

Follow the Money: A Close Look at Recent Southern California Foreclosures

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Overview

- We look at the title history for houses going to foreclosure in Nov 2006; Nov 2007; and Nov 2008 (slightly over 4,000 total observations) in five Southern California counties
- We value the properties as of foreclosure date using an AVM, calculate the amount of negative equity, then follow property sale at auction or later as REO

Some Surprising Results!

- Defaulting borrowers did not purchase at the top of the market (average acquisition year was actually 2002)
- Across all three cohorts:
 - Most (52%) had already refinanced at least once
 - 79% had a second lien
 - 16% had a third lien
 - 4% had a fourth lien
 - Original LTV only 84%, but CLTV (including all liens) as of foreclosure sale date was about 150%

The Data

(Source: countyrecordsresearch.com)

- 161 foreclosure sales in Nov 2006
- 1,869 foreclosure sales in Nov 2007
- 2,358 foreclosures sales in Nov 2008
- Geographically:
 - 1,342 from Los Angeles County
 - 1,180 from Riverside County
 - 844 from San Diego County
 - 505 from San Bernardino County
 - 517 from Orange County
- Let's look at a few representative examples:

Representative case from the 2006 Cohort:

2584 Leebe, Pomona: 4 Bd, 2 ba, 1,200 sq ft, built in '54

Los Angeles County

Purchased for \$310 in '04;

Refinanced with \$356 loan in '05;

Defaulted in '06; AVM value \$381k

Bank got for \$328 at foreclosure sale;

Re-sold for \$320 in 2007; buyer re-sold for \$350 six months later



Representative case from the 2007 Cohort:

7812 La Corona, Buena Park: 3 Bd, 2 ba, 1,141 sq ft, built in '57

Orange County

Purchased in '03 for
\$345k

Refinanced in '04 for
\$405

Refinanced again in '05
with a \$412k first and a
\$103k second

Defaulted in 2007 owing
\$515k; AVM value \$458k

Holder of first got the
property at the
foreclosure sale for
\$344k, wiping out the
second lien holder

Bank resold the property
for \$390k in Feb '08



Representative case from the 2008 Cohort:

40030 Oak Grove Ave, Murrieta: 4 Bd, 2.5 ba, 1,816 sq ft, built in '88

Riverside County

Purchased for \$337k in '04

Refinanced in '05 with a new first for \$340k and a second for \$42.5k

Defaulted in '08 owing \$382.5k; AVM value \$207

Bank got property for \$183 at foreclosure sale in '08

Pending sale as of 5/09 at \$173 list price



Sources of Negative Equity

- $E_t = (MV_t - MV_0) - (D_t - D_0) + E_0$
- So negative equity can arise both from house price declines and from debt increases
- Which one is more important?

Regression Models Estimated

- Logit models for the probability of negative equity
- OLS models for the magnitude of negative equity
- For subset of data, we can estimate the effect of original LTV
- Robustness check: re-estimate everything using only observations where AVM is very accurate

Some Key Results

- Only about half of all borrowers actually had a capital loss (based on AVM value)
- Equity dilution (post-origination borrowing) is about as important as having bought at the top of the market (2005-2006)
- Losses to lenders are likely to total around \$1.0 billion whereas borrowers extracted about \$2.0 billion on equity invested of only \$262 million (implies at least 40% return on equity)

More Key Results

- High original LTV actually had a beneficial effect in reducing negative equity presumably because it constrained further borrowing
- So it's not the case, in general, the high LTV borrowers defaulted after prices starting declining; rather moderate LTV borrowers defaulted after extracting more than all their equity and price declines prevented them from continuing to do so (or, presumably, selling)

Table 3: All 3 Cohorts

Totals by Cohort	All Cohorts		
Total Purchase Price Paid	\$ 1,517,310,487	100%	Total Purchase Costs
Total Borrower Equity Invested	\$ 262,347,577	17%	Estimated Equity
Total Debt as of Foreclosure Date	\$ 2,256,938,669	149%	Borrowing Over Purchase Costs
Total Equity Extracted	\$ 1,994,591,092	7.6X	Multiple of Equity Extracted
Total Liquidation Recoveries	\$ 1,269,105,852	56%	Lender Recovery as Pct of Total Debt
Total Lender Losses	\$ 987,832,817	-44%	Gross Lender Loss Rates

A Few Caveats

- We don't know what the borrowers did with the equity extracted (e.g. capital improvements to the home, consumer spending, refinanced other debts, or simply serviced their debt)
- We don't know anything about the transaction costs of refinancing or junior lien borrowing
- We don't know who is an owner-occupant and who is an investor
- We don't anything about credit quality or any of the loan terms (just some lender names)

Conclusions

- Conventional view of the foreclosure problem may be incorrect (at least in Southern California)
- Post-origination borrower behavior is an important source of both the incidence and magnitude of negative equity for those facing foreclosure
- Research should be replicated in other markets to better understand the extent of this phenomenon