Date: April 22, 2008

California Housing Finance Agency
Foreclosure Relief/Economic- Stimulus Housing Financing

SUBJECT: Housing Finance

CURRENT HOUSING MORTGAGE CRISIS: Without action, foreclosures brought on by the current mortgage crisis will bring the number of empty residences in California to a staggering level as early as Summer 2008. This situation has already resulted in dramatically reduced home values and has the potential to bring blight and economic stress to communities all across the State, resulting in serious revenue loss to not only local governments but the State general fund. Ironically, these dramatically reduced prices have increased the number of homes that qualify as "affordable" in the State.

At the same time, lending institutions (and liquidity providers such as Fannie Mae) understandably have adopted more conservative and restrictive lending practices. For example, Fannie Mae informed participating lenders that it would not buy loans at loan-to-value ratios of greater than 95 percent for those borrower applications received after January 15, 2008. In addition, mortgage loans from non-GSE lending institutions have essentially become unavailable, even for borrowers who could otherwise meet traditional underwriting standards. Accordingly, even if a borrower wants to purchase a foreclosed home for occupancy, they are unlikely to be able to obtain the funding to purchase the home in the current market. This has created the "perfect storm" in the sense of the state having the greatest volumes of affordable housing stock but the most restrictive credit/lending practices in over a decade.

Despite this "perfect storm," the California Housing Finance Agency (CalHFA) believes there is an opportunity to take advantage of this crisis by helping "would be" first-time homebuyers that had been priced out of the market now realize the dream of homeownership.

SUMMARY: CalHFA would offer a custom loan product with special terms including lower interest rates and higher loan-to-value (LTV) ratios than currently offered in the market to take advantage of depressed home prices to make "want-to-be-homebuyers" into first-time homeowners. This program requires a state award of additional tax-exempt bond issuance authority for CalHFA. Bonds issued under this new authority will be used solely to fund loans to first-time homebuyers for the purpose of purchasing properties owned by financial institutions (i.e., REO properties) originally financed with "subprime" loans. The program would be offered only in certain areas of the state that experienced a substantial level of non-traditional lending activity and where significant numbers of REOs are offered for sale by institutions with the expectation that funds could be leveraged where the concentrations are highest. For example, to make these properties more affordable, financial institutions would be required to sell these homes at reduced prices. By making these properties more affordable, banks that are subject to the federal Community Reinvestment Act (CRA) may be eligible for CRA credits. The combination of discounted purchase prices and below market interest rate loans would result in a tremendous increase in housing affordability in these communities.

Specifically, this program would:

1) Provide CalHFA with $200 million in additional tax-exempt bond issuance authority. Tax-exempt bonds would provide the lowest cost of funds and would allow the Agency to offer loans at an interest rate that is as much as 125 basis points (1.25%) below current market rates. Assuming an average loan balance of $225,000 to $250,000, a program of this size would provide assistance to approximately 800 - 900 families. (See Attachment 1 -- a matrix comparing current market terms vs. terms proposed to be offered by CalHFA under this program and benefits offered to potential homebuyers. Final rates will be determined based on market conditions at time of tax-exempt bond sale.) Fannie Mae has offered to provide loan guarantees to facilitate the funding of these loans through the issuance of Mortgage Backed Securities (MBS) which would be purchased by CalHFA with the proceeds of tax-exempt bonds. In addition, Fannie would provide a liquidity "backstop" that would effectively lower the cost of the CalHFA issued tax-exempt bonds.

2) Offer first-time homebuyers a CalHFA 30-year fixed rate loan at a below market interest rate that could be used to purchase an existing home that is currently owned by a financial institution.

3) Require financial institutions to set the purchase price of each eligible property at approximately 10 – 20% below the current appraised value, the final discount amount to be determined in discussion with financial institutions holding REOs. A discounted purchase price would increase the affordability of these homes to individuals in these communities and would leverage the scarce resource of tax-exempt bond authority committed to this program. Again, only REO properties originally financed with "subprime" loans would be eligible for the program. Banks that are subject to the Community Reinvestment Act may be eligible to receive credits.

4) Specific areas of the State that have been seen a high level of non-traditional lending activity and foreclosures have been identified as possible target areas for this program. Using data from the Federal Reserve Bank of New York (which sites as its data source First American CoreLogic, Loan Performance Data) and additional data from First American Loan Performance, four counties and an additional four zip codes consistently rank in such top categories as "subprime" loan outstanding balances and numbers of these loans compared to housing units in the area; subprime loans that are seriously delinquent (i.e., over 90 days delinquent, in foreclosure and REO); and number of subprime REOs compared to total housing units. Based on these top rankings the following possible target areas may be considered for the program as we explore opportunities for increasing leverage:

   Counties: Merced, Riverside, San Joaquin, and Stanislaus;
   Zip Code Areas: 92336 (San Bernardino County); 94565 (Contra Costa County); 93550 (Los Angeles County) and 93535 (Los Angeles County).

5) Further efficiencies could be achieved in this program by bringing together the financial institutions that have these properties in their "REO" inventories, realtors who specialize in these impacted areas, Community Development Housing Organizations (CHDOs) and non-profit self-help housing organizations such as Habitat for Habitat for Humanity and Self-Help Enterprises. These non-profit entities could play a major role in an effort to fill these empty residences with qualified homeowners.

IMPLEMENTATION TIMEFRAME: CalHFA currently has over 50 approved lenders with offices statewide. If this program were approved, the Agency would provide program details and loan terms to those lenders with offices in certain areas within 30 days of the determination of program partnerships (e.g., financial institutions holding REOs and a master servicer) . CDLAC approved the allocation of $200 million of tax-exempt authority for this program on March 26, 2008.

AUTHORITY

Existing federal and state law allows CalHFA to make loans to first time homebuyers.

NEW LAW

No new legislation or regulatory changes would be needed.

FISCAL EFFECT: No impact to the state General Fund. This program would be funded through CalHFA which is a self-supporting state entity. This proposal would require $200 million of new tax-exempt bond financing to be allocated to CalHFA by CDLAC. For 2008, CDLAC has established the state's ceiling of private activity bond volume cap of approximately $3.1 billion. This tax-exempt bond issuance authority is available for such private purposes as multifamily rental housing financing, single family housing mortgages, student loans, pollution control facilities and industrial development bond financing.

COMMENTS:

1) Areas of the State where significant non-traditional lending activity took are experiencing a very high number of vacant properties. Experience has shown that significant numbers of vacant properties in communities bring down residential and commercial property values in the surrounding area, negatively impact commercial investment and economic growth in the community and contribute to crime related activities. Loss of property value and economic growth has already significantly impacted local property tax revenues, sales tax revenues and other revenues for local governments (including schools, social service programs and fire and safety services) in these communities. Of course, because the State must backfill the K-12 portion of any property tax loss, the General Fund is directly impacted as well.

2) Unfortunately, once properties are added to the "REO" (real estate owned) inventory, financial institutions often do not move quickly to move these now empty residences back into the hands of homeowners. And the longer these properties remain vacant, the greater the impact on the communities. A solution is needed to move these homes out of the inventories of financial institutions into the hands of new homeowners as quickly and efficiently as possible.

3) The Administration already has negotiated with key loan servicers for collective action to mitigate foreclosure action. Still, delinquencies continue to rise and an increasing number of foreclosures are inevitable. According to a survey of 15 major mortgage loan servicers recently completed by the California Corporations Commissioner DuFauchard, loans that went into foreclosure or were added to REO inventory on a monthly basis steadily increased

in the first three quarters of 2007 from approximately 3,300 in January to approximately 6,000 in September.

4) A potential source of funding for this proposal would be banks, since they are subject to the Community Reinvestment Act ("CRA") which is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. As an example, banks are given credit under the CRA for participation in local housing finance programs. CRA credit may be available to these financial institutions if they make their REO inventory homes available at below market prices to make these homes more affordable to potential homebuyers. However, the law does not require institutions to make high-risk loans that jeopardize their safety. In fact, the CRA makes it clear that an institution's CRA activities should be undertaken in a safe and sound manner.

5) Established in 1975, CalHFA was chartered as the State's affordable housing bank to make below market-rate loans through the sale of tax-exempt bonds. CalHFA is a self-supporting entity, and its debts, including those related to the compensation and retirement costs of its employees are separate from the State of California. Investor capital, through the sale of bonds, provides the Agency's source of revenue; not taxpayers' proceeds. Existing statutes and bond indentures state that the Agency's debts are not a debt or liability of the State or any political subdivision thereof and are not backed by the faith and credit of the State of California. Federal tax law only allows tax-exempt bond proceeds to be used to finance loans to first-time homebuyers and does not allow the use of proceeds for purposes of refinancing existing loans.

6) Although this program is not designed to save existing borrowers in default, it would provide a viable, effective, and potentially statewide beneficial use of REO properties for affordable housing purposes and it would ultimately get the REO property re-distributed much quicker in many cases than if the properties were "worked off" by the financial institutions.

Attachment 1
Comparison of Proposed Program Benefits to Current Market Financing

LOAN PRODUCT COMPARISON

	CalHFA REO Product MBS Program 28% MI Coverage			Current CalHFA Product Whole Loan 35% MI Coverage			Conventional Loan Product		
Sales Price:	$	250,000		$	250,000		$	250,000	
Loan Amount:	$	250,000		$	237,500		$	237,500	
LTV Ratio		100.00%			95.00%			95.00%	
Loan Term:		360	Months		360	Months		360	Months
Interest Rate:		5.45%			6.75%			6.50%	
Monthly P&I Payment:		**$1,411.64**			**$1,540.42**			**$1,501.16**	
Mortgage Insurance:		CalHFA MI	79 Bps		CalHFA MI	96 Bps		Private MI	100 Bps
Annual MI Premium:	$	1,975		$	2,280		$	2,375	
Additional Annual Payment:	**$**	**-**		**$**	**1,850**		**$**	**1,474**	
Required Down Payment:	**$**	**-**		**$**	**12,500**		**$**	**12,500**	
Closing Costs :	**$**	**5,000**		**$**	**4,750**		**$**	**5,344**	
Subordinate Financing:									
CHDAP / CHAP	$	5,000		$	12,500		$	-	
Simple Interest		3.00%			Various			N/A	
Deferred Payment		Yes			Yes				
Required Cash to Close:	**$**	**-**		**$**	**4,750**		**$**	**17,844**	

Benefits:

The program will provide financing to approximately 800 - 900 borrowers that CalHFA would otherwise not be able to serve.
The borrowers would be from revitalization areas in need of a stimulus.
Annual mortgage savings of almost than $1,500.
Elimination of down payment of more than $17,000