

UCLA ECONOMIC LETTER

REAL ESTATE AND THE MACROECONOMY

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Monthly condensed analyses of crucial real estate and economic issues offered by the UCLA Anderson Forecast and UCLA Ziman Center for Real Estate. Here, Stuart Gabriel, UCLA Ziman Center for Real Estate, Matteo Iacoviello, Board of Governors of the Federal Reserve System; and Chandler Lutz, Copenhagen Business School, summarize their findings that California Foreclosure Prevention Laws enacted during the housing crisis were effective in mitigating foreclosures and stabilizing the housing market. The following article is condensed from the authors' in-depth study. The complete paper, with all attributions and source material, can be found [here](#).

How California's Foreclosure Prevention Policy Out-Performed the Feds

By [Stuart A. Gabriel](#), Arden Realty Chair, Professor of Finance, UCLA Anderson School of Management, and Director, UCLA Ziman Center; [Matteo Iacoviello](#), Chief Economist, Trade and Financial Studies Section, Division of International Finance, Board of Governors of the Federal Reserve System; and [Chandler Lutz](#), Associate Professor, Department of Economics, Copenhagen Business School

Our paper investigates the 2000s crisis-period California Foreclosure Prevention Laws (CFPLs). The CFPLs encouraged lenders to modify mortgage loans by increasing the required time and lender out-of-pocket costs of foreclosure. We find that the CFPLs prevented 380,000 California foreclosures, equivalent to a 16% reduction during the treatment period. These effects did not reverse after the conclusion of the policy, implying that the CFPLs were not a stopgap measure that simply pushed foreclosures further into the future.

“Our most conservative estimates show that the CFPLs reduced foreclosures by 16 percent and hence prevented 380,000 California borrowers from losing their homes.”

Further, these policies increased house prices by 6 percent and in doing so created \$300 billion of housing wealth. Additionally, the gains in housing wealth translated into increased durable consumption as measured by auto sales.

Altogether, results suggest that the CFPLs were substantially more effective in mitigating foreclosures and stabilizing housing markets than the U.S. Government's Home Affordable Modification Program (HAMP). Until our research was conducted, there had been no prior evaluation of the alternative California policy.

CALIFORNIA AT THE EPICENTER OF THE HOUSING BUST

At the height of the housing boom in 2005, California accounted for one-quarter of U.S. housing wealth. But as 2006 boom turned into 2008 bust, house prices in the state fell 30 percent and over 800,000 California homes entered foreclosure. In an effort to contain mounting foreclosures both in California and beyond, the Federal Government in 2009 enacted HAMP. This program offered financial subsidies to both borrowers and lenders to modify individual loans on a piecemeal basis. However, HAMP reached few borrowers during the depths of the crisis as many mortgage lenders lacked the infrastructure to modify loans on a large scale.

Meanwhile, at the epicenter of the housing bust, the State of California pursued an alternative strategy. In contrast to the U.S. Government approach of offering financial incentives to modify individual loans, California instead enacted broad-based legislation that imposed foreclosure moratoria and increased lender out-of-pocket foreclosure costs to facilitate widespread lender adoption of mortgage modification programs. Unlike in HAMP, California's policy effects were wide-reaching, as distressed borrowers received immediate treatment even in the event of inaction by their lenders.

In July 2008 and in the midst of a severe housing crisis, the state passed the first of the CFPLs, Senate Bill 1137. This bill prohibited mortgage lenders and servicers from issuing a Notice of Default (NOD) until 30 days after informing the homeowner of potential foreclosure alternatives either by telephone or in person. The homeowner then had the right within 14 days of first contact to schedule a second telephonic meeting with the lender to discuss foreclosure alternatives. SB-1137 additionally mandated that agents who obtained a residential vacant property through home foreclosure must maintain the property or face fines of up to \$1000 per day, further increasing lender out-of-pocket foreclosure costs.

In the second CFPL wave, California passed the California Foreclosure Prevention Act (CFPA) in early 2009. The CFPA prohibited mortgage lenders from sending borrowers a Notice of Sale (NOS) for an additional 90 days subsequent to the issuance of the NOD unless the lender had implemented a broad-based mortgage modification program. The adequacy of mortgage modification programs was determined by the State of California based on debt-to-income targets and potential interest rate or principal payment reductions. Therefore, like SB-1137, the CFPA extended the duration and pecuniary costs of foreclosure in an effort to encourage widespread mortgage modification and limit the ongoing mortgage default crisis.

Our most conservative estimates show that the CFPLs reduced Real Estate Owned (REO) foreclosures by 16 percent and hence prevented 380,000 California borrowers from losing their homes. The CFPLs also mitigated prime and subprime foreclosure starts and reduced household mortgage default risk.

The relative gain in California house prices due to the CFPLs was 6 percent -- equivalent to a \$300 billion increase in housing wealth. Our median and preferred estimate of the house price appreciation associated with the CFPLs, derived using highly disaggregated zip code level data, is 9 percent. These effects were largely concentrated in the hard-hit areas of Southern California where the CFPLs dramatically lowered foreclosures. Indeed, foreclosure reduction is the key channel by which the CFPLs affect house prices, and using zip code level data we find that the CFPLs caused a 14.7 percent relative house price increase in the Southern California Inland and Coastal regions.

CALIFORNIA HOUSING GAINS WERE GREATER THAN FEDERAL STIMULUS

To put the CFPL house price gains into perspective, note that the effective U.S. Government fiscal stimulus during the crisis -- through the American Recovery and Reinvestment Act of 2009 (ARRA) and social transfers -- totaled \$114 billion. The magnitude of the housing stimulus created by the CFPLs (\$300 billion using our most conservative estimate) was thus 260 percent of the effective U.S. Government package.

The CFPLs not only lowered foreclosures, but also increased mortgage modifications. We find that the modification rate for delinquent loans in California increased 0.5 percentage points -- a 29 percent relative increase -- due to the CFPLs.

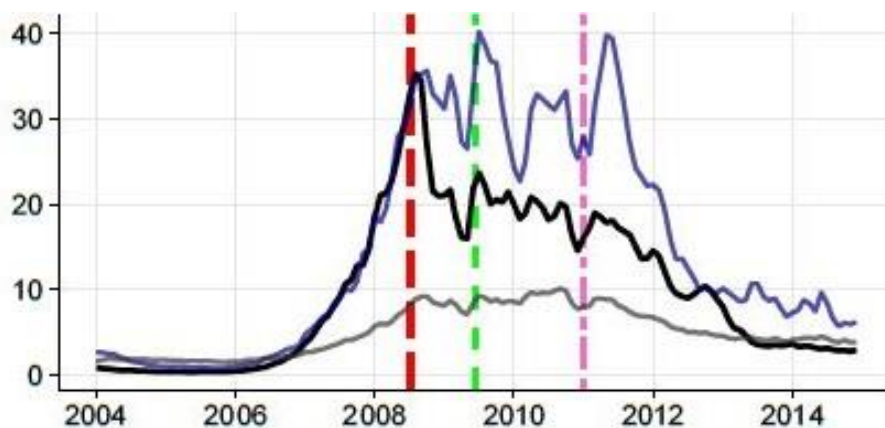
Larry Summers, the Director of the National Economic Council during the crisis, noted that the Federal Government elected not to increase foreclosure durations, arguing that any such increase would simply delay foreclosures until a later date. This was the prevailing view among leading US policymakers during the crisis.

However, by increasing the duration and cost of the foreclosure process, the CFPLs could have had a positive effect on housing markets if these laws reduced the flow of homes entering the foreclosure process. This is what we find in our empirical work: The CFPLs lowered mortgage defaults while increasing modifications and thus damped the downturn in housing, suggesting that an increase in mandated foreclosure costs is effective in buttressing ailing housing markets. Further, in contrast to the views of Summers and other leading policymakers, we find no evidence that policy effects later reversed as the CFPLs did not induce lingering delinquencies, prolong the crisis, or simply delay foreclosures until a later date. In other words, the salutary effects of the CFPLs were not transitory.

In addition to bolstering housing markets, the CFPLs were broadly beneficial to the real economy. Specifically, we find that these policies increased durable consumption as measured by auto sales. Compared to an estimated counterfactual, California auto sales increased 12 percent; further, growth in auto sales was highest in areas where the CFPLs were most efficacious.

All said, results of our analysis suggest that the CFPLs were substantially more effective than the US Government's HAMP Program for purposes of stabilizing housing markets and mitigating foreclosures. Further, contrary to concerns raised by policymakers regarding the likely transitory nature of foreclosure abeyance, our results suggest the gains to housing markets were long-lived. (Chart below shows drop in California foreclosures following passage of SB-1137 relative to synthetic control for California foreclosures in the absence of policy intervention.)

Zillow Real Estate Owned Foreclosures per 10,000 People



Black = California. Blue = Synthetic Control. Grey = unweighted sample average. Long-dashed-red vertical lines shows the passage CA-1137 in 2008Q3. Short-dash-green vertical line shows CFPA implementation date in 2009Q2, and two-dashed-pink line is sunset date for the CFPA and the end of the policy period in 2010M12 (2010Q4).