City and County of San Francisco

Controller's Office

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Assisting Homeowners with Troubled Mortgages

February 05, 2015

Resolution #140709

Executive Summary: Background

- On October 28th, 2014, the Board of Supervisors issued a resolution asking the Controller to study possible approaches to assisting homeowners with troubled mortgages. The intent of this study is to recommend possible foreclosure prevention measures to help current homeowners in default or at risk of default, and to establish a system that will mitigate the effects of another mortgage default crisis.

Background: San Francisco Housing Stock and History of Foreclosures

- There are an estimated 378,186 housing units in San Francisco, a small portion of which face foreclosure every year. San Francisco foreclosure rates have been historically low relative to the rest of the nation. In 2014, San Francisco had 528 foreclosures bringing the foreclosure rate to 0.15%. In comparison, the U.S. foreclosure was 1.04%, seven times greater than San Francisco.
- While the impact of the mortgage default crisis has hit harder in other regions of the country, San Francisco has not been completely insulated. Between 2008 and 2012, the height of the mortgage default crisis, San Francisco had 3,827 foreclosures. The five years prior to this period, San Francisco had 605 foreclosures. This represents a 533% increase in foreclosures.
- Across the city, the volume of foreclosures have been falling steadily since 2011 and the mortgage default crisis appears to be receding. However, zip codes representing southern and southeastern areas of the city continue to have comparatively high foreclosure rates. Bayview-Hunters Point has a foreclosure rate of 0.62%, four times the citywide foreclosure rate.

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Executive Summary: Factors of Foreclosure

Factors of Foreclosure

- Increasing foreclosure rates are typically attributable to economic factors and bank lending practices. This report looks at three main causes of foreclosures during the mortgage crisis:
    1. Unemployment rate
    2. Home values
    3. Prevalence of high-cost and private-label securities (PLS)
- Borrowers typically default on mortgages when they lack the capacity to make payments, such as when they lose their job, but if there is any equity remaining in the home, the borrower has every incentive to sell the home and keep the equity rather than foreclose.
- Even when home prices fall, borrowers who can afford their mortgage payments will typically continue to do so even if they owe more than the property is worth since the cost to a borrower's credit rating from default is substantial. In addition, a choice to sell the property means the borrower will have to realize the loss on the home whereas keeping the home preserves the option of future gains in the property's value.
- However, an income loss in combination with an underwater home puts borrowers in a situation where the incentive is greater to foreclose rather than realize the losses from selling the home.
- Lastly, high-cost and private-label securities perform significantly worse than conventional loans, and the prevalence of these loans preceded the run-up of foreclosures during the mortgage default crisis. At the height of originations of these types of loans, the prevalence was greatest in the Black population and in southern and southeastern neighborhoods of San Francisco.

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Executive Summary: The Population At Risk of Foreclosure

The Population At Risk of Foreclosure

- 3,002 loans in San Francisco, or 2.4% of all loans with owner-occupied units, are underwater or near-underwater.
- Nearly half of these underwater or near-underwater homes are concentrated in the section of the city contained in zip codes 94112, 94124, and 94134. These zip codes are concentrated in the south and southeastern neighborhoods of the city and represent Ingelside-Excelsior/Crocker-Amazon, Bayview-Hunters Point, and Visitacion Valley/Sunnydale.
- 746 of at-risk borrowers also have a feature that increases their risk of default. These risky features include interest-only, negative amortization, or a balloon payment.
- Certain loan and borrower attributes can make it difficult to assist the at-risk population. These attributes include the number of loans, the size of the loan, and the income of the borrower. Programs often exclude borrowers with more than one loan, with debt over the conforming limit, and income over a certain threshold. Of the at-risk population, only 256 at-risk borrowers have taken out one loan that is below the conforming level with an income estimated to fall within a 120% AMI threshold for a family of four.
- In addition to the population most at risk of foreclosure, borrowers who have equity but lack the capacity to make payments may be subject to a short-sale. In the case of a short-sale, the borrower would have to leave her home. And despite gains received from the sale of the home, the current housing market would make it difficult to relocate into a home within the city.

Executive Summary: Mortgage Assistance Programs

Mortgage Assistance Programs

- In our review, few post-purchase assistance programs for homeowners exist at the municipal level. The ones that do are mainly in the form of home maintenance loans with the aim of helping low-income homeowners bring their homes up to code.
- At the federal and state level, few programs existed until recently when a number of assistance programs were created in response to the mortgage default crisis. These programs provide assistance to homeowners in three ways:
  1. Principal reduction
  2. Refinance Incentives
  3. Income support/One-time grants
- In addition to government programs, a number of Community Development Financial Institutions (CDFI's) and nonprofits exist with the goal of stabilizing communities through the acquisition of non-performing loans. The acquired loans are then restructured and stabilized before being resold.
- Outside of mortgage assistance programs, recent legislation from the State of California and rule changes from the Consumer Financial Protection Bureau have changed underwriting standards in the last year, which may mitigate the prevalence of high-cost loans, PLS loans, and loans with risky attributes.
- The prevalence of PLS loans has been increasing in recent years, which suggests there is a need for financial education among potential borrowers of these loans. Pre-purchase housing counseling has been shown to be an effective way to reduce delinquency rates and to mitigate credit risk.

Executive Summary: Recommendations

Recommendations

- Programs currently available to San Francisco homeowners with troubled mortgages have a positive impact on reducing foreclosures, but have a number of limitations. This report makes two recommendations for reducing negative equity or mitigating the impact of sudden economic hardship should policymakers wish to assist homeowners with troubled mortgages:
    1. Develop a mortgage assistance program for homeowners with troubled mortgages that would reduce a borrower's principal loan amount in order to support a loan restructure.
    2. Develop an emergency assistance program targeting homeowners who have had an unexpected hardship and have defaulted or are at risk of default.
- Should policymakers wish to pursue these recommendations, the structure of the programs, including income and other restrictions will need to be set to define an eligible population to target limited resources. An analysis on the number of borrowers served and staffing would also be needed in order to determine the cost of the programs.
- In addition to these recommendations, three ideas were introduced in this report that warrant further exploration:
    1. CDFI's and nonprofits acquiring non-performing loans seem to pose low financial risks and low administrative burden to the City, with possible, but likely minimal, benefits that warrant an exploration of a partnership.
    2. Enhanced legal assistance may be helpful for homeowners seeking legal representation against lenders violating recently implemented mortgage servicing rules.
    3. Enhanced pre-purchase housing counseling services for outreach to neighborhoods with comparatively high prevalence rates of high-cost loans and PLS loans.

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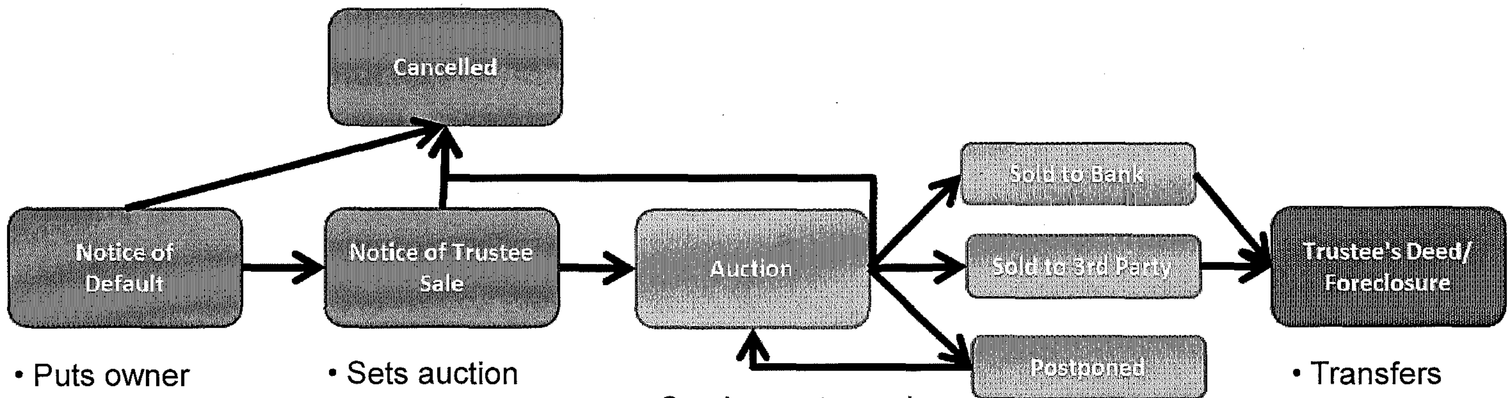
Introduction

- On October 28th, 2014, the Board of Supervisors issued a resolution asking the Controller to study possible approaches to assist homeowners with troubled mortgages. The intent of this study is to recommend possible foreclosure prevention measures to help current homeowners in default or at risk of default, and to establish a system that will mitigate the effects of another mortgage default crisis.
- There are an estimated 378,186 housing units in San Francisco, 345,344 which are occupied. Of these occupied units, 63.4% are renter-occupied, while the remaining 36.6% are owner-occupied. Of the 126,394 owner-occupied units in San Francisco, 70.3% have at least one mortgage.[1] In 2014, San Francisco had 528 foreclosures.[2]
- While foreclosures are small in comparison to the number of housing units in San Francisco, mortgage foreclosures are costly for homeowners, lenders, servicers, insurers, and cities.[18]
  - Homeowners lose a stable, secure place to live, they lose equity, their credit rating is damaged, and in the current housing market, they face potentially higher costs to replace lost housing if they wish to remain in the city.
  - Lenders absorb the loss for outstanding principal, legal fees, costs of holding and maintaining the property, and real estate broker fees less the amount recovered from sale.
  - Servicers lose the income stream from servicing fees when borrowers halt payments.
  - Mortgage insurers pay for claims equal to the outstanding principal and all expenses incurred less the proceeds from the sale of the house.
  - Foreclosed properties deteriorate and lose value. Cities lose tax revenue from vacant homes. In addition foreclosed properties affect the value and marketability of neighboring homes.

Introduction: Foreclosures Process



Notice of Default
- Puts owner on notice
- Starts the 90 day time clock

Notice of Trustee Sale
- Sets auction date and time
- 20 Days posting publishing
- 20 days recording

Auction
- Can be postponed
- Lender places first bid
- Pay in full, in cash
- Subject to senior loans

Trustee's Deed/ Foreclosure
- Transfers ownership
- Occupant may have to be evicted

- At any time, before Trustee Deed/Foreclosure, the process can be cancelled.
- In 2013, the average time from Notice of Default to Trust of Deed in California was approximately 425 days.[1]

Introduction: Report Outline

- This report has four sections:
  1. The Mortgage Default Crisis and Factors of Foreclosure
     - This section first looks at the impact of the mortgage default crisis and the effect it has had across different parts of San Francisco.
     - It then looks at three key factors of foreclosure: home values, unemployment, and the prevalence of high-cost loans and private-label security loans.
  2. The Population At Risk of Foreclosure Today
     - This section estimates the population at risk of foreclosure today.
  3. A Survey of Mortgage Assistance Programs
     - This section reviews a number of existing government programs, various loan acquisition strategies by non-governmental entities, and state and federal mortgage servicing rules that have been recently implemented.
  4. Recommendations
     - This section recommends possible actions that can be taken by the City and County of San Francisco based on the findings in this report.

Section 1: The Mortgage Default Crisis and Factors of Foreclosures in San Francisco

San Francisco's Housing Stock and History of Foreclosures

- There are an estimated 378,186 housing units in San Francisco, a small portion of which face foreclosure every year.[1] San Francisco foreclosure rates have been historically low relative to the rest of the nation. In 2014, San Francisco had 528 foreclosures bringing the foreclosure rate to 0.15%. In comparison, the U.S. foreclosure was 1.04% in 2014, seven times greater than San Francisco.[2]
- While the impact of the mortgage default crisis has hit harder in other regions of the country, San Francisco has not been completely insulated. Between 2008 and 2012, the height of the mortgage default crisis, San Francisco had 3,827 foreclosures. The five years prior to this period, San Francisco had 605 foreclosures. This represents a 533% increase in foreclosures.
- In 2008, the likelihood of defaults being cured fell to the point that defaulting borrowers were just as likely to foreclose as they were to cure a default.
- Across the city, the volume of foreclosures have been falling steadily since 2011 and the mortgage default crisis appears to be receding. However, zip codes representing southern and southeastern areas of the city continue to have comparatively high foreclosure rates. Bayview-Hunters Point has a foreclosure rate of 0.62%, four times the citywide foreclosure rate.

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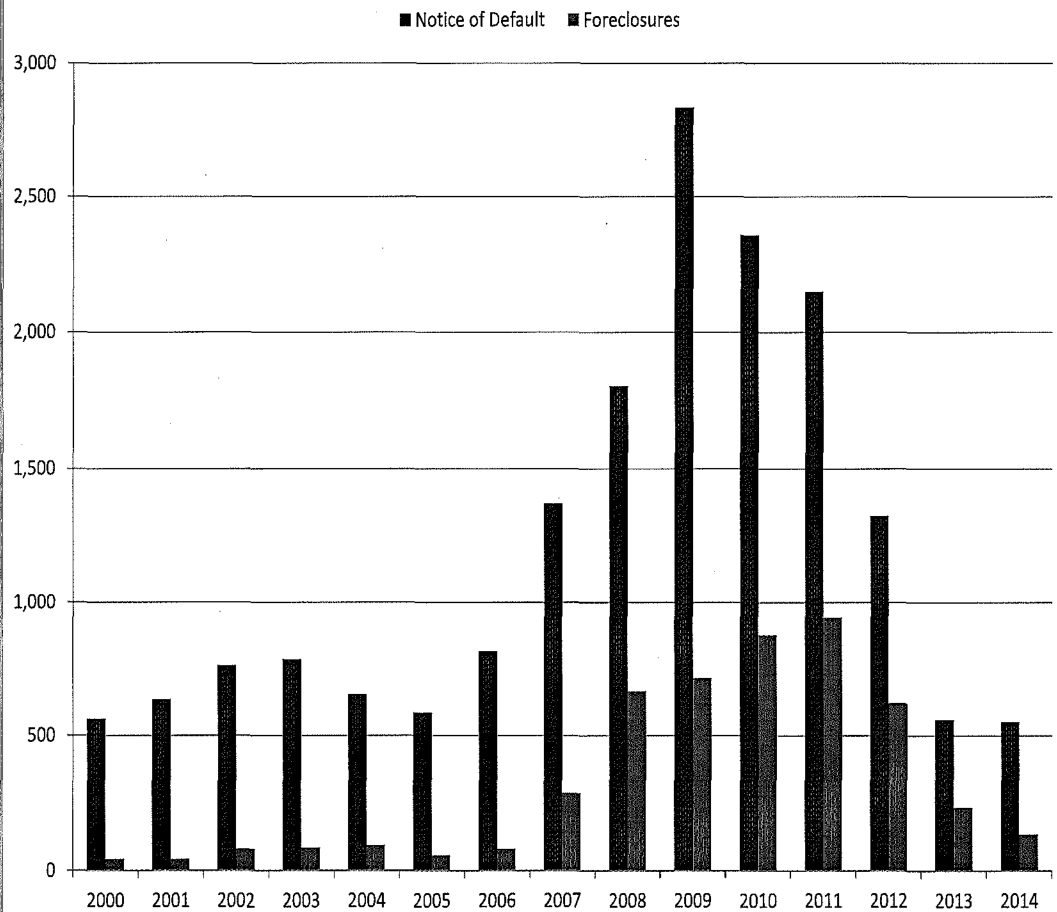
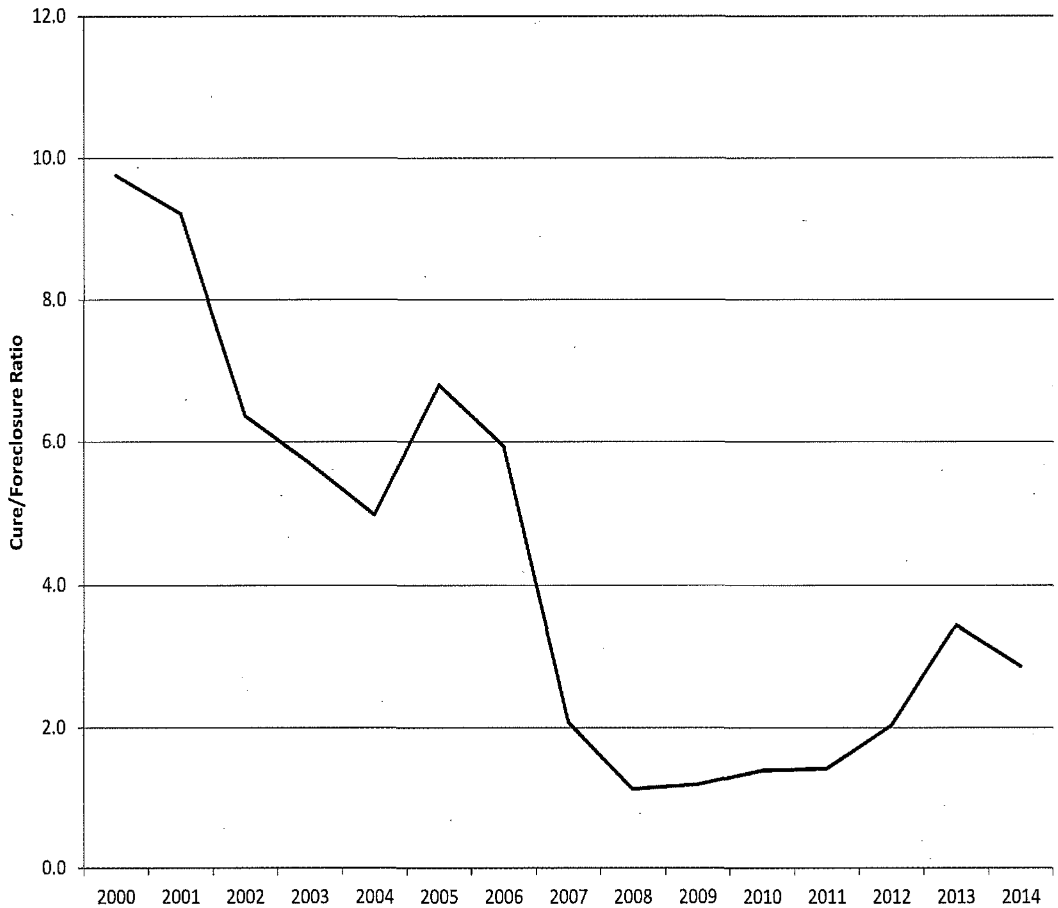
Impact of the Mortgage Default Crisis in San Francisco



- Notices of Default and foreclosures increased modestly between 2000 and 2003 after the dot-com bust compared to increases during the mortgage crisis.
- Notices of Default began to escalate between 2006, peaking in 2009, growing at an average annual rate of 64.1%.
- Foreclosures began to increase during this period as well, but peaked two years later in 2011.
- Between 2006 and 2011, foreclosures grew at an average annual rate of 250%.

Cure/Foreclosure Ratio



- This chart shows the Cure/Foreclosure ratio
- A higher ratio means more defaults ended in a cure than foreclosure in a given year.
- This ratio has been as high as 10 cures to every default ending in foreclosure.
- Before the mortgage crisis, in 2005, the ratio was 6 to 1.
- By 2008, this ratio was 1 to 1, meaning that defaulting borrowers were just as likely to foreclose as they were to cure their default.
- The ratio remained low through 2011 before it began to pick back up.
- In 2014, the ratio was at 3 cures to every default ending in foreclosure.

High foreclosure rates are concentrated in southern and southeastern neighborhoods of San Francisco.

Zip Code	Neighborhood	Foreclosure Rate 2011	Foreclosure Rate 2014
94124	Bayview-Hunters Point	2.06%	0.62%
94127	St. Francis Wood/Miraloma/West Portal	1.18%	0.45%
94112	Ingelside-Excelsior/Crocker-Amazon	1.20%	0.31%
94134	Visitacion Valley/Sunnydale	1.20%	0.31%
All Other Zip Codes	All Other San Francisco Neighborhoods	0.43%	0.11%
Citywide	San Francisco Citywide Average	0.56%	0.15%

- Foreclosures are mainly concentrated in the zip codes representing the southern and southeastern neighborhoods.
- Since the mortgage default crisis, the number and the rate of foreclosures have receded significantly. Since 2011, at the height of foreclosures, the citywide average foreclosure rate has fallen from .56% to .15%.
- However, foreclosure rates still remain comparatively high in certain low-income neighborhoods. Bayview-Hunters Point has a foreclosure rate over four times the citywide average.

Foreclosure Factors

- Increasing foreclosure rates are typically attributable to economic factors and bank lending practices. This report looks at three main causes of foreclosures during the mortgage crisis:
    1. Unemployment rate
    2. Home values
    3. Prevalence of high-cost and private-label securities (PLS) lending.
- Borrowers typically default on mortgages when they lack the capacity to make payments, such as when they lose their job, but if there is any equity remaining in the home, the borrower has every incentive to sell the home and keep the equity rather than foreclose.
- Even when home prices fall, borrowers who can afford their mortgage payments will typically continue to do so even if they owe more than the property is worth since the cost to a borrower's credit rating from default is substantial. In addition, a choice to sell the property means the borrower will have to realize the loss on the home whereas keeping the home preserves the option of future gains in the property's value.
- However, an income loss in combination with an underwater home puts borrowers in a situation where the incentive is greater to foreclose rather than realize the losses from selling the home.[3,4,5]
- Lastly, high-cost and private-label securities perform significantly worse than conventional loans, and the prevalence of these loans preceded the run-up of foreclosures during the mortgage default crisis. At the height of originations of these types of loans, the prevalence was greatest in the Black population and in southern and southeastern neighborhoods of San Francisco.

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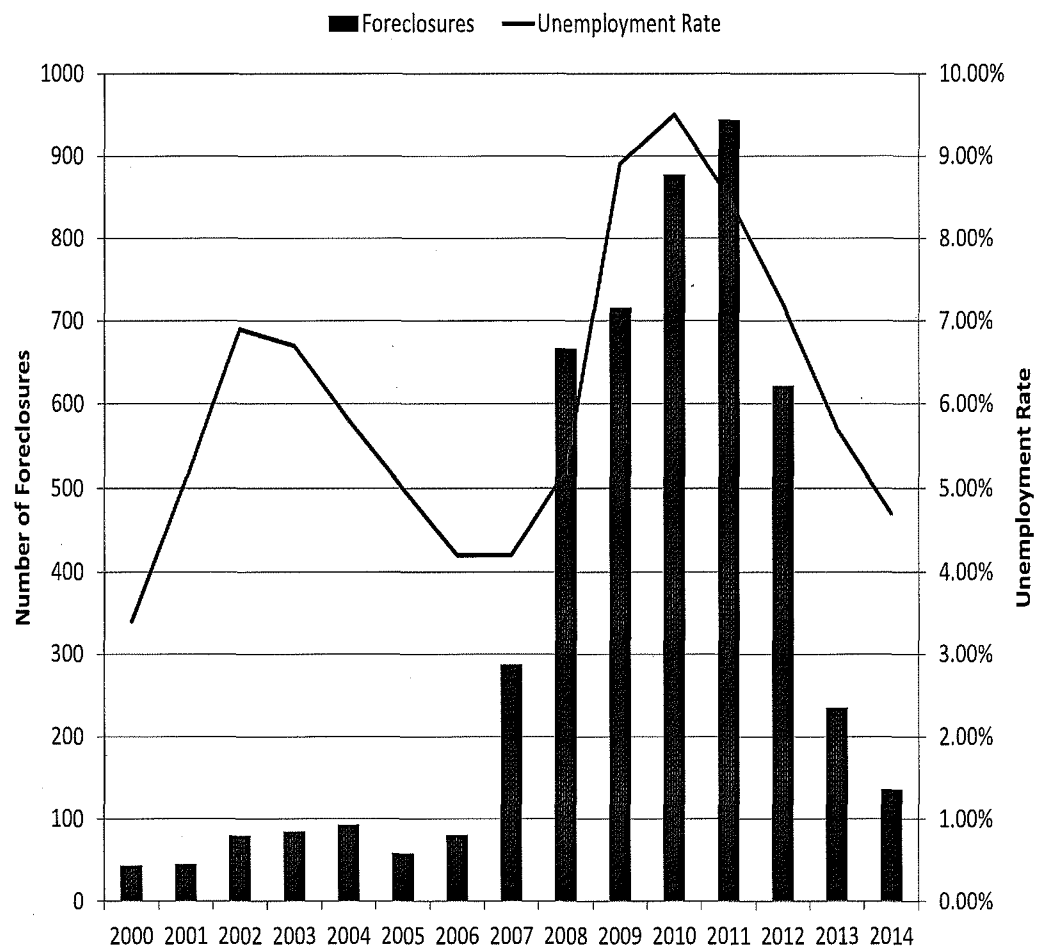
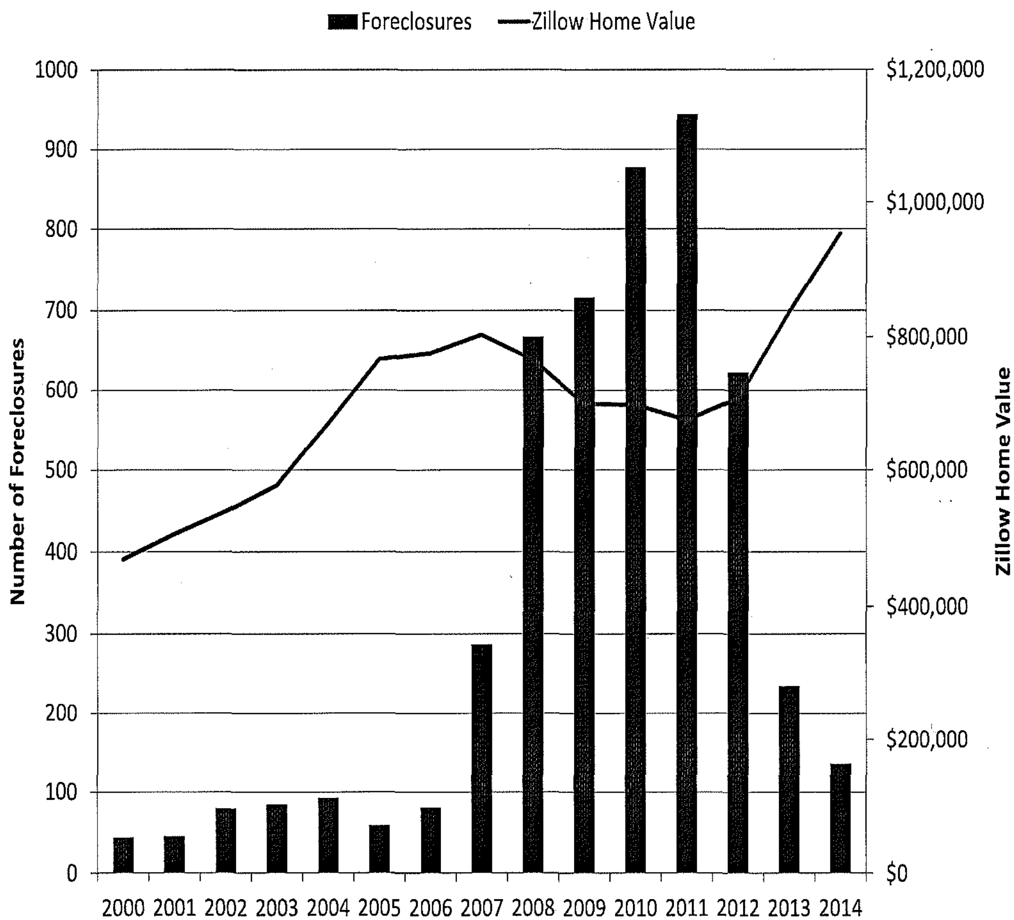
Foreclosures vs Unemployment Rate 2000-2014



- After the dot-com bust, unemployment rose as high as 6.9% in 2002, while foreclosures remained relatively level.
- As demonstrated in the next slide, home prices increased during this period, which may account for the modest response of foreclosures to increasing unemployment compared to the period during the mortgage default crisis.
- By 2007, foreclosures coincided with rising unemployment rates, which grew from 4.2% to a peak of 9.5% between 2007 and 2010.

Foreclosures vs Home Values 2000-2014



- In 2002, when unemployment rates rose to 6.9%, home values had increased by 6.5% from 2001.
- It is likely that increasing home values during this period contributed to the low rates of foreclosures, because borrowers were able to sell their homes and retain their equity rather than foreclose.
- After 2007, during the second unemployment peak, home prices dropped, declining at an annual average rate of 4.2% between 2008 and 2011.
- The combination of high unemployment and negative equity led to a rise in foreclosures over this period.

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Prevalence of High-Cost and Privately-Label Security Lending

- Mortgage-backed securities (MBS) are debt obligations that represent claims to the cash flows from pools of mortgage loans. Most of which are issued by the federal agency Ginnie Mae or the federally sponsored enterprises, Fannie Mae and Freddie Mac.
- Some private institutions also securitize mortgages, and these types of mortgage-backed securities are known as **private-label securities (PLS).** PLS loans are mortgage loans in these private-label securities.
- **High-cost loans** are defined in this report as loans with a high interest rate spread between the loan rate and the rate of Treasury securities with comparable maturity.[6]
- Both PLS and high-cost loans perform significantly worse than prime loans.[7, 8, 9]
- In the two years before the mortgage default crisis hit, originations in these types of loans increased dramatically in San Francisco. In particular, the prevalence of high-cost/PLS loans was greatest for Blacks. The prevalence of high-cost/PLS loans was between 11% to 24% greater for Blacks than Whites. The highest prevalence across all categories was among Blacks with $150,000 to $199,999 in income with a prevalence 36%, compared to 21% for Hispanics, 19% for Asians, and 12% for Whites.[g]
- In addition, these loans had the highest prevalence among zip codes representing the southern and southeastern zip codes of San Francisco. This would suggest a targeted marketing effort in specific geographical locations.

g Race and ethnicity categorizations are based on Home Mortgage Disclosure Act data designations.

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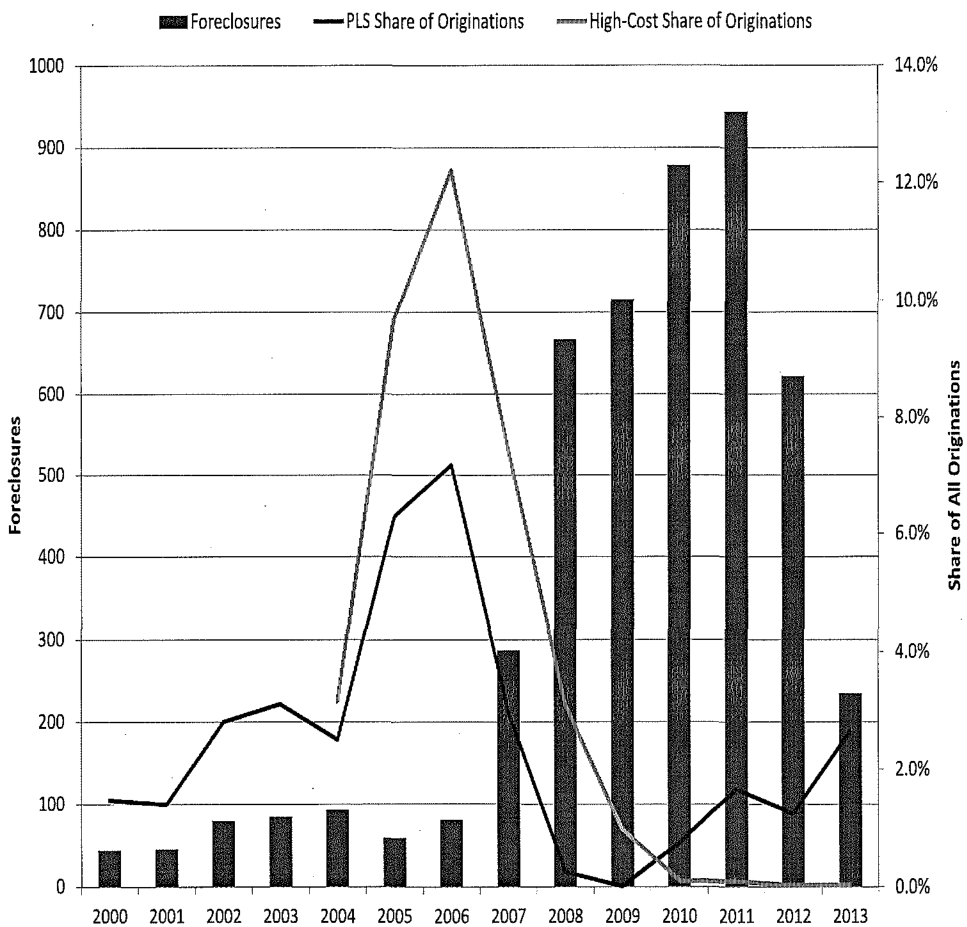
Prevalence of High Cost and PLS Loans



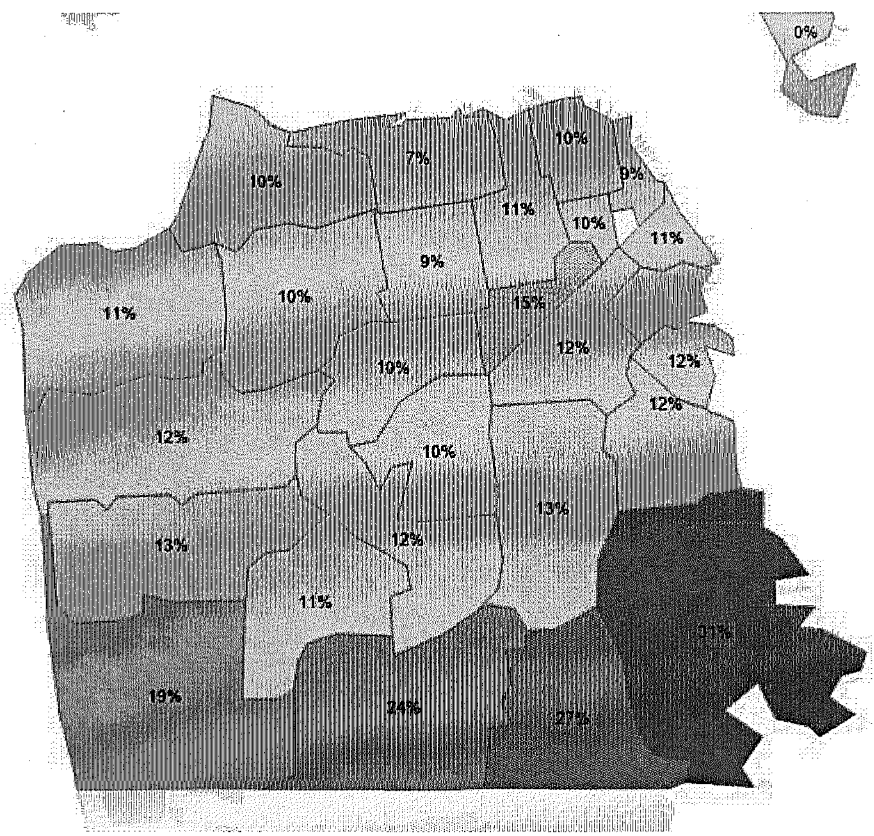
- The trend of increasing PLS loan originations began in 2002. After a small decline in 2004, the share of PLS originations increased from 2.5% to a peak of 7.2% in 2006.
- A similar spike in the share high-cost originations occurred between 2004 and 2006 as the share went from 2.3% to 12.2%.
- Since 2006, the share of high-cost loan originations has fallen dramatically.
- High-cost share of loans have remained low, falling to 0.02% in 2013, but the share of PLS originations has been increasing. In 2013, the share of PLS originations was 2.6%.

Prevalence of High-Cost and PLS Originations in 2005-2006 by Borrower Income and Race

Borrower Income	Loan Type	Asian	Black	Hispanic	White
Less than $50,000	High-Cost/PLS	18%	28%	16%	16%
	Prime Loan	82%	72%	84%	84%
$50,000-$99,999	High-Cost/PLS	7%	20%	14%	9%
	Prime Loan	93%	80%	86%	91%
$100,000-$149,999	High-Cost/PLS	13%	30%	18%	9%
	Prime Loan	87%	70%	82%	91%
$150,000-$199,999	High-Cost/PLS	19%	36%	21%	12%
	Prime Loan	81%	64%	79%	88%
$200,000 or more	High-Cost/PLS	18%	35%	15%	10%
	Prime Loan	82%	65%	85%	90%

- In order to compare the prevalence of originations of high-cost/PLS loans across race, we divided the number high-cost/PLS loans originated within each race by the total number of loans originated within each race. For example, for borrower incomes less than $50,000, 18% of all loans made to Asians were high-cost/PLS. This table looks at originations from 2005-2006, the height of high-cost/PLS originations.
- Across all income categories, the prevalence of high-cost/PLS loans was greatest for Blacks. The prevalence was between 11% to 25% greater for Blacks than Whites. The highest prevalence across all categories was among Blacks with $150,000 to $199,999 in income with a prevalence 36%, compared to 21% for Hispanics, 19% for Asians, and 12% for Whites.

Prevalence of High-Cost and PLS Originations in 2005-2006 by Zip Code[10]



- This map shows the prevalence of high-cost and PLS loans by zip code between 2005 and 2006, the height of high-cost/PLS originations.¥
- Zip Codes with the highest prevalence of high-cost and PLS originations were concentrated along the southern and southeastern border of San Francisco.
- The greatest prevalence was in Bay View-Hunters Point where nearly a third of originations were high-cost or PLS loans.
- Other southern neighborhoods with high prevalence include Lake Merced, Visitacion Valley/Sunnydale, and Ingelside-Excelsior/Crocker-Amazon.
- The concentration of these loans suggests targeted marketing efforts in specific geographical locations.

¥ This calculation is made by dividing the number of high-cost/PLS loan originations in a particularly zip code by total loan originations in the same zip code.

Section 2: The Population At Risk of Foreclosure Today

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The Population At Risk of Foreclosure Today

- 3,002 loans in San Francisco, or 2.4% of all loans with owner-occupied units, are underwater or near-underwater.±
- Nearly half of these underwater or near-underwater homes are concentrated in the section of the city contained in zip codes 94112, 94124, and 94134. These zip codes are concentrated in the south and southeastern neighborhoods of the city and represent Ingelside-Excelsior/Crocker-Amazon, Bayview-Hunters Point, and Visitacion Valley/Sunnydale.
- 746 of at-risk borrowers also have another feature that increases their risk of default. These risky features include interest-only, negative amortization, or a balloon payment.
- Certain loan and borrower attributes can make it difficult to assist the at-risk population. These attributes include the number of loans, the size of the loan, and the income of the borrower. Programs often exclude borrowers with more than one loan, with debt over the conforming limit, and income over a certain threshold. Of the at-risk population, only 256 at-risk borrowers have taken out one loan that is below the conforming level with an income estimated to fall within a 120% AMI threshold for a family of four.
- In addition to the population most at risk of foreclosure, borrowers who have equity but lack the capacity to make payments may be subject to a short-sale. In the case of a short-sale, the borrower would have to leave her home. And despite gains received from the sale of the home, the current housing market would make it difficult to relocate into a home within the city.

±This excludes homes with a current value over $1.5 million, homes more than $1 million underwater, below-market rate homes, and homes with Federal Housing Administration loans.

Defining the Population At Risk of Foreclosure Today

- The population at greatest risk of foreclosure today are borrowers with homes that are underwater or near-underwater. In the case of another recession, an increase in unemployment would make this group more likely to foreclose than other homeowners.
- **Underwater Home or Negative Equity:** A home is considered underwater when the borrower has a higher debt balance on the home purchase loan than the current market value of the home. This means these homes have a loan-to-value (LTV) ratio greater than 100%.
- **Near-Underwater Home:** A home is considered near-underwater when the borrower has an LTV between 91% and 100%.
- **At-Risk Population:** For the purposes of our estimates, the Controller's Office defines the at-risk population as a borrower that:
    - Occupies his or her home
    - Has a loan-to-value ratio greater than 90%
    - Is not participating in the City's Below Market Rate (BMR) program or has a Federal Housing Administration (FHA) loan.
    - Has a current home value of less than $1.5 million
    - Is less than $1 million underwater[11]
- In addition to defining the at-risk population, this report looks at loans within this population with additional risky features as well as the population of borrowers in this at-risk population that is most reachable to a mortgage assistance program.

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All Mortgages in San Francisco, 2014±

Loan Feature	Count	%
All Owner-Occupied Loans	121,731	100%
Multiple Mortgages	29,068	23.9%
PLS	3,377	2.8%
Risky Attribute	5,385	4.4%
Reverse Mortgage	879	0.7%
Near-Underwater (LTV 91%-100%)	1,744	1.4%
Underwater (LTV>100%)	2,328	1.9%

- There are over 174,010 loans in San Francisco, including 2nd and 3rd liens. Of these loans 121,731 are in owner-occupied units, nearly a quarter of which have more than one loan.
- 2.8% of owner-occupied loans are PLS.
- 4.4% of loans in San Francisco have a risky feature, which includes one or more of the following: interest-only, negative amortization, or balloon payment
- 3.3% of San Francisco loans are underwater or near-underwater.

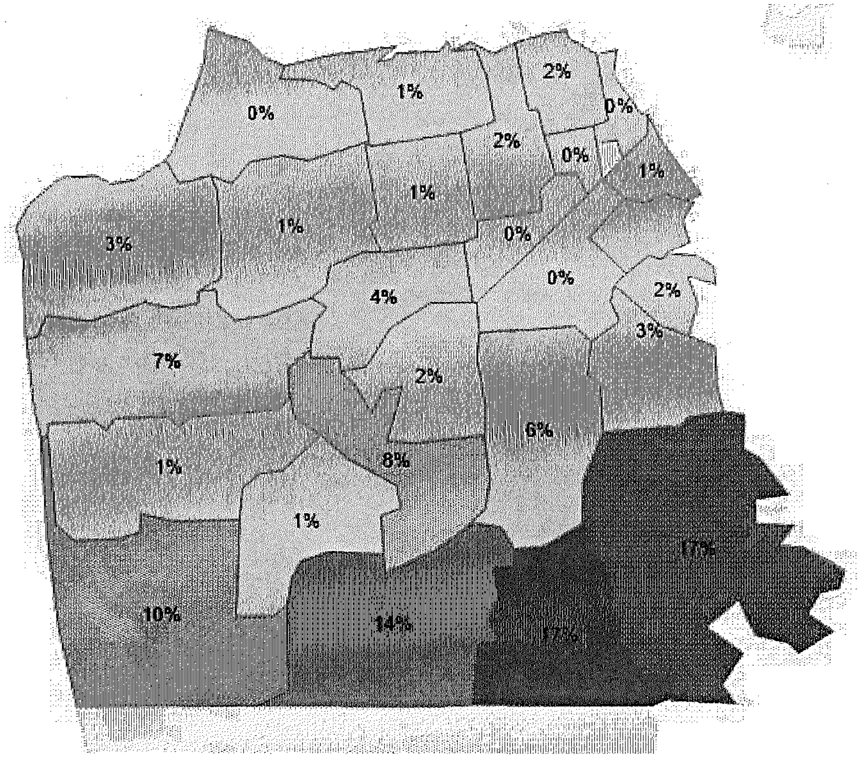
±The number of loans include 2nd and 3rd liens, which is why there are nearly as many loans as there are owner-occupied units in San Francisco.

At-risk population in San Francisco makes up approximately 3% of city wide borrowers.

Loan-to-Value Ratio	All Borrowers	PLS
Greater than 100%	1,455	37
91% to 100%	1,547	23
Total	**3,002**	**60**

- After excluding homes with a current value greater than $1.5 million, homes that are more than $1 million underwater, BMR loans, and FHA loans, the current estimated at-risk population comes to 3,002 homes. This makes up approximately 2.4% of all loans with owner-occupied units in San Francisco.
- Of these homes, 1,455 are underwater making up over 48% of the at-risk loans. 37 of these underwater loans are PLS.
- The Controller's Office also considers near-underwater loans at-risk because the gains from selling a near-underwater home would be little or negative after commissions and fees. Near-underwater homes also face the risk of becoming underwater, even with small declines in home prices. There are 1,547 near-underwater homes, 23 of which are PLS. A 5% drop in home prices will push nearly half of these loans from near-underwater to underwater.

Percent of At-Risk Population by Zip Code



- Nearly half of the 3,002 at-risk borrowers live within three zip codes: 94112, 94124, and 94134 zip codes, which contain many low-income communities.
- The 94124 and 94134 zip codes, which represent Bay View Hunters Point and Visitacion Valley/Sunnydale, make up the highest proportion of the at-risk borrowers, each with 17% of the at-risk population.
- The 94112 zip code, which represents Excelsior/Crocker-Amazon, makes up 14% of at-risk borrowers.

First Mortgage Loan Attributes of At-Risk Borrowers

Loan Feature	Borrowers	% of At-Risk Borrowers
Interest Only	510	17.0%
Negative Amortization	346	11.5%
Balloon Payment	44	1.5%
One or More Risky Attribute	746	24.9%
Adjustable Rate Mortgage	1,344	44.8%

- Risky attributes are considered attributes leading to adjustments in a loan that make it more difficult for borrowers to make their payments. These attributes include:
  - **Interest-only:** the borrower pays only the interest on the principal balance for a set term.
  - **Negative amortization:** For a set term, the borrower has a loan payment less than the interest charged. The difference in the payment and interest is added to the unpaid principal balance.
  - **Balloon loan:** a loan that does not fully amortize over the term of the loan, leaving a balance due at maturity.
- Nearly a quarter of at-risk borrowers has one or more risky attributes. 17.0% have an interest only feature, 11.5% have a negative amortization feature, and 1.5% have a balloon payment feature.
- In addition to these risky attributes, 44.8% of at-risk borrowers have an adjustable rate mortgage (ARM) on their first mortgage that is pending adjustment.

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First Mortgage Loan Adjustments

Time Until Next Rate Adjustment	At-Risk Borrowers with Pending Adjustments	%	ARM with Risky Attributes	ARM wtihout Risky Attributes
6 Months	886	65.9%	619	561
6-12 Months	207	15.4%	76	139
1-3 Years	82	6.1%	22	60
3 or More Years	169	12.6%	18	157
Total	1344	100.0%	735	917

- 81% of at-risk borrowers with pending rate adjustments will see their rates adjust in the next year, but not all rate adjustments are necessarily harmful to borrowers.
- Today's low interest rates lower the probability of significant payment increases after rate adjustments.
- However, there is a particularly high rate of borrowers among this group with both a rate adjustment and a risky attribute.
- 735 of these borrowers have some form of risky attribute in their loan, which makes up 55% of the population with pending adjustments. These 735 borrowers have a higher likelihood of facing unmanageable payments in the future than other borrowers.

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Lien Status of At-Risk Borrowers

Lien Status	At-Risk Borrowers	%	Adjustable First Loans	Risky Attribute
First Mortgage Only	925	31%	387	211
Loan Secured with 2nd Lien	1659	55%	846	470
Loan Secured with 3rd Lien	418	14%	111	65
Total	3002	100%	1344	746

- Of the at-risk borrower population, 2,919 are secured with more than one loan, which makes assistance programs aimed at restructuring these mortgages challenging. This means that two-thirds of the at-risk population will have trouble becoming eligible for assistance.
- In addition, a large number of borrowers with multiple mortgages also have adjustable loans or risky attributes. Of these borrowers with multiple mortgages, 1,249 have adjustable loans and 535 have loans with risky attributes.

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Conforming Loans

Combined Loan Value	Borrowers	First Mortgage Only
Less than $300,000	56	35
$300,000 to $625,500	1125	438
$625,500 to $800,000	837	159
$800,000 to $1,000,000	452	116
$1,000,000 or more	532	177

- Loan size is a factor that could affect a borrower's ability to receive assistance in a loan modification. A conforming loan amount in San Francisco is $625,500. This means, 1,181 at-risk borrowers have conforming loans. Of these, 473 are borrowers with only one mortgage.

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At-Risk Borrowers by Home Value

Home Value	Borrowers	Conforming Loans	Conforming Loans First Mortgage Only
Less than $250,000	13	13	10
$250,000 to $500,000	562	522	246
$500,000 to $750,000	1337	646	217
$750,000 to $1,000,000	635	0	0
$1,000,000 or more	455	0	0
Total	3002	1181	473

- The data used to look at at-risk borrowers does not include income information. However, home values can be used as a rough approximation.
- Assistance programs often have income limits set to some level of area median income (AMI). For example, the income threshold for the existing San Francisco down payment loan assistance program is set at 120% of AMI. A household of four at 120% of AMI would have an income of $116,500. Depending on factors such as down payment, interest rate, other debt, etc., this household could afford a home between $400,00 and $500,000.
- This suggests that an assistance program restructuring only conforming loans with first mortgages set at 120% AMI would be eligible to 256 at-risk borrowers. A higher AMI threshold would support a broader program.

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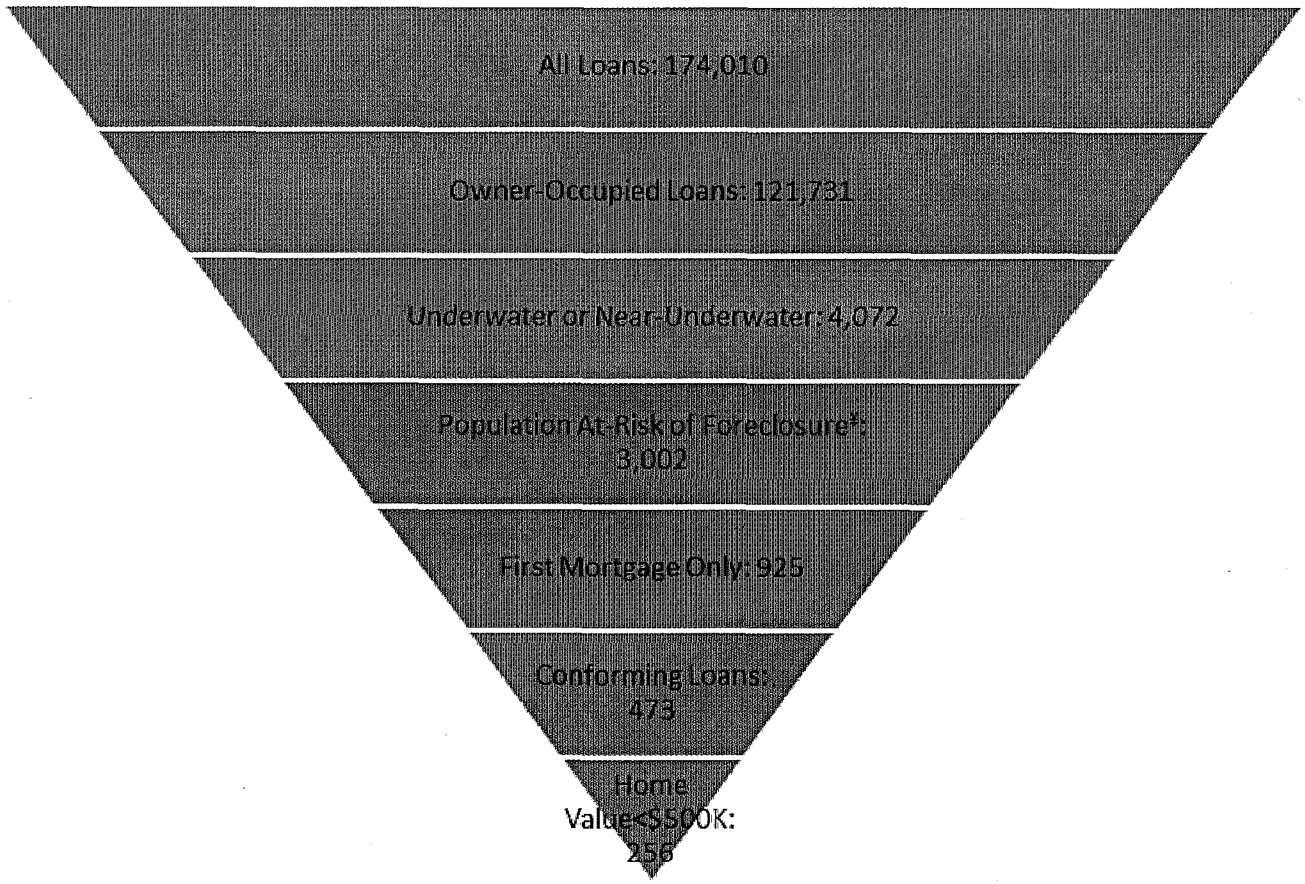
At-Risk Population Break Down



¥ This cut excludes home values greater than $1.5 million, homes more than $1 million underwater, BMR loans, and FHA loans.

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Underwater Borrowers

Estimate	Underwater Conforming Loans First Mortgage Only	Underwater Conforming Loans First Mortgage Only Home Value < $500k
Borrowers	222	160
Total Home Value	$97 million	$63 million
Total Loan Value	$110 million	$74 million
Amount Underwater	-$13 million	-$11 million

- The amount of negative equity in a borrower's home tells us how much would be needed in principal reduction to bring the home above water.
- If we exclude the near-underwater population from at-risk borrowers with confomring loans, a single mortgage, and a home value of less than $500,000, only 160 at-risk borrowers remain.
- These borrowers have a combined total home value of $63 million, and a combined total loan value of $74 million, which means that this group of borrowers has $11 million in negative equity.

Population At Risk of Default and Relocation

- The analysis in this section focuses on the population most at risk of foreclosure based mainly on loan-to-value ratios underwater or near-underwater. The reason for defining this as the population at-risk of foreclosure is because any loss of income or increase in payment that forces a borrower into default creates an incentive for the borrower to foreclose rather than realize the losses from selling the home.
- A borrower that has equity in the home, but lacks the capacity to make payments has every incentive to sell her home and keep the equity rather than foreclose. Borrowers with equity have more options than underwater borrowers. They are generally better candidate for a mortgage restructure and they have the option of a sale. However, in the situation of a short-sale, the borrower would have to leave her home. And despite gains received from the sale of her home, the current housing market would make it difficult to relocate into a home within the city.

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Section 3: A Survey of Mortgage Assistance Programs

Homeowner Assistance Program Summary

- In our review, few post-purchase assistance programs for homeowners exist at the municipal level. The ones that do are mainly in the form of home maintenance loans with the aim of helping low-income homeowners bring their homes up to code.
- At the federal and state level, few programs existed until recently when a number of assistance programs were created in response to the mortgage default crisis. These programs provide assistance to homeowners in three ways:
    1. Principal reduction
    2. Refinance Incentives
    3. Income support/One-time grants
- In addition to government programs, a number of Community Development Financial Institutions (CDFI's) and nonprofits exist with the goal of stabilizing communities through the acquisition of non-performing loans. The acquired loans are then restructured and stabilized before being resold.
- This report also looks at how recent legislation from the State of California and rules from the Consumer Financial Protection Bureau have changed underwriting standards in the last year, which may mitigate the prevalence of high-cost loans, PLS loans, and loans with risky attributes.
- Lastly, the prevalence of PLS loans has been increasing in recent years, which suggests there is a need for financial education among potential borrowers of these loans. Pre-purchase housing counseling has been shown to be an effective way to reduce delinquency rates and to mitigate credit risk.

Principal Reduction Programs

- The intent of principal reduction programs is to help borrowers establish an appropriate level debt and an affordable payment, by reducing the principal balance of a homeowner's first loan in connection with a recast, modification or a stand-alone curtailment.
- Two notable programs exist aimed at principal reduction:
  1. **Keep Your Home CA (KYHCA) Principal Reduction Program:** The California Housing Finance Authority (CalHFA) uses Hardest Hit Fund money from the U.S. Treasury to administer a set of post-purchase homeowner assistance programs through Keep Your Home CA. Included in this set of programs is the KYHCA Principal Reduction Program, which provides a principal reduction grant to homeowners with demonstrable hardship.
  2. **New York City Mortgage Assistance Program (MAP):** New York City used public and philanthropic funding to create a grant program in the form of a second loan. MAP loans feature no interest and deferred payment for a 30-year term. In addition, the program has a process for exceptions for payment at the end of the loan term.

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Principal Reduction Programs

- There is a large difference in the number of borrowers served by each program. This is due in part to the different populations being served and different eligibility criteria.
- The KYHCA program has only served three borrowers in San Francisco in its four year existence. Of the 65 applicants, 32% withdrew their application, while 42% were ineligible. This low approval rate is due in part to the fact that KYHCA serves the entire state and assists more borrowers in areas of California with greater concentrations of distressed mortgages. However, some of this may have to do with the eligibility criteria.
- MAP, which began in 2010 and ended in 2014, served 233 borrowers. Of the 855 applicants, 22% withdrew their application and 50% were ineligible.
- These programs can be designed with a number of eligibility criteria, such as:
    - Maximum income level, generally set to a percentage of area median income (AMI) Debt-to-income (DTI) ratio levels pre- and post- assistance
    - Loan-to-value (LTV) ratios pre- and post- assistance
- The MAP program has a more expansive criteria compared to the other two programs.. KYHCA's eligibility criteria is more restrictive in its LTV, DTI, and AMI thresholds than the MAP program.

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Principal Reduction Programs

- These programs demonstrate that program design can greatly affect the number of borrowers being served. Eligibility criteria can have a large effect on restricting the pool of borrowers or expanding it.
- The drawback of more expansive criteria is that it could potentially lead to lower homeownership retention rates. However, despite MAP's more generous eligibility criteria, it has a 100% homeownership retention rate with only one loan currently in default.
- A principal reduction program can be designed to provide either a grant or a loan, both of which have benefits and drawbacks.
- In a grant program, the borrower has the advantage of being free and clear of any new debt and the benefits of having a reduced principal balance remain through the life of the loan. However, in order to sustain a grant program indefinitely, an on-going funding source would be needed.
- A loan program has the advantage of being more sustainable. Like the grant program, a loan program can only serve as many borrowers as funds are available. However, the advantage of a loan program is that as loans are paid back, funds will become available to service new loans. In addition, a loan program could be designed in a way that loans are repackaged and sold to free up capital to service additional loans.

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Refinance Incentive Program

- The goal of a refinance incentive program is to encourage lenders and servicers to modify loans through cash bonuses.
- The U.S. Treasury and the U.S. Department of Housing and Urban Development (HUD), administers a refinance incentive program called the Home Assistance Mortgage Program (HAMP), which targets troubled mortgages that were originated before 2009. Homeowners in this program have their delinquencies immediately resolved and the program aims to reduce monthly mortgage payments through the following methods:
  - Change mortgage loan type (e.g. adjustable rate mortgage to a fixed-rate).
  - Extend the term of the mortgage (e.g. from a 30-year to a 40-year term)
  - Lower interest rates either temporarily or permanently to as low as 2%.
  - Add any past-due amounts, such as interest and escrow, to the unpaid principal balance, which is then re-amortized over a new term.
- The program works through incentives to lenders and services that include:
  - Shared cost of reductions in monthly payments on first mortgages with lenders from 38% debt-to-income to 31% debt-to-income by HAMP.
  - Bonuses based on the number of modifications and on performing loans serviced.
- In the San Francisco-Oakland-Fremont MSA in the third quarter of 2014, this program had 38,342 active permanent modifications. The median reduction of pre-modification payments is around 40%.

Refinance Incentive Program

- One of the main barriers to loan modification is denial of a loan modification request by the borrower's bank. The bank may still deny requests for loan modifications even when borrowers are able to receive assistance through government programs that make them a better candidate for modification. Generally, denials are made because gains from modification are small or in some cases non-existent relative to foreclosure from the investor's point of view.[3]
- Rather than bolster a borrower's financial situation to make them a better candidate for modification, a refinance incentive program tries to increase the benefits to the lender from modification through a cash bonus to the bank. The advantage to the borrower is that a modification through a program like HAMP will reduce their monthly payment. However, a HAMP-like program does not necessarily reduce the amount of total debt to the borrower. For example, one method of reducing monthly payments is to add past-due amounts to the principal, which actually increases the borrowers total debt amount.
- Because this type of program works as a cash incentive to banks, in order to make it sustainable, an on-going funding source would be needed.

Income Assistance/One-Time Grant Programs

- The intent of an income assistance program is to help homeowners facing sudden, unexpected economic hardship that makes it difficult for them to make their mortgage payments.
- The most notable existing program is through **KYHCA's Unemployment Mortgage Assistance Program (UMAP)**, which gives cash assistance to homeowners who have experienced involuntary job loss and receive CA Employment Development Department (CA EDD) unemployment benefits. Approved applicants can receive up to $3,000 a month for up to 18 months ($54,000 maximum).
- In addition to income assistance, KYHCA also has two other one-time grant programs:
  1. **Mortgage Reinstatement Assistance Program (MRAP):** This program targets borrowers who have fallen behind on payments and need help reinstating their past due first mortgage loans. Approved applicants are eligible for a one-time payment of up to $25,000 to cover principal, interest, taxes, insurance, and HOA fees.
  2. **Transition Assistance Program (TAP):** This program provides funds to homeowners who have been through a foreclosure to help them transition into a new home. Households can receive up to $5,000 in funding.

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Income Assistance/One-Time Grant Programs

Program	Applicants	Approved Borrowers	Reduction per Borrower	Total Cost	Approved	Withdrawn	Ineligible
UMAP	363	203	$16,924	$3,435,610	56%	33%	12%
MRAP	310	24	$17,089	$410,143	8%	51%	42%
TAP	5	0	$0	$0	0%	40%	60%

- UMAP is KYHCA's largest program in San Francisco, both in number of borrowers served, and in total cost. In its four years of existence, UMAP has served 203 borrowers in San Francisco with an applicant approval rate of 56%. This approval rate is high relative to KYHCA's other programs. This could be due in part to the criteria that requires borrowers to be receiving CA EDD unemployment benefits. Borrowers seeking assistance are likely selecting out if they aren't receiving CA EDD assistance, which restricts to pool to borrowers that are more likely to be eligible.
- KYHCA's one-time grant programs have been less robust in San Francisco. Only 24 borrowers were served through the MRAP program and no borrowers were served in TAP. MRAP has only an 8% applicant approval rate, but the reasons for ineligible applications are not possible to determine based on KYHCA information provided. However, for KYHCA programs as a whole, servicers not approving applications for assistance make up one-fifth of ineligibility reasons.

Income Assistance Program/One-Time Grant Programs

- An income assistance program addresses the issue of sudden economic hardship, which combined with negative equity, becomes the biggest reason for foreclosure.
- The relatively high take-up of the KYHCA Unemployment Mortgage Assistance Program provides evidence that this is an important program in helping homeowners retain their homes.
- Income supports can be designed in a number of ways that include maximum amounts, time limits, income tests, etc. An advantage of an income assistance program over a one-time grant is that it can sustain a borrower over a period of time through regular payments. In the case of KYHCA, this is an 18 month period of unemployment support. However, like any cash assistance program, in order for it to be sustainable, an on-going funding source would be needed.
- A one-time grant or time-limited grant program can be designed to serve the purpose of emergency funding. The likelihood of default greatly increases when a borrower faces a sudden economic hardship. An emergency assistance program can serve to bridge the borrower through a difficult period.

Loan Acquisition by CDFI's and Nonprofits

- A number of Community Development Financial Institutions (CDFI)[12] and nonprofit investment companies have the mission of stabilizing communities through the acquisition, modification, and reselling of troubled mortgages using a combination of private capital and public funding.
- These organizations mainly acquire loans at a discount through either HUD pools of non-performing loans or through direct agreements with lenders.
- Three programs are reviewed in this report:
  1. National Community Capital (NCC): This is the subsidiary of a CDFI, that acquires loans mainly through HUD pools of non-performing loans. NCC has acquired loans in New Jersey, Florida, and North Carolina and uses a combination of private capital and money from the Hardest Hit Fund to those loans.
  2. Hogar Hispano: This group is a nonprofit that works directly with banks to acquire pools of loans. These loans are restructured using mainly private capital and in some cases Hardest Hit Fund money.
  3. Mortgage Resolution Partners (MRP): This organization had the goal of seizing private-label securities through eminent domain to restructure and resell. To date, MRP has not been able to operationalize their plan, and recent federal legislation has limited their strategy.

Loan Acquisition by CDFI's and Nonprofits

Program Profile	National Communtiy Capital	Hogar Hispano
Borrowers Receiving Program Service	379	463
Average Pre-Assistance UPB	$189,091	$72,203
Public Funding Principal Reduction	$29,082	$0
Private Capital Principal Reduction	$42,175	$5,791
Average Post-Assistance UPB	$117,833	$66,412

- NCC has serviced 379 loans mainly through HUD pools of non-performing loans while Hogar Hispano has served 463 loans mainly through pools of loans bought directly from banks.
- NCC draws its public funding from the Hardest Hit Fund money to supplement private capital principal reduction. Hogar Hispano uses private capital to pay down principal balances.
- NCC has stated that 60% of its loans are stabilized. 67.6% of Hogar Hispano loans have a status of re-performing, modified, short sale, or paid in full.
- These loans are from state-level pools. Our review has not found a municipal-level strategy for acquiring loans. However, NCC has been in discussions with Oakland in trying to acquire loans.
- Given the small geographical area of a city, and the rising home prices in the Bay Area, the number of loans investors would be willing to sell to CDFI's and nonprofits may be very small.

The Use of Eminent Domain: Program Design

- The City of Richmond CARES program and its partnership with Mortgage Resolution Partners (MRP) represents a model of acquiring underwater PLS loans through the use of eminent domain.
- MRP's program would rely primarily on refinancing seized loans through the Federal Housing Administration's (FHA) short refinance program and securitization through Ginnie Mae.
- An example from an Urban Institute study assumes a home with a market value of $200,000 was purchased for $400,000, with a loan of $300,000.
- The City would use eminent domain to seize the loan, and with MRP financing, compensate the lender by 80% of the fair market value ($160,000).
- The loan would be transferred to MRP for servicing, and MRP would help the homeowner refinance the loan for $195,500, with $5,000 of proceeds held by HFA for initial loan insurance premium.
- Fees to fund city staff and MRP's expenses would come from the difference between the refinance proceeds and the loan cost ($190,500-$160,000=$30,500).
- MRP would receive a $4,500 servicing fee per successful transaction, and the rest of the proceeds would go to MRP's funders and the City.[13]

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The Use of Eminent Domain: Federal Limitations

- The strategy of using eminent domain to restructure loans has been limited with the passage of the Fiscal Year 2015 Omnibus Appropriations bill, which contains language that effectively prohibits HUD, FHA, or Ginnie Mae's involvement with any mortgage seized through eminent domain, or any mortgage replacing a seized mortgage.[14]
- The provision does not preclude the participation of the Federal Housing Finance Agency (FHFA), Fannie Mae, or Freddie Mac from the purchase of seized mortgages.
- However, FHFA General Counsel issued a memorandum in opposition to the use of eminent domain, finding that it "presents a clear threat to the safe and sound operations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks…" and would "run contrary to the goals set by Congress for the operation of conservatorships by FHFA…"[15]
- In a subsequent statement, FHFA described possible actions that it could take, which include initiating legal challenges to any jurisdiction sanctioning the use of eminent domain to restructure loans and cease business activities within any jurisdiction employing eminent domain to restructure loans.[16]
- The Controller's Office reached out the General Counsel and confirmed that the positions taken in the memo and statement have remain unchanged.
- Precluding any participation from Fannie Mae or Freddie Mac, the use of eminent domain would seem to be an inviable option.
- One possible option would be the purchase of loans from third parties and the sale of loans to third parties, but this option poses similar legal risks as outlined in the FHFA General Counsel memo.

The Use of Eminent Domain: Risks to the City

- Securitized loans are particularly difficult to restructure in large part because they exist in pools of loans with multiple investors and contracts governing the pools that make it difficult to restructure individual loans. Eminent domain circumvents this problem by seizing these loans.
- However, the use of eminent domain comes with a number of risks, including risks to the City's borrowing costs, legal risks, and the impact on cost of lending in the city.

Borrowing Cost Impact:

- The City's participation in an eminent domain program will likely have broader negative impacts on the City's participation in financial markets, at least for an initial period following program adoption.
- Approval of proposed legislation will likely be negatively perceived by financial markets, insurers, other financial intermediaries, and potential investors in the city. It is likely that after proposing an eminent domain program, the City would need to use a "negotiated sale" versus a "competitive sale" approach to selling City bonds for a some period after the proposal, which would draw fewer potential investors and transaction participants, resulting in higher sale costs and less competitive interest rates.
- If this occurs, this would increase debt service costs over the life of the bonds, or reduce the amount of bond proceeds available for various financed projects. For example, a modest 10 basis point (or 0.1%) increase equates to a net present value of $30 million in additional interest costs over the 20 to 30 year life of the $1.62 billion in bonds the City plans to issue this fiscal year.

The Use of Eminent Domain: Risks to the City

Legal Risks to the City:

Lenders are likely to challenge any eminent domain proceedings in two ways:

1. Right to Take: Questions on the "Right to Take" center around whether or not there is a public purpose, whether or not a "taking" is necessary, and whether or not mortgages are within the City's territorial jurisdiction.
   - The MRP strategies uses eminent domain to seize performing loans. Opponents of this program have argued that this is an improper "taking" because a performing loan creates no threat to the community, particularly when no assurance exists that the asset would cease performing.
   - Since mortgage backed securities are traded domestically and internationally, some opponents have suggested that using eminent domain this way would be a violation of the Commerce clause, which requires states not to interfere with interstate commerce except where there is a legitimate interest.
2. Just Compensation: When using eminent domain, the City must pay just compensation (i.e. fair market value) as defined under state and federal law. Such a program will encounter difficulty in determining values of performing loans. MRP's strategy calls for a price that they say factors in the risk of default, but opponents argue that this price is below market value. Opponents also argue that the forfeiture discount is based on an exaggeration of foreclosure risk.

The Use of Eminent Domain: Risks to the City

Impact on Mortgage Lending in San Francisco:

- The use of eminent domain will likely have an impact on the availability of credit to potential borrowers.
- Lenders currently do not account for the possibility of eminent domain seizures in their risk models and the implementation of an eminent domain program would warrant an adjustment. Lenders are likely to risk adjust by either raising interest rates, demanding larger down payments, or both.
- These adjustments would be made to compensate for future potential seizures and to provide a buffer against losses in the event of a seizure. The adjustments create restrictions in credit that would make it more difficult for potential homebuyers to get affordable loans and lower the number of homebuyers in the market.
- Lastly, the effect of such a program could actually artificially depress the value of homes.

Mortgage Servicing Rules

- In response to the mortgage crisis, federal and state governments implemented new mortgage rules aimed at reducing foreclosures and tightening underwriting standards.
- The California Homeowners Bill of Rights became law on January 1, 2013 to ensure fair lending and borrowing practices for California Homeowners. The laws are designed to guarantee basic fairness and transparency for homeowners in the foreclosure process.
- Key provisions include:
  - Restriction on dual track foreclosure: Mortgage servicers are restricted from advancing the foreclosure process if the homeowner is working on securing a loan modification.
  - Guaranteed single point of contact: Homeowners are guaranteed a single point of contact as they navigate the system and try to keep their homes.
  - Verification of documents (i.e. no robo-signing): Lenders that record and file multiple unverified documents will be subject to a civil penalty of up to $7,500 per loan in action brought by a civil prosecutor.
  - Enforceability: Borrowers will have authority to seek redress of "material" violations of the new foreclosure process protections.
- These key provisions were created to reduce the likelihood of foreclosure.

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Mortgage Servicing Rules

- The Consumer Financial Protection Bureau (CFPB) issued new mortgage servicing rules, which began implementation in 2014.
- There were many key provisions implemented to make it easier for borrowers to cure defaults and two key provisions that affect underwriting standards.
- The first provision affecting underwriting standards is the "Ability-to-repay" provision, which requires creditors to make a reasonable and good-faith determination that a borrower has the ability to repay the loan according the loan terms. The provision lists a guideline for basis of determination of the ability to pay and includes rules on verification of documents, such as income or assets, employment status, and credit report. This tightening of underwriting rules will have an impact on originations of high-cost and PLS loans.
- The second key provision is a new category of loan called the "qualified mortgage." A "qualified mortgage" is a category of loans that has certain, more stable features that make it more likely that a borrower will be able to afford the loan. For example, interest-only loans are not permitted. Servicers are incentivized to issue "qualified mortgages because the creditor or assignee enjoys certain legal protections in the form of a safe harbor or rebuttable presumption of compliance with the ability-to-pay requirements. This provision seeks to reduce loans with risky features through incentives to creditors.

Housing Counseling and Financial Education

- Before the onset of the mortgage default crisis, there was a sharp increase in the prevalence of high-cost and PLS loan originations in 2005 and 2006. In the three years after this spike, lenders dramatically reduced originations of these types of loans. Since 2009, the prevalence of high-cost loans has remained low. However, PLS loans have begun to see an increase in prevalence, making up 2.6% of loan originations in 2013. While this is well below its 2006 prevalence rate of 7.2%, the percentage of PLS loan originations is still trending upwards.
- Pre-purchase housing counseling has been shown to be an effective way to reduce delinquency rates and to mitigate credit risk.[17] However, the use of housing counseling services has been tied mainly to loans and programs that make housing counseling a requirement. High-cost loans and PLS loans are generally market rate purchases not tied to programs that require housing counseling services, which makes it harder for housing counselors to access borrowers who may potentially be entering into these types of loans.
- In addition, since the dissolution of redevelopment agencies, housing counseling agencies have seen diminished funding, which affects their ability to reach borrowers who could be helped by pre-purchase housing counseling services.

Section 4: Recommendations

Recommendations

- Programs currently available to San Francisco homeowners with troubled mortgages have a positive impact on reducing foreclosures, but have a number of limitations. This report makes two recommendations for reducing negative equity or mitigating the impact of sudden economic hardship should policymakers wish to assist homeowners with troubled mortgages:
    1. Develop a mortgage assistance program for homeowners with troubled mortgages that would reduce a borrower's principal loan amount in order to support a loan restructure.
    2. Develop an emergency assistance program targeting homeowners who have had an unexpected hardship and have defaulted or are at risk of default.
- Should policymakers wish to pursue these recommendations, the structure of the programs, including income and other restrictions will need to be set to define an eligible population to target limited resources. An analysis on the number of borrowers served and staffing would also be needed in order to determine the cost of the programs.
- In addition to these recommendations, three ideas were introduced in this report that warrant further exploration:
    1. CDFI's and nonprofits acquiring non-performing loans seem to pose low financial risks and low administrative burden to the City, with possible, but likely minimal, benefits that warrant an exploration of a partnership.
    2. Enhanced legal assistance may be helpful for homeowners seeking legal representation against lenders violating recently implemented mortgage servicing rules.
    3. Enhanced pre-purchase housing counseling services for outreach to neighborhoods with comparatively high prevalence rates of high-cost loans and PLS loans.

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Recommendations: Down Payment Assistance Loan Program

- The risk of foreclosure greatly increases when a borrower is underwater and options for homeowners are limited in terms of principal reduction.
- HAMP is able to assist borrowers whose originations were before 2009, but over 40% of the estimated at-risk borrowers had loan originations in 2009 or later. This leaves a large number of at-risk borrowers whose only safety net is KYHCA should they have trouble with their mortgages. But given KYHCA's strict eligibility requirements and its expiration in 2016, these borrowers have few good options in terms of principal reduction programs.
- Given the large number of borrowers at-risk without a safety-net, this report concludes that the Mayor's Office of Housing should develop a mortgage assistance program for homeowners with troubled mortgages that would support a loan restructure by reducing the principal amount through a second loan.
- Eligibility criteria can include loan-to-value ratios, debt-to-income ratios, and area median income percentage in order to define a population to target limited resources.

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Recommendations: Emergency Assistance Program

- Underwater borrowers having trouble with their mortgage payments are more likely to find that their best alternative is to foreclose. Bringing a borrower above water or helping them with their payments removes this incentive.
- In some cases, reducing the borrower's principal amount to support a loan restructure as the first recommendation suggests is not the appropriate solution for borrowers facing a sudden economic hardship. In such cases, it's possible the borrower needs one-time or short-term assistance to carry them through an economic hardship.
- An emergency assistance program can be as either a loan or a grant. And since this program would act as emergency support it would require parameters for a maximum assistance amount, and a time-limited duration of support.
- An income assistance program should include criteria such as the ability of the borrower to demonstrate economic hardship (e.g. receiving CA EDD unemployment benefits, sudden unexpected medical expense, etc.). A program like this could be developed in conjunction with the expiration of KYHCA.

Recommendations: Explore partnership with CDFI or nonprofit

- CDFI's and nonprofits in the business of acquiring, restructuring, and reselling loans generally acquire pools of loans at the state level.
- It is unclear how effective a program like this would be at the municipal level, given the small geographical location and San Francisco's rising home prices. As home prices continue to rise in San Francisco, investors will be less willing to sell loans in their portfolio.
- However, the only participation by the City would be to connect these organizations with the banks. The City would have no fiscal exposure, and seemingly no administrative responsibility aside from making the initial connection between the organization and the banks.
- Since the risks seem minimal, but the benefits unclear, we believe a partnership with a CDFI or nonprofit warrants some exploration.

Recommendations: Explore Enhanced Legal Assistance

- The recently enacted mortgage servicing rules were created to reduce the likelihood of foreclosure and to reduce the prevalence of originations of riskier loans. These rules also allow borrowers to seek redress of "material" violations of the new foreclosure process protections.
- However, not all borrowers have the knowledge necessary to seek redress of "material" violations and not all borrowers have the means to acquire legal counsel in order to seek redress of these violations.
- This report recommends exploring the use of funds for enhanced legal assistance to borrowers facing lenders who have violated the new mortgage servicing rules.

Recommendations: Enhanced Housing Counseling Services

- Pre-purchase housing counseling has been shown to be an effective way to reduce delinquency rates and to mitigate credit risk. However, the use of housing counseling services has been tied mainly to loans and programs that make housing counseling a requirement. High-cost loans and PLS loans are generally market rate purchases not tied to programs that require housing counseling services, which makes it harder for housing counselors to access borrowers who may potentially be entering into these types of loans.
- Since the dissolution of redevelopment agencies, housing counseling agencies have seen diminished funding, which affects their ability to reach borrowers who could be helped by pre-purchase housing counseling services.
- This report recommends exploring enhanced housing counseling services with the purpose of outreach to communities and neighborhoods where there is a comparatively high prevalence of high-cost loans.

Appendix: Data Description

- **U.S. Census Bureau, American Community Survey**: This data was used for its estimate on the number of housing units in San Francisco. This data was used to report the number of housing units and to calculate foreclosure rates.
- **Assessor-Recorder Foreclosure Data**: This data comes from the Office of the Assessor. It is used mainly in the first section of the report to analyze the impact of the mortgage default crisis, including trends in defaults and foreclosure, cure rates, and foreclosure rates by neighborhood. In addition, the data was compared to home value trends, unemployment rate, and the prevalence of high-cost and PLS loans.
- **Zillow Home Values**: Zillow estimates the market value of homes using tax assessments, prior and current transactions, and physical attributes of the home such as location, lot size, square footage, number of bedrooms and bathrooms, and other details.
- **California Employment Development Department**: Unemployment rate estimates were taking from the CA EDD.
- **Home Mortgage Disclosure Act data**: This data was used to estimate the prevalence of high-cost and PLS loans.
- **Corelogic Listsource data**: This data was used to estimate the population at-risk of foreclosure, and to analyze various loan attributes of this population.

End Notes

1. American Community Survey 2009-2013 5-Year Estimate.
2. San Francisco foreclosure rate calculated using data from the San Francisco Assessor's Office, American Community Survey. The U.S. foreclosure rate comes from RealtyTrac average of quarterly foreclosure rates in 2014.
3. Deng, Yong Heng, John Quigley, and Robert Van Order. 2000. "Mortgage Terminations, Heterogeneity, and the Exercise of Mortgage Options." Econometrica 68 (2): 275-307.
4. Lacour-Little, Micahel. 20047. "Equity Dilution: An Alternative Perspective on Mortgage Default." Real Estate Economics 32 (3):359-384
5. Cutts, Amy Crews, and Richard K. Green. 2005. "Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?" In N. Retsinas, & E. Belsky (Eds.), *Building Assets, Building Credit: Creating wealth in Low-Income Communities*, pp. 348-377. Washington DC: The Brookings Institution press.
6. This method of identifying high-cost loans is a replication of the method used by the Furman Center for Real Estate & Urban Policy in the report, "Declining Credit & Growing Disparities: Key Findings from HMDA 2007.": HMDA requires lenders to report when the spread between the annual percentage rate of a loan and the rate of Treasury securities of comparable maturity is greater than three percentage points for first lien loans, and five percentage points for junior lien loans. In this report, all loans with APRs above this threshold are referred to as high-cost loans. The high-cost loan estimate serves as a proxy for subprime loans.
7. Foote, Christopher, Kristopher Gerardi, and Paul Willen, 2008, "Negative Equity and Foreclosure: Theory and Evidence," Journal of Urban Economics, 6 (2), 234-245
8. Mayer, Christopher, Karen Pence, Shane M. Sherlund. 2009, "The Rise in Mortgage Defaults." Journal of Economic Perspectives, 23 (1), 27-50.
9. Furman Center for Real Estate & Urban Policy, 2008, "Declining Credit & Growing Disparities: Key Findings from HMDA 2007." Furman Center for Real Estate & Urban Policy, New York University School of Law and Wagner School of Public Service.
10. This map is based on 2014 zip code boundaries in Tableau. Two zip codes from the data do not exist in Tableau, 94160 and 94143. 16 originations were transferred from 94160 to 94102 and 302 originations were transferred from 94143 to 94122.
11. We exclude homeowners that are more than $1 million underwater because these borrowers generally have high-value homes and are too deeply underwater to be reached by any meaningful assistance program.
12. Community Development Financial Institutions are U.S. Treasury certified institutions that provide credit and financial services to underserved markets and populations

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End Notes

13. Lee, Pamela. 2013. "Eminent Domain: The Debate Distracts from Pressing Problems." Urban Institute, Housing Finance Policy Center.
14. Section 236 of the FY 2015 Omnibus Appropriations bill: "None of the funds made available in this Act shall be used by the Federal Housing Administration, the Government National Mortgage Administration, or the Department of Housing and Urban Development to insure, securitize, or establish a Federal guarantee of an mortgage or mortgage backed security that refinances or otherwise replaces a mortgage that has been subject to eminent domain condemnation or seizure, by a state, municipality, or any other political subdivision of a state."
15. Pollard, Alfred M., General Counsel. *Summary of Comments and Additional Analysis Regarding Input on Use of Eminent Domain to Restructure Mortgages* [General Counsel Memorandum]. Washington, DC: Federal Housing Finance Agency. August 7, 2013.
16. Federal Housing Finance Agency. *FHFA Statement on Eminent Domain* [Federal Housing Finance Agency Statement]. Washington, DC. Federal Housing Finance Agency. August 8, 2013.
17. Hatcher, Desiree. 2006 "Foreclosure Alternatives: A Case for Preserving Homeownership." Profitwise News and Views.

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