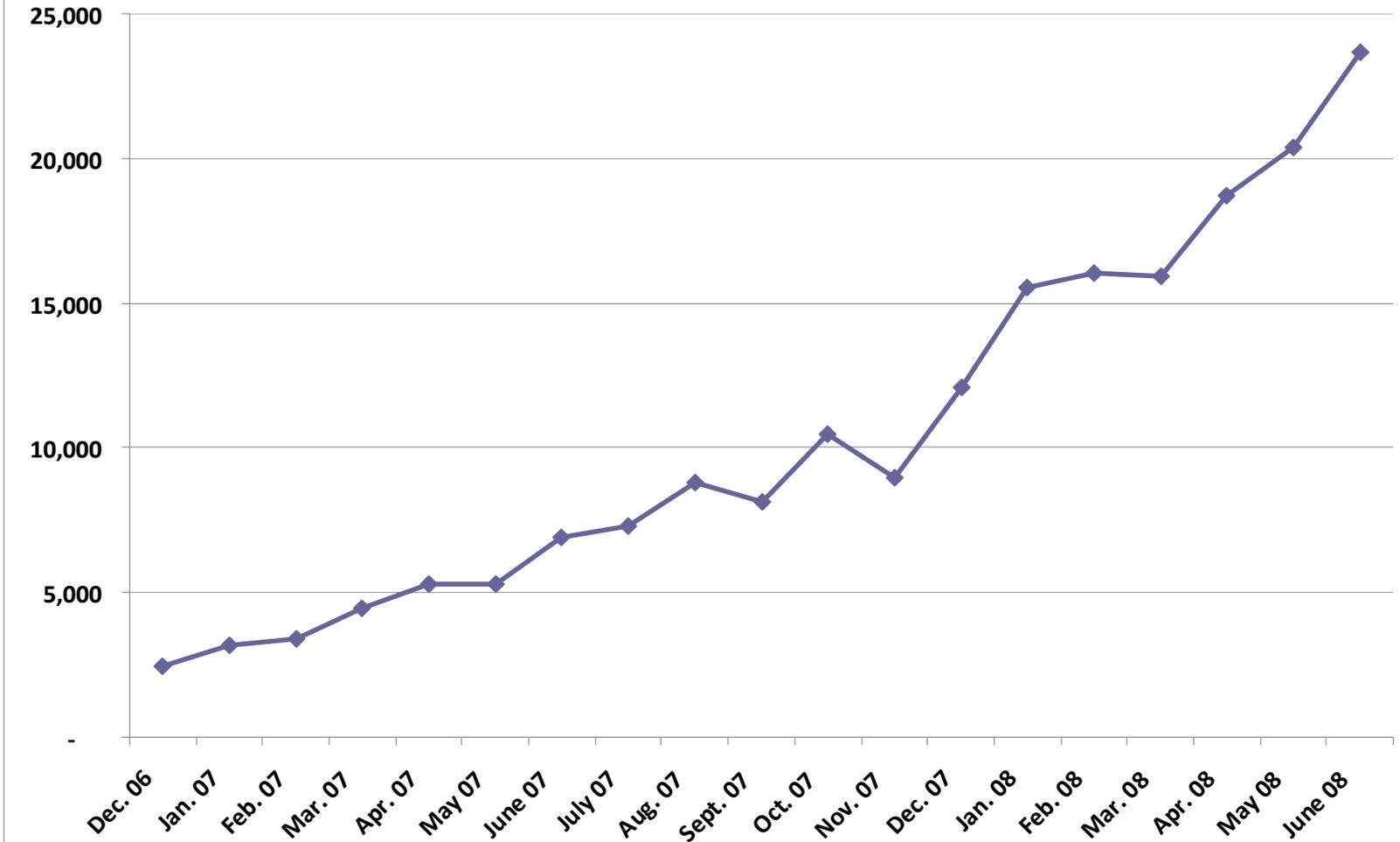
CENTRAL VALLEY DEFAULTS BY COUNTY

(Per DataQuick)



CALIFORNIA TRUSTEE SALES

(Per DataQuick)



CENTRAL VALLEY FORECLOSURES BY COUNTY

(Per DataQuick)

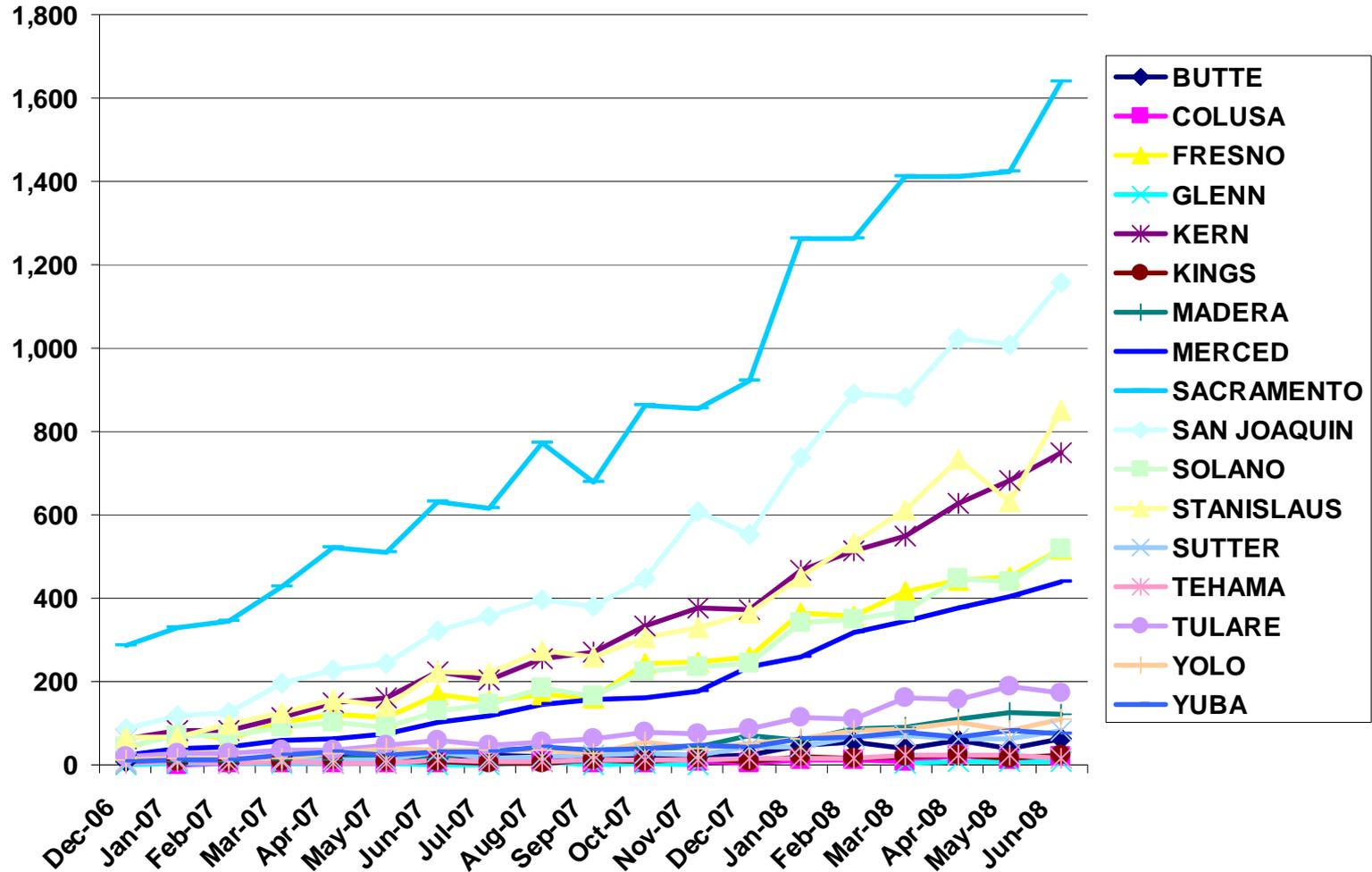
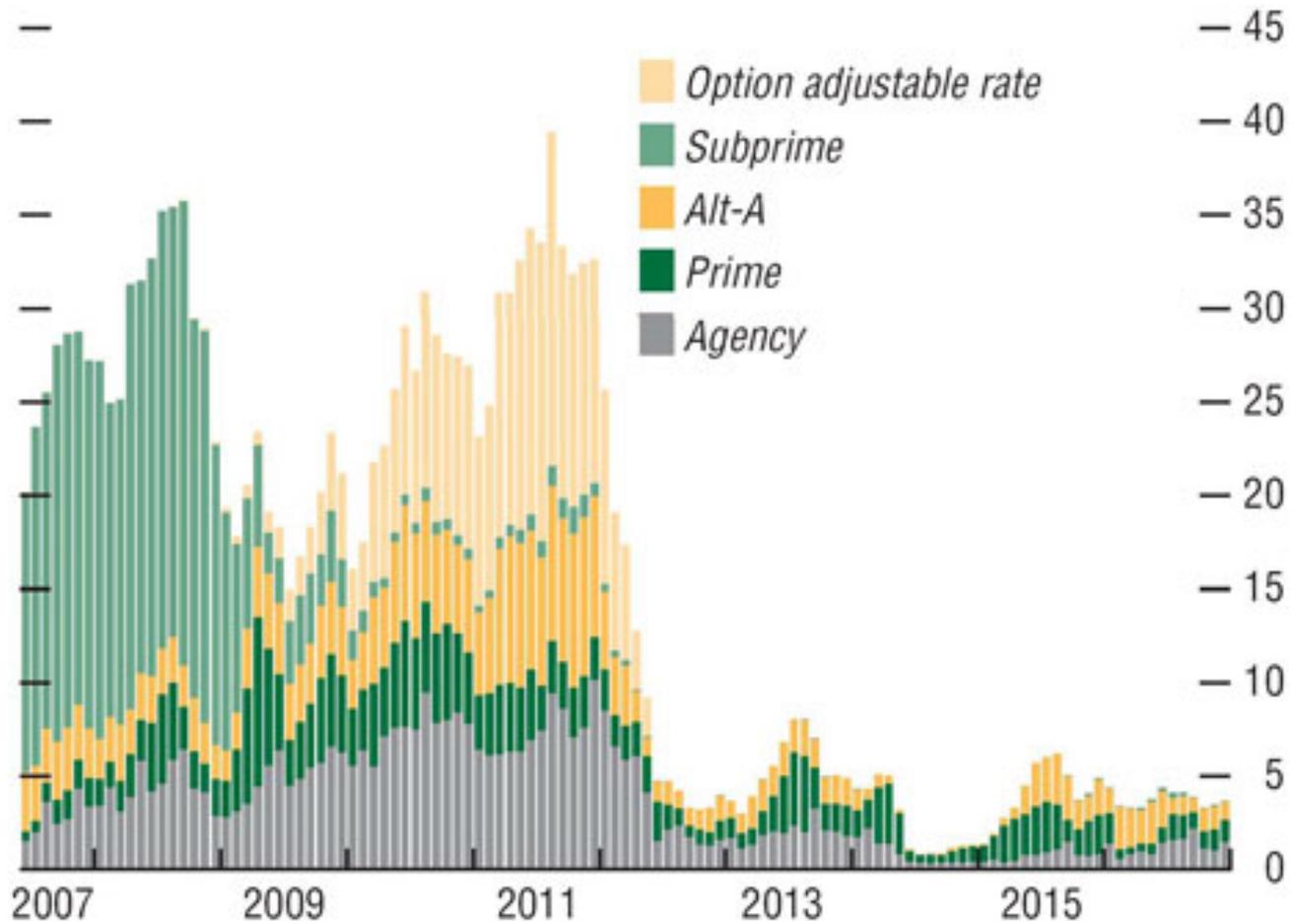


Figure 1.7. Monthly Mortgage Rate Resets
(First reset in billions of U.S. dollars)



Source: Credit Suisse.