THE RECENTLY ANNOUNCED REVISIONS TO THE HOME AFFORDABLE MODIFICATION PROGRAM (HAMP)

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 14, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–122

U.S. GOVERNMENT PRINTING OFFICE

57–740 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIÉRREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

MAXINE WATERS, California, *Chairwoman*

NYDIA M. VELÁZQUEZ, New York
STEPHEN F. LYNCH, Massachusetts
EMANUEL CLEAVER, Missouri
AL GREEN, Texas
WM. LACY CLAY, Missouri
KEITH ELLISON, Minnesota
JOE DONNELLY, Indiana
MICHAEL E. CAPUANO, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
LUIS V. GUTIERREZ, Illinois
STEVE DRIEHAUS, Ohio
MARY JO KILROY, Ohio
JIM HIMES, Connecticut
DAN MAFFEI, New York

SHELLEY MOORE CAPITO, West Virginia
THADDEUS G. McCOTTER, Michigan
JUDY BIGGERT, Illinois
GARY G. MILLER, California
RANDY NEUGEBAUER, Texas
WALTER B. JONES, JR., North Carolina
ADAM PUTNAM, Florida
KENNY MARCHANT, Texas
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York

CONTENTS

WITNESSES

WEDNESDAY, APRIL 14, 2010

APPENDIX

THE RECENTLY ANNOUNCED REVISIONS TO THE HOME AFFORDABLE MODIFICATION PROGRAM (HAMP)

Wednesday, April 14, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:08 p.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Cleaver, Green, Donnelly, Driehaus, Himes; Capito and Jenkins.

Also present: Representatives Watt and Bean.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Good afternoon, ladies and gentlemen. I would like to thank the ranking member and other members of the Subcommittee on Housing and Community Opportunity for joining me today for this hearing on the recently announced revisions to the Home Affordable Modification Program, commonly referred to as HAMP.

Today's hearing will again revisit the Administration's program to prevent foreclosures. This is the third subcommittee hearing on the topic since the Administration announced the program just over a year ago. In that time, we have seen about 1.4 million trial loan modifications take place, but only 230,000 modifications have been made permanent.

At the same time, performance on home mortgages serviced by the largest national banks and thrifts continued to decline through the end of 2009. While foreclosure activity decreased from January to February of this year, the February 2010 numbers are still 6 percent higher than the numbers from February 2009.

So, I am pleased that the Administration addressed something that had long been clear to me and many of us in Congress: the original HAMP program was not doing enough to address the foreclosure crisis as it exists today. While the original program helped borrowers get lower interest rates, it did nothing to address the concerns of unemployed homeowners or underwater borrowers.

In my hearings, my conversations with agency and bank officials, and my discussions with homeowners impacted by these policies, I have advocated for stronger foreclosure intervention programs. In December of last year, the Wall Street Reform and Consumer Protection Act included a provision I authored to provide $3 billion in assistance to unemployed borrowers nearing foreclosure, a much more robust program than what the Treasury Department has proposed.

I hope that a provision similar to what I authored will be included in the Senate's Wall Street Reform bill. And I have likewise been a strong proponent for principal reduction programs, seeing the devastation in Los Angeles.

A recent study by First American CoreLogic estimated that the average borrower in Southern California would not get out from being underwater until 2016. So I'm curious today to hear from the Administration and from advocates about how these new initiatives will address these pressing issues.

Though I am concerned that these programs won't be operational until the fall, I am also interested to hear the Commissioner elaborate on how these policy changes will impact FHA's capital reserve level, given the important legislation I am crafting to address that issue. And I am also interested in hearing from advocates about what we should expect from these new initiatives. Will it be enough? Or do we need to mandate that these banks take steps to more seriously assist homeowners?

Increasingly, I am unconvinced that these voluntary programs are going to provide the assistance that homeowners desperately need. I find it curious that some major banking institutions have said publicly that principal reductions for struggling homeowners are unfair, and cause market distortions. However, when these financial institutions find themselves underwater on their own real estate investments, they themselves often stop making payments.

For example, Morgan Stanley recently decided to stop paying on five underwater office buildings in San Francisco. And when the Mortgage Bankers Association found itself underwater on its headquarters, they were able to rely on other lenders to get out from under this unsustainable mortgage. Unfortunately, it seems that many of their members oppose giving homeowners the right to do the same.

And I also remain troubled by the behavior of servicers who continue to construct barriers for some in search of loan modifications. I will continue to demand more accountability for servicers, and I will work with Chairman Frank to enact mandatory loss mitigation legislation.

I would now like to recognize our subcommittee's ranking member, Mrs. Capito, for 5 minutes to make an opening statement.

Mrs. CAPITO. Thank you. I would like to thank the chairwoman for holding this hearing today.

Last month, the Treasury and the Department of Housing and Urban Development announced another round of revisions to the Administration's Home Affordable Modification Program, commonly referred to as HAMP. Rolled out with the fanfare of promising to help nine million struggling homeowners, the HAMP program has fallen woefully short. As of March 12, 2010, Treasury disclosed that only 170,000 homeowners had received permanent modifications.

From the beginning, I have had significant concerns about the over-promising of assistance by these programs from this Administration. For families who are struggling, all this fanfare accomplishes is raised expectations about a program that is providing assistance to a fraction of the population that it is supposed to help.

I also have concerns about the precedents set by the changes of this program. There is no doubt that some homeowners were victims of mortgage fraud in the years running up to the housing bubble. However, the problems we are now seeing in the housing markets are less related to exotic mortgage products.

Are we creating a moral hazard here for future home buyers that will give them less incentive to pay their mortgages on time, and purchase a home that is well within their means? Is it fair to the vast majority of Americans who rent, own their home outright, or are current on their mortgage, that some Americans who are not as responsible with their financial decisions are now receiving these benefits?

The newest revisions allow borrowers to refinance into the FHA program, which is already struggling with their capital reserve fund below the mandated 2 percent level. We are in the process of crafting legislation to address the issues facing the FHA, but it concerns me that we are utilizing a program with significant challenges as part of foreclosure mitigation. It is tough to predict the effect these additional refinances will have on FHA.

I look forward to hearing from our witnesses and, again, I would like to thank the chairwoman for holding this important hearing.

Chairwoman WATERS. Thank you very much. Mr. Green, for 2 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. I thank the witnesses for appearing, and would like to assure you that I am very much interested in hearing about principal reduction programs that are being made available. My understanding is that on March 26th, Treasury and FHA announced a program, and on March 26th, the HAMP program was also reconstructed, or it was modified such that it would emphasize principal reductions, as well.

So, principal reductions are being implemented currently, as I understand it, by Bank of America. And I will be interested in knowing if you have some knowledge or empirical evidence as to how Bank of America is doing this, and doing it effectively. My belief is that at some point, we will have such a large number of persons who are underwater that principal reduction would become more appealing to private enterprise.

Initially, the servicers had concerns with no incentives. We provided incentives. Then, one of the concerns was too much liability. We passed some measures to help with liabilities. We have gone through tranche warfare. Any number of reasons why we can't do what they say can be done but does not get done on a large scale.

So, I am interested very much in hearing what you have to say about these things. And I thank you, Madam Chairwoman, for hosting this hearing today. I yield back.

Chairwoman WATERS. Thank you very much. Mr. Donnelly, for 2 minutes.

[No response.]

Chairwoman WATERS. Mr. Donnelly does not wish to speak. We will go right to our witnesses.

I am pleased to welcome our distinguished first panel. Our first witness will be the Honorable David Stevens, Assistant Secretary for Housing/FHA Commissioner, U.S. Department of Housing and Urban Development.

Our second witness will be Ms. Phyllis Caldwell, Chief Homeownership Preservation Officer, U.S. Department of the Treasury.

Thank you for appearing before the subcommittee today. And, without objection, your written statements will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. STEVENS. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify today on the Administration's recently announced adjustments to FHA and HAMP to prevent more avoidable foreclosures, and to better assist homeowners who owe more than their home is worth.

The Obama Administration's goal is to promote stability for both the housing market and homeowners. To meet the objectives, we have developed a comprehensive approach, using State and local housing agency initiatives, tax credits for home buyers, neighborhood stabilization and community development programs, mortgage modifications and refinancings, support of Fannie Mae and Freddie Mac to stabilize mortgage and securities markets, and several reforms to restore confidence in FHA.

With this past year's record low mortgage rates, thanks in large part to these initiatives, more than four million homeowners have refinanced their mortgages to more affordable levels. This helped save homeowners more than $7 billion last year, and more than 1 million families are saving an average of $500 per month through the Administration's mortgage modification program.

Home equity increased, on average, by more than $13,000 for homeowners in the last 3 quarters of 2009. These efforts have begun to restore the confidence we need to get our economy moving, creating 162,000 jobs last month, the best job report in 3 years.

Even with the success, we continue to see challenges. Our strategy to address the housing crisis must evolve, because our challenges have also evolved. In addition to housing affordability, the recently announced FHA and HAMP initiatives are designed to tackle two of the biggest threats to our housing recovery: unemployment; and underwater borrowers.

Our housing initiatives must balance the need to help responsible homeowners struggling to stay in their homes, with the recognition that we cannot stop every foreclosure. Some people simply cannot afford to stay in their homes. The Home Affordable Foreclosure Alternatives program includes a variety of options to help homeowners transition to more affordable housing, including incentives for expanded use of short sales and deeds in lieu, as well as relocation assistance.

For those homeowners who can be helped, the Administration has also expanded efforts to prevent avoidable foreclosures by providing responsible borrowers with opportunities to sustainably modify or refinance their loan. Last month, we announced the FHA refinance option, which will provide more opportunities for lenders to restructure loans for families who owe more on their home than it is now worth, due to price declines in their communities. This option is voluntary for the lender and borrower. To qualify for a new FHA loan, a borrower must meet FHA's fully documented underwriting requirements, must be current on their mortgage, and the lender must reduce the amount owed on the original loan by at least 10 percent.

We have also included incentives to encourage the private sector to write down second liens. Total mortgage debt after refinancing cannot be greater than 115 percent of the current value of the home, giving homeowners a path to regain equity in their homes, and an affordable monthly payment. These adjustments support principal reduction efforts already under way in the private market, and offer incentives to expand their reach. The vast majority of the burden of writing down these loans will fall where it belongs: on lenders and investors, not the taxpayer.

I have appeared before this committee several times to discuss the reforms we have made to strengthen FHA. It is because we are in a strong position today that we are able to facilitate these efforts to assist more struggling homeowners.

Furthermore, the Administration has designated $14 billion of TARP funds allocated to supporting the housing recovery, to provide incentives to write down second liens, and to mitigate risk to the FHA fund. This FHA refinance option, in addition to changes to the Home Affordable Modification Program which Chief Homeownership Preservation Officer Phyllis Caldwell is here to discuss, will help the Administration meet its goal of assisting three to four million homeowners avoid foreclosure.

I have submitted more detailed testimony about these efforts for the record. Madam Chairwoman, taken together, the Administration's broad housing initiatives and these newly announced flexibilities will offer a second chance for millions of responsible American families to stay in their homes. These expanded efforts build upon the substantial progress that has already been made, and will further help stabilize our neighborhoods and communities, and contribute to economic recovery. Thank you.

[The prepared statement of Commissioner Stevens can be found on page 108 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Caldwell?

STATEMENT OF PHYLLIS CALDWELL, CHIEF HOMEOWNERSHIP PRESERVATION OFFICER, U.S. DEPARTMENT OF THE TREASURY

Ms. CALDWELL. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify today on the recently announced enhancements to the Home Affordable Modification Program, or HAMP, a key component of the Administration's Making Home Affordable initiative.

These program enhancements will better assist responsible homeowners who have been affected by the economic crisis. The program modifications will provide greater protections for borrowers at risk of foreclosure, expand the program's flexibility to assist more unemployed homeowners, and help more people who owe more on their mortgage than their home is worth. Costs will be shared between the private sector and the Federal Government. Funding from the Troubled Asset Relief Program, TARP, will not exceed the $50 billion originally allocated for housing programs.

At the time we launched HAMP in March 2009, President Obama said that the program would enable as many as 3 million to 4 million homeowners to modify the terms of their mortgages. Through March, over one million homeowners were in active trial or permanent modifications, and nearly 230,000 homeowners are in active permanent modifications.

An additional 108,000 permanent modifications have been offered and are waiting only for the borrower's signature. Borrowers and permanent modifications are saving a median of 36 percent or more than $500 each month. And HAMP has proven it is helping borrowers who have faced real financial hardship. Nearly 60 percent of borrowers in permanent modifications have faced a reduction in income, including loss of wages, hours, or unemployment of a spouse.

HAMP has demonstrated real progress in the first year of the program, and we continue to improve it, based on lessons learned and feedback from homeowners, investors, servicers, and borrower advocates. Despite the progress, however, we have encountered a number of policy and operational issues that have been challenging to address. These include difficulties converting trial modifications to permanent status, confusion surrounding the concurrent foreclosure and modification process, and significant economic challenges posed by unemployment and severe negative equity.

After working with stakeholders at nearly every stage of the housing finance process, we have moved aggressively to implement program changes and expansions to help at-risk homeowners. To ensure that borrowers will not be caught in a long trial period, we have increased up-front document requirements for a trial modification, and established concrete time frames for servicer response.

We have made improvements around borrower solicitation and communication that will take effect in June, ensuring that homeowners are evaluated for HAMP prior to foreclosure proceedings, and requiring servicers to consider borrowers and bankruptcy upon request.

To further assist certain unemployed homeowners, servicers will be required to reduce their mortgage payments temporarily to an affordable level for a minimum of 3 months while they look for a job. If a homeowner does not find a job before the assistance period is over, the homeowner will be evaluated for permanent HAMP or possibly may be eligible for a short sale program.

To expand the use of principal write-downs, servicers will soon be required to consider an alternative modification approach that emphasizes principal relief. Under the alternative approach, servicers will be asked to consider principal write-down balances above 115 percent current loan-to-value, and eligible homeowners will earn this forgiveness on a pay-for-success basis, with principal forgiven in three equal steps over time, as long as the borrower remains current.

And lastly, four servicers, representing over half of the second lien mortgage market, have signed on to participate in the second lien program, or 2MP, which provides for concurrent modification or extinguishment of a second lien when the first is modified in HAMP.

We believe these changes will better enable us to reach our goal of preventing avoidable foreclosures. Thank you.

[The prepared statement of Ms. Caldwell can be found on page 51 of the appendix.]

Chairwoman WATERS. Thank you very much. I will now recognize myself for questions to our first panelists.

First of all, let me thank you for being here. Mr. Stevens, as you know, we are working on legislation to empower FHA to increase its capital reserves. Please elaborate on how the Administration's proposed refinance program will interact with FHA's capital reserves. Should we be worried that this creates more risk for FHA?

Mr. STEVENS. So let me start by making one point very clear about the FHA refinance option. The option that we announced utilizes the existing FHA program as it stands today with no changes to policy within the FHA program to utilize it. So all we are doing is using existing resources currently available within the FHA guidelines.

Furthermore, to protect any unknown risk—and I want to emphasize that we do not expect—we have looked at a lot of modeling on this particular option, and do not expect necessarily to use these funds. However—these funds to be needed—TARP funds will be made available, $14 billion of TARP funds will be made available, to offset lender claims on defaulted loans, and will reduce a portion of the FHA risk on these loans.

That, combined with the fact that these are existing policies, leads us to the conclusion, based on our analytics, that this should not expose FHA to further risk and their own MMI funding the portfolio.

Chairwoman WATERS. That's good, and that helps me to understand how you are going to do this. But when does the new refinance program begin? In the fall, is it?

Mr. STEVENS. The new—I'm sorry, Madam Chairwoman, when—

Chairwoman WATERS. The program that you announced for refinance—

Mr. STEVENS. Yes.

Chairwoman WATERS. —does not begin right away. It starts some time in the fall?

Mr. STEVENS. That's correct. We have to issue a mortgagee letter, some guidance to the industry. We have to pull together the industry participants so that the dialogue can begin to occur.

One of the fundamental challenges we have had with many of these modification efforts is that the industry is very fragmented between servicers, originators, investors, and the borrower, who all have to come together in order to form this union that can result in the principal write-down. For this program, this option under the refinance guideline, to be effective, we need to pull those components together and give clear guidance to the industry, not only how to make the operations work, but, as well, to ensure that the fundamentals associated with the TARP execution related to this for the lenders when they submit claims down the road is also effective and available at that time.

So, for that reason, we do not expect this to be operational until the fall—late summer, at best.

Chairwoman WATERS. I'm a little bit worried about many homeowners who have paid their bills on time for the length of the mortgage that they are holding. They have gotten into trouble, they have missed payments, they are trying to get loan modifications, they are trying to get refinanced, they are trying to do whatever they can.

But under your program, for example, if you use the same criteria that you use for your FHA mortgages, are they going to be eligible?

Mr. STEVENS. The FHA program, FHA refinance option, is merely one of a variety of options that's provided by this Administration, particularly with the recent announcements that we just made a couple of weeks ago that helps provide a series of alternatives to help affect responsible homeowners who we are able to effectively reach.

We do need to be clear, and the President has said that not everybody will avoid foreclosure. And to that extent, there will be some borrowers who cannot qualify. However, given the FHA guidelines, we believe that there will be a significant opportunity for homeowners who are in distress, underwater in their homes, who can afford a mortgage if it was written down to an appropriate level, who will be able to make their payments for the long term. And that is who this particular portion of the Administration's programs are designed to reach.

Chairwoman WATERS. Thank you very much. Mrs. Capito?

Mrs. CAPITO. Thank you. Let me make sure I get how this is going to work. If you're in an underwater mortgage, and let's say you have a second lien, like a lot of people do, you are going to extinguish that. Who pays for that?

Mr. STEVENS. Let me just walk—I will give you the full scenario. What will happen is—let's assume there is a second lien in the case you are using as an example. The first lien investor will most likely have an underwater loan to begin with. They have to do at least a 10 percent principal write-down, and the borrower has to benefit from that transaction and write down the principal to our maximum loan-to-value available in FHA, which is roughly 97 percent.

Mrs. CAPITO. Okay. Let me stop you there. When they write it down, is that what Ms. Caldwell—I think in her testimony—said the cost is shared by the private sector and TARP?

Mr. STEVENS. No, this—the entire cost for the first lien write-down by the investor is borne by the investor. There are no TARP funds associated whatsoever with the investor—

Mrs. CAPITO. What's the incentive—

Mr. STEVENS. —portion of the write-down in the FHA program.

Mrs. CAPITO. Is the $1,500 increased fee for the lender to do this, is that what they're—

Mr. STEVENS. No. The motivation for the investors—and we have had a multitude of investors come visit a variety of the agencies in Washington, and talk about their concern about some of the at-risk borrowers in the population—is that by writing down a portion of the loan, they are willing to take that loss for the benefit of ultimately having a loan that gets refinanced out of their portfolio, rather than risking it to potentially go into default at a deeply underwater level, simply because that borrower may be at risk for strategically defaulting, or have had income reductions that no longer allow them to support the loan as it stands today, and have no other alternative but to refinance out.

So, again, the lender will take a portion of that write-down for the security of knowing that the underlying loan that ultimately gets restructured will perform. And that's in their—that, in many cases—

Mrs. CAPITO. But then it goes off their books, because it goes into the FHA—

Mr. STEVENS. It goes into an FHA.

Mrs. CAPITO. Okay. So the hit to the lender, really, is the write-down in the—say if it goes to the FHA for 100 and they have it at 200, they take $100,000—

Mr. STEVENS. That's correct. And that's one of the unique attributes—

Mrs. CAPITO. But what's going to prevent the lender—excuse me for interrupting—

Mr. STEVENS. Go ahead.

Mrs. CAPITO. —but I only have a little bit of time—what's going to prevent the lender from saying, "Well, now, we started out with this, and then we moved to that, and refinancing, and remodifications, and now it's going to be this. You know what? I might just wait another 6 months. There might be another program coming down the road that's going to be better for me."

Mr. STEVENS. Look, the key about this program is it's entirely optional. It does require these participants in the market to make this decision on their own. If investors want to take the gamble and delay, thinking that some new option is going to be available, that's a risk that they have the opportunity to take. I think—

Mrs. CAPITO. Or—

Mr. STEVENS. I think that's a very high-risk—

Mrs. CAPITO. Or they could force the borrower into foreclosure, correct?

Mr. STEVENS. Yes, the alternative—they have the traditional alternatives they have today. One is the borrower may go into foreclosure, at which point most of these loans would ultimately be complete losses to their balance sheet.

They could delay, hoping—to your point—that something new down the road is coming. I think that's a fairly high-risk option, given the realities of the market together.

Mrs. CAPITO. Well, they have had several options, so I don't think it's that high risk.

Mr. STEVENS. Well, they have—except as we all know, they all had effectiveness at relative levels. So they—there is no single solution here that has been provided that gives mass relief, particularly to these mortgage investors who are very concerned about broad-based impacts to the capital levels and their balance sheet.

So, there is no question that they will look through their portfolio, they will look at borrowers who are most at risk for default, based on negative equity, perhaps income reductions, who are stressed. And they will recognize that a portion of these borrowers, if they were re-underwritten to their actual new income levels that have been adjusted during this recession, and a new appraisal, based on the actual property value, that this borrower would actually qualify for a new loan.

So, they will take that proportional write-down for the benefit of not incurring the complete loss in the event of that loan going to foreclosure.

Mrs. CAPITO. Well, a complete loss would be—it wouldn't be a complete loss, because they—wouldn't they become owners of the property? It has some value.

Mr. STEVENS. That's correct. It would be the net difference of the post-foreclosure expense against the resale price of that real estate—to your point, that's why we do not believe these numbers will be of the magnitude to solve the housing crisis.

We think this is another solution that can be combined with the variety of solutions offered by this Administration—which, again, have just been enhanced a little bit further—to help provide more alternatives for investors, servicers, and borrowers to deal with this particular climate. But it will not be a fix-all solution, by any means.

Mrs. CAPITO. Okay. Let me just ask Ms. Caldwell, in the part of your statement where you said the cost will be borne by the private sector and by the TARP, what cost are you referring to there?

Ms. CALDWELL. Thank you. In the HAMP modification, to get to affordability, a homeowner comes into HAMP because they are having trouble paying their mortgage. And so, the HAMP modifies the mortgage to 31 percent of the homeowner's debt to income. To the extent—for the—

Mrs. CAPITO. So—but that could be through extending the life of the loan, or—

Ms. CALDWELL. Correct.

Mrs. CAPITO. —lowering the interest payment. It's not necessarily a write-down, correct?

Ms. CALDWELL. But the—not a write-down on the principal balance.

Mrs. CAPITO. Right.

Ms. CALDWELL. But a write-down on the monthly payment.

Mrs. CAPITO. Right.

Ms. CALDWELL. And so, the difference between that write-down from 38 to 31 percent debt-to-income is shared through incentives from the Treasury and incentives—and reduced payment from the investors. On the—

Mrs. CAPITO. And how does that split out, like half and half or—

Ms. CALDWELL. Half and half. On the short sale deed in lieu program, for example, if a homeowner goes to short sale, there are incentives for the servicer for doing that, yet the second lien holder must release the lien. There is some compensation, but not full. And the second lien holder has to discharge future obligation from that borrower. So the—

Mrs. CAPITO. So the second lien holder is compensated by the Treasury? Or is it split?

Ms. CALDWELL. It's partially—it would depend on the amount of the lien split.

There is incentive available to pay up to $6,000 for release of the second lien, but that lien could be $20,000, it could be $30,000, or it could be some other amount.

Mrs. CAPITO. Well, my time is up, but I will say this: all of this is so darn confusing. I don't see how people could plan into the future when the programs keep changing. And I understand the motivation here is to try to stem the tide and you find the bottom, I guess, for want of a better term.

But if we keep moving the boundaries around here, increasing the program—I went around to my district in the last 2 weeks and tried to explain this program that we're going to have forbearance for people who have lost their jobs. This is not selling in the American public, the ones who have been sitting there paying their bills, doing what they want to do, cutting back on all of their daily expenses to try to make sure they meet that one big thing in their life, which is their mortgage payment, I just have concerns about the changes, the confusion, who is taking the hit. Is it just another hit to the taxpayer? Thank you.

Chairwoman WATERS. Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman. Is it fair to say that homeowners who are playing by the rules, who made all of their payments timely, and been blessed to keep their jobs, that they have a stake in this, as well?

Is it fair to say that because property values decline when we have foreclosures in a community, that those who have played by the rules are impacted by the foreclosures that take place?

I have some evidence that property values decline on an average of about $150,000-plus in some communities. So we all have a stake in this. Whether it is a direct impact or indirect, we still have an impact upon us. Is that a fair statement, Mr. Stevens?

Mr. STEVENS. Absolutely. And I think it relates a bit to the previous statement, in that even homeowners who have been able to pay responsibly get impacted when a home goes to foreclosure in their neighborhood and drives down home values.

So, that is a key component to making sure this program is managed responsibly.

The thing I would absolutely highlight, to your point, is that the issue of negative equity, for example, is heavily concentrated in a select number of States in this country. And in those States—take Nevada as an example, where the average loan-to-value is over 100 percent—any event that impacts a family living in a home—loss of job, something that impacts a family—would make it literally impossible for them to get out from that home or afford that mortgage without some other solution. And that is a result of no fault of their own, necessarily, it's a fault of the depression of the entire market.

Mr. GREEN. And my suspicion is that there is empirical evidence to support the notion that the prices receding, being devalued, will impact homes on the market, which will impact housing starts, which will impact employment, which impacts employment, by the way, in housing but also in people who lay carpet, people who manufacture carpet, people who sell appliances, people who make appliances. The domino impact is one that is felt throughout the economy. So we have to do something to stop this slide in housing prices and foreclosures, because of the impact that it has on the economy, as a whole. So, we all have a stake in it.

And I understand the moral hazard argument, but there is also what I call an immoral hazard argument. It is immoral to do nothing, and just watch as the economy slides into some sort of abyss from which it may be difficult to extricate itself.

Now, let's talk for just a moment about empirical evidence necessary to evaluate these programs. The servicers are key. Do we have in place a requirement of some sort that servicers provide evidence of rejections, number of rejections, why the rejections took place? And are there sanctions available, in the event the servicers don't provide the empirical evidence necessary to evaluate the programs?

Ms. CALDWELL. I will take that question. It's a very important question, something that we spend a lot of time thinking about.

And the short answer is yes. Servicers that are part of the HAMP program have signed a servicer participation agreement that specifically spells out their obligations under the program, including fair lending, including reporting of denials, and including modifying according to HAMP guidelines.

I think it's also important, though, to remember that this is a voluntary program. And so, at the beginning, as we try to get servicers, investors, and homeowners together at the table, this is fundamentally shifting how the servicing business is done. And so, some of the challenges that we have seen in the first year, as servicers have ramped up, has been a result of a rapid growth in the program and adjusting to the program.

But yes, absolutely, we do. We publish a monthly servicer performance report, and we released our most recent one today, that highlights, by servicer, their delinquencies, the number of homeowners they have on trial modifications, and the numbers they have converted to.

Mr. GREEN. Will the raw empirical evidence be made available to the public for those organizations that take this information and massage it in such a way as to come to conclusions about how efficacious the program is?

Ms. CALDWELL. At this point, part of the program is very committed to transparency. We began collecting denial codes, as well as race and gender information in December. At this point, we are beginning to get those first collections in. But our intention is to make that data available to the public as soon as it is scrubbed and ready.

Mr. GREEN. [presiding] I yield back. Thank you. Ms. Jenkins is now recognized for 5 minutes.

Ms. JENKINS. Thank you, Mr. Chairman. Some analysts are predicting losses as great as $30 billion between the 4 banks currently participating in the 2MP program associated with home equity lines. Are these estimates within the projections Treasury anticipates, and are banks prepared for this much damage to their revenues?

Ms. CALDWELL. I think the question of second liens and valuation—I will let the respective institutions speak to the estimates for on their balance sheet. But I do think it is important, in the context of 2MP, to know that we worked very closely with the second—with these second lien investors. It was a voluntary program to sign up for, and we got the four largest servicers to sign up in February. And that was after each of them looked at their second lien portfolio, understood what it meant, and made a commitment to modify those second liens that were behind a first mortgage that had been modified in HAMP.

And so, it is our expectation that they will do that in accordance with the program guidelines. But I can't speak to the accounting treatment on their own balance sheets, as a result of their participation.

Ms. JENKINS. Okay. And the roll-out of the Treasury Department's second lien modification program will not be effective until September of this year, under the—

Ms. CALDWELL. The—oh, sorry, go ahead.

Ms. JENKINS. Under the HAMP program, a servicer cannot execute a foreclosure until all available modification options have been tried. Does the September 2010 start date for the 2MP initiative amount to a 6-month foreclosure moratorium?

Ms. CALDWELL. Let me clarify two things. The September date for 2MP is actually the date that the Treasury systems will be up and running to report on the second lien program. As with all things in HAMP, servicers may implement the program when they are ready.

At this point, those servicers that have a second mortgage behind a first mortgage that they service—meaning they know when they have the first being modified and they hold a second—they have indicated that they will begin modifying those loans immediately.

One of the key components of the second lien program is a matching system that notifies a second lien holder when the first lien has been modified, even if that first mortgage is done by another servicer. And so, that matching system should be in place within the next month. And then, second lien holders will know when they have a junior lien on a mortgage that has been modified.

And again, our expectation is they will begin making those modifications, even though they will not be able to report them and receive incentives, they will just accrue them.

To your second point regarding the borrower notice and outreach and solicitation, that takes effect in June. And that is specifically about those trial modifications where a homeowner has provided up-front documentation to get into a trial. That guidance clarifies that if a homeowner is in a trial modification and making payments, they may not be referred to foreclosure. So I would not characterize the 2MP timing as related to anything on the foreclosure process.

Ms. JENKINS. Okay, thank you. I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. Mr. Driehaus?

Mr. DRIEHAUS. Thank you, Madam Chairwoman. Just to follow up, if Ms. Caldwell or Mr. Stevens could provide clarification, because this remains a problem in Cincinnati for folks that we are dealing with, in terms of folks who are seeking modification—and it might be—it's usually the huge entities. It's dealing with one of these—Deutsche Bank, or one of these massive entities, where at the same time they're dealing with a modification, someone else at the institution is proceeding with a foreclosure.

And I apologize if I'm asking you to repeat yourself. But if you could, help me better understand specifically what you're doing to prevent that from happening, and what type of clarification we are requiring of the financial institutions, so that this isn't occurring.

Ms. CALDWELL. Absolutely. And that's a very important issue in the HAMP program.

When the program was originally announced, servicers were allowed to have dual track foreclosure, meaning they could go down the modification process, but could also continue along the foreclosure. That has been a standard practice in the industry. And very often, it was a practice used to get homeowners' attention.

That was—HAMP guidelines have always prohibited a home from going to foreclosure sale while a homeowner was in HAMP. But there was confusion between what is a foreclosure process, meaning actions leading up to sale, and actual sale. And so, what the new guidance did is require servicers to clarify the difference between process and sale in those cases where there might be homeowners already in a simultaneous foreclosure.

But for new homeowners coming into the program, servicers must provide outreach to the homeowner, and try to contact them before initiating a foreclosure action. And to the extent that homeowner has been evaluated for HAMP and is in HAMP, they cannot refer the loan to a simultaneous foreclosure, as long as that homeowner is making the three trial payments.

Mr. DRIEHAUS. So, if they're being evaluated for HAMP, they still are provided those protections. This isn't—because there was a distinction being made between the evaluation process and the actual, in the program, being modified, and having been approved for modification and they're in the program, and therefore we would stop the foreclosure proceedings.

But now, if they're being evaluated, we can no longer proceed with the foreclosure proceedings?

Ms. CALDWELL. That is correct. For those homeowners who are being evaluated effective June 1st, in those evaluations where the homeowner has provided up-front documentation, the loan may not be referred to foreclosure until a decision has been made that they are not in HAMP. And if they are in a HAMP trial and they are making payments, they may not be referred.

There are some circumstances where there are homeowners where the foreclosure process has already started, and they are already in the trial process. In that, servicers will be required to send notice to explain that they are already in a simultaneous foreclosure process, but that their house will not go to sale until they are declined from HAMP.

Mr. DRIEHAUS. And we aren't able to put a freeze on that process? Why are we doing this prospectively, beginning in June, rather than saying, "Hey, look, this is a problem right now with folks who are experiencing this." We are sending a lot of mixed messages, especially to people who are getting confused about the information that is coming to them.

They are doing everything they can. They understand that the government is on their side, trying to help them stay in their home, yet they are getting a notice from the same bank, telling them they're being foreclosed on, and they're proceeding with the foreclosure action.

So, what we're saying is that, well, in June we are going to change the process. But if you're already there, you're already there. Is there any way for us to prohibit them from proceeding with the foreclosure process for those who are already in the system?

Ms. CALDWELL. That's a good question. For those who are in the process, it's sometimes very difficult and often more expensive to stop and start a foreclosure action. And so, based on feedback from multiple stakeholders, we made the decision, from a process standpoint, with the number of changes coming out we should do something prospectively, but just aggressively communicate what has been happening to address the confusion that had been in the program.

But in terms of going back and retroactively changing process for one million homeowners in trial modifications, we focused on going forward.

Mr. DRIEHAUS. I guess my concern is that is one million problems in terms of, if we aren't going back and trying to address— because there are so many people who are experiencing this right now, and if we are not addressing it right now—that's great, that we're fixing the problem prospectively. But there are a lot of people stuck in that situation right now. And I hope that the communication is enough. But my fear is that it's not. Thank you, Madam Chairwoman.

Chairwoman WATERS. You're welcome. Representative Bean is in attendance. Without objection, Representative Melissa Bean will be considered a member of the subcommittee for the duration of this hearing.

Ms. BEAN. Thank you, Madam Chairwoman. My question is, why is the FHA rolling out a new FHA refinance plan, instead of working with the existing HOPE for Homeowners program that has been ready to go?

And now that the new guidelines are finalized, how many refinances do you expect would be done through HOPE for Homeowners this year?

Mr. STEVENS. Just to be clear, we look at the HOPE for Homeowners as a complementary program to the FHA refinance option. As—HOPE for Homeowners was, obviously, created legislatively. That program still exists today. It has not had the volume that was originally anticipated. That's clear. We have just—we made some recent adjustments to it in the fall, and have re-added those to the roll-out.

While we have seen some increase, it has still been extremely moderate, in terms of take-up. And while I'm not passing—come to the point where I can draw conclusions as to why, it is a very different program in terms of documentation standards, requirements for servicers, etc. And so, that program exists and we are hoping that it does sort of pick up steam, in terms of success.

The refinance option that FHA has announced is really utilizing an existing FHA refinance option that already was available. It just adds some additional advancements to it, in combination with our partnership with Treasury to help facilitate that relationship between the servicer, the investor, and the originator, to make it utilized as well.

So, we're hoping, between the two, we can reach a broader segment of the distressed homeownership population.

Ms. BEAN. So you are expecting some increase in HOPE for Homeowners participation?

Mr. STEVENS. Yes, we have already seen some increase. It is extremely moderate.

Ms. BEAN. My other question is for Ms. Caldwell. On average, how many hours are spent modifying a loan through the HAMP program? And how does this compare to when it first started?

And besides delays caused by the borrowers themselves, what's the biggest internal delay mortgage servicers face in completing a loan mod?

Ms. CALDWELL. The—I think it's—as we think about the delays and modifications, we have seen three things. The first has been the servicer capacity to overhaul the business that had been a payment collection and processing business to what looks much more like an origination business, and an origination business for homeowners facing real distress. So, first would be servicer capacity.

The second one would be understanding the changes and the requirements of the program. As homeowners, investors, and servicers have had to come together and learn a program that was started from scratch to address a problem at huge scale, just the understanding and ramp-up and learning and coordinating among all those parties has taken a lot of time.

And then third would be the documentation issue. Last year, Treasury made a decision to open up trial modifications to homeowners, based on stated income in an effort to get more people into the program, and more immediate savings into American homeowners.

What we underestimated was the challenge that would result in getting the documentation in, getting it reconciled, and getting those homeowners and trials converted. And that has really been the bulk of the focus of the last few months, is getting that backlog of trial modifications that came in, where people are saving on their mortgage, decisioned and converted.

Ms. BEAN. We know that also contributed, the fact that people got into trial mods without documents, and then later it turned out they didn't have enough unemployment to justify a permanent mod, that we sort of set some people up to think they were on track to get a permanent modification, only to find out later that they were never going to be eligible. So we are glad to see some changes in that regard.

What specific changes have been instituted as a result of the auditing on servicers by HAMP compliance officers?

Ms. CALDWELL. From the compliance we have done a number of things. The first has been the institution of the temporary review period that we announced at the end of December, where we said servicers could not decline anyone from HAMP until they did a thorough review—or decline anyone from HAMP unless the property was ineligible.

That was done, in part, because our compliance showed that the servicers had not yet put—were not yet understanding all of the rules of the program. So we had servicers go back and do a temporary review.

In addition, there have been some servicers that have been instructed to re-run the net present value test, as we have also learned that the net present value test coming in and coming out has been confusing.

And so, we have really focused the compliance effort on making sure the homeowners are not inappropriately denied a HAMP modification. And that's why we have kept people in trial modifications longer than many would have liked, but it's really to make sure that when someone is declined a HAMP mod, it is really for the right reason.

Ms. BEAN. Thank you. I see my time has expired. I yield back.

Chairwoman WATERS. Thank you. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. I have one question.

I am a little bewildered by the fact that I think it's a generally accepted fact that minorities were targeted for subprime loans and all the exotic products were made available to minorities at a much, much higher level.

And so, I am concerned, if that is a fact—which I believe it is—I can't understand why Treasury has not released the data that they have been collecting, and pledging to make it public. And we have no data on the applications for HAMP based on race, sex, or national origin. Can you give me some indication, either, as to when Treasury is going to release that data?

Ms. CALDWELL. Absolutely. At Treasury, we are very focused on the impact on low and moderate income and ethnic minority communities, in terms of mortgage modifications. And we partner with NeighborWorks and housing counselors, and have targeted outreach events to try and reach all populations in HAMP.

In terms of the data, we began collecting it in December of 2009. And we will begin reporting it, making it publicly available in raw form as soon as it has been scrubbed and is ready.

I will say a few things. One, it is—in terms of the modification program, the servicers can only report what people self-identify on their modification documents. And the early results are coming in that many people are opting not to identify. So we are a bit concerned. I don't want to set expectations that the data will be complete.

Second, we are also finding that many of the low and moderate income and ethnic minority communities are adversely impacted by other conditions, such as unemployment, that are also making it very difficult to qualify for a HAMP modification. But we are very, very focused on the program.

And all servicers that are part of HAMP are required to comply with fair lending guidelines.

Mr. CLEAVER. Yes. But even if we get partial data, it will still give us, I think, some indication as to who the applicants are, and it can even provide much clearer information about the people who were steered into these subprime loans.

So, do you have any indication of when maybe the Chair can receive that?

Ms. CALDWELL. The target date for release has been by the end of June. And that's assuming we have collected—we should have it collected in, and it allows some time for scrubbing of the data and removing of all personally-identifying information and compliance with all privacy guidelines to make sure that it's in a format that can be released. But we are certainly on track, to get that made public.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Chairwoman WATERS. You're welcome. Without objection, the Chair is going to have a second round with this panel.

Mr. Himes just came in. Mr. Himes, for 5 minutes.

[No response.]

Chairwoman WATERS. Not yet? The Chair is going to initiate a second round with this panel. It is so important, because we are all confused. The public gets confused. We are not getting the modifications that are being represented. And let me just quote you Elizabeth Warren, who released an Oversight Panel report strongly criticizing HAMP today, saying in the end it will only prevent 276,000 foreclosures. As you know, we have listened to you, and you have told us that the Administration claimed it would prevent three to four million foreclosures.

Now, the reason that I am going to go a second round with you is this: I think it's very important for you to share everything that you can with us, and for us to be very honest with you about what we're feeling about the Administration's foreclosure programs.

I know that, as you start your testimony with us, and as we see your representations in the press, you talk about progress, and you talk about things are better, etc. But the fact of the matter is our constituents are unhappy, and they are constantly bombarding us with the problems of your voluntary modification programs.

For example, your document requirements are awesome. And many of the folks who are in foreclosure—and some are elderly—who are attempting to comply—I say "your document;" the document request of the various institutions—we don't know how much you monitor the servicers. We know that the servicers have been slow. We know that some of them appear not to be as well-trained, or to understand the program as well as they should. And now the program is changing, and so we're going to have to go through another period of time where servicers are not fully informed about what the Administration's program is.

And so, voluntary, not enough oversight with servicers, a complete misunderstanding of the HAMP program, as it relates to the—what is it, the 3-month period that you allow the homeowner to be in a program based on their income, prior to determining whether or not they get a loan modification? Is it 3 months? What is it?

Ms. CALDWELL. Correct, a 3-month trial modification period.

Chairwoman WATERS. Trial modification. We have complaints that people are going into foreclosure while in trial modification. We have many of those complaints. And it goes on and on and on.

We are going to have to make some decisions about what we must do. And it seems to me there must be a combination of something mandatory and voluntary, and there must be a way by which to speed up these modifications. And despite the fact—we are working very closely with FHA to make sure that program is solid—we get a little bit worried. Even when you talk about using some of the TARP resources, we get a little bit worried about a lot of refis being thrown into FHA.

And so, I want to make sure that I use my period of time to say to you that on both sides of the aisle, we're not happy, and that we're really concerned about the inability to really, really move something substantially.

For example, let me ask you about unemployed individuals. You just referred to maybe you're finding with some of the minority populations that it's a little bit harder, because maybe the unemployment is higher. It is higher. But as you know, the Administration, I think the President, came up with an Executive Order based on my bill about dealing with unemployed homeowners, and making it possible for them to stay in their homes that's patterned after the program in Pennsylvania. Is that working yet in the—is that program working yet for the unemployed?

Ms. CALDWELL. There is a—the program I believe you're referring to is the hardest-hit fund that President Obama announced to target five States. And one of the options they could use to address unemployment or negative equity are programs similar to the Pennsylvania—

Chairwoman WATERS. The program is in the Wall Street Reform bill that we passed out of this committee and off the Floor. That's the one. He targeted five States.

Ms. CALDWELL. Five States?

Chairwoman WATERS. Is that working yet?

Ms. CALDWELL. The proposals for the program from the various States are due Friday, for how they would like to use those funds. And we expect funding to go out the door in June. So it is operating.

Chairwoman WATERS. Thank you very much. Mrs. Capito?

Mrs. CAPITO. I have no further questions for the panel, Madam Chairwoman. Thank you.

Chairwoman WATERS. Thank you. Mr. Cleaver.

Mr. CLEAVER. Are there some adjustments that you would recommend that we make, legislatively, to empower the Treasury to respond more favorably and quickly?

As soon as I turned on the television this morning, the first news story was the failure of this program. Diane Sawyer—did you hear a report? Does anybody tell you about it?

Ms. CALDWELL. I did not see Diane Sawyer's report this morning, but I am familiar with the Congressional Oversight Panel report that was released.

Mr. CLEAVER. Right, that's what she used to start out by saying—which some of us would like—would rather not hear—the President's housing program is a failure.

What can we do? We have people who are angry with us because they don't know that we don't go out and actually do the modifications, although all of us will probably have to get involved on the telephone with some of the lending institutions, mortgage companies. Is there anything we can do to help you do a lot more than is being done?

Ms. CALDWELL. I think the most important thing is to make sure that homeowners understand that there is help available, and they should not be paying a cost or paying scammers for any of that help.

Mr. CLEAVER. Is that the number one problem we have?

Ms. CALDWELL. It is a big problem. Mortgage fraud scams in the modification business are a huge problem.

But we do have a number, a call center number, 888–995–HOPE. And what we do is we—when we hear from homeowners, it helps us understand where servicers are failing, it enables us to go back and intervene on their behalf, and it enables homeowners to be in touch with a homeownership counselor to help guide them through the process.

So, I think the most important thing is to make sure that we do outreach to the homeowners, that we do continue to follow up on all those reports that we understand, and keep the pressure on for modifications.

Mr. CLEAVER. Yes. Do we need to try to meet with the FBI to ask for more agents? If fraud is the number one inhibitor, then we need to hire more FBI agents or Lassie, Rin Tin Tin, whatever. I don't know.

Ms. CALDWELL. I don't know that it's the number one inhibitor, but it is an inhibitor. But this is a crisis at a scale that we have not seen before. And as we try to pull together multiple parties, including homeowners, servicers, investors, and counselors, to come together and address this program, I do think we have a lot of very complex issues and a lot of different sides, and scams are one of them. Understanding the program is another one. And the fact that it is a program where we have a lot of people who are in distress, but it's not a program that is designed to help everyone.

And so, we do have to make sure that we don't set the expectation that everyone is going to be helped. This is for people who live in their homes, own their homes, have an ability to stay in their homes, but have a hardship. And so there are many people with second homes or jumbo mortgages who are also facing hardship.

Mr. CLEAVER. Yes, okay. You're actually frustrating me, but I will—that's what the program was designed to do, all the people you just—I don't know of anybody who is trying to help somebody who is not in their home. Everything you said, that's what we're trying to—

And I admit, Madam Chairwoman, that this is a difficult program to do, and I don't want to suggest, even lightly, that it's not. Maybe this is self-defense because of the pressure that's being applied to us. And then I'm sure that after this latest report hits, and the pressure will increase. So out of my frustration, I am raising these issues. I yield back.

Chairwoman WATERS. Thank you. Mr. Green.

Mr. GREEN. Thank you. The number of persons who don't qualify for the program, my assumption is that this is something that is quantifiable perhaps after the fact, if not before. You can get some notion of it.

And my assumption is that the program, having been designed specifically for persons who do qualify—my question is, do we overemphasize that line of—remember now, we have a lot of people who won't be able to qualify, and that's understandable, but is that being overly emphasized, do you think?

Ms. CALDWELL. I don't think it's being overly emphasized. But one of the reasons that we made the changes that are moving the program to up-front documentation is to make sure that the program is focused on those homeowners who are qualified for the program and can stay in the program. One of the things that we did learn from opening the program up based on stated income is that many times the stated income versus the verified income didn't match. And so someone may have thought they were eligible for the program, and they weren't.

So, as we go through this trial period, we are going to have some people who thought they were eligible and they were not. And the importance of this change is to make sure that homeowners going into trial modifications have been screened and determined to be eligible. And the only responsibility that homeowner will have is to make the three trial payments on time.

But, yes, you're correct. In the trial population we do have to focus on making sure that people understand whether or not they are eligible.

Mr. GREEN. You mentioned second homes, and that persons who have second homes, maybe third, that they are not eligible, correct?

Ms. CALDWELL. Correct.

Mr. STEVENS. Correct.

Mr. GREEN. They do have something that they are eligible for, a bankruptcy. Not that anybody wants to go into bankruptcy. It's a horrible thing. But they are eligible for bankruptcy, as a means of preserving those second and third homes, true? Or do you know? Maybe that's something you're not familiar with.

Ms. CALDWELL. Yes, I can't speak to the full range of bankruptcy on primary and secondary residences.

Mr. GREEN. All right. Thank you, Madam Chairwoman.

Chairwoman WATERS. You're welcome. Ms. Melissa Bean, you have about 8 minutes left before we go to the Floor. We will recess after your questions.

Ms. BEAN. Thank you, Madam Chairwoman. I just have one very specific question. How many HAMP compliance officers are there in the field, and what's the ratio of those officers to servicers? How does that compare to, say, bank examiners to banks?

Ms. CALDWELL. In terms of the HAMP compliance officers, Freddie Mac has a separate organization, a Making Home Affordable compliance that has been set up to do the compliance on HAMP. I don't know the exact head count of how they staff it, and how it would compare to bank examiners, but it is set up to provide an audit-like function. So it is designed to do random sampling across all of the servicers. They have been out, they have done second looks at each of the servicers. They have done test audits of declines, and they have also done testing around outreach. So it is—and they do have the ability to staff up and contract as needed to get the job done.

Ms. BEAN. And can I ask you to just provide that in follow-up?

Ms. CALDWELL. Yes.

Ms. BEAN. Thank you. I yield back.

Chairwoman WATERS. This committee will stand in recess. We have to go and take some votes. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

This panel is now dismissed. And thank you so very much. We will call the second panel upon our return.

[recess]

Chairwoman WATERS. The Subcommittee on Housing and Community Opportunity will come to order. I thank all of the witnesses for remaining. This is quite unfortunate, that we had to spend the time on the Floor. It was unavoidable. But I do appreciate your patience, and I am going to introduce the second panel.

I am pleased to welcome my distinguished second panel. Our first witness will be Dr. Dean Baker, co-director, Center for Economic and Policy Research.

Our second witness will be Ms. Alys Cohen, staff attorney, National Consumer Law Center.

Our third witness will be Mr. Vincent Fiorillo, trading/portfolio manager, Doubleline Capital LP.

Our fourth witness will be Mr. Andrew Jakabovics, associate director for housing and economics, Center for American Progress Action Fund.

Our fifth witness will be Dr. Arnold Kling, member, Mercatus Center Working Group on Financial Markets, George Mason University.

Our sixth witness will be Mr. Robert E. Story, Jr. chairman, Mortgage Bankers Association.

And our seventh witness will be Mr. Alan White, assistant professor, Valparaiso University School of Law.

Thank you. We will start with our first witness, Dr. Dean Baker.

STATEMENT OF DEAN BAKER, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Mr. BAKER. Thank you, Chairwoman Waters. I appreciate the opportunity to address the committee today.

The main point I would like to raise is the fact that I think, in considering the various mortgage modification programs, and certainly the new ones being put forward by the Administration last week, there has been a failure to consider the underlying state of the housing market. And I think this has been a real tragedy, not just in these modification programs, but this is really the problem that got us here to begin with.

Specifically, we had a hugely overvalued housing market. By my calculations, we had an $8 trillion housing bubble which is in the process of deflating. That is the underlying cause of the problems facing homeowners today. And as much as these programs might be well-intentioned, I have to say that even in a best case scenario, it's very unlikely that you're going to benefit more than 15 or 20 percent of homeowners with permanent modifications.

And, perhaps even more seriously, I think because of the state of the housing market, many of those homeowners will not end up benefitting at the end of the day. And what I mean by that is we should care at the end of the day whether we have actually helped homeowners in terms of saving them money on housing costs, and also providing equity for them in their home.

And what I would argue is that because in many markets the bubble has yet to deflate, we are going to still be in a situation where homeowners are likely paying much more in ownership costs than they would pay to rent a comparable unit. And secondly, because house prices are going to fall further, even if we are able to negotiate a permanent modification that leaves them at least temporarily with a little equity in their home, because prices are going to fall further they will end up again underwater in 2 or 3 years, and likely end up in a similar situation, when they're prepared to sell their home.

Very quickly, what I just would point to is if you look at the long-term trend in house prices, we have a 100-year-long trend, 1895 to 1995, where house prices had just kept even with the overall rate of inflation. That's a nationwide average. There are, of course, huge variations around the country. You have markets like California, Manhattan, and other markets where home prices rose more rapidly. But it's a nationwide average. We have 100-year-long data, which should be pretty compelling evidence as to what you should expect to see in housing prices.

In the period from 1996 until the peak of the bubble in 2006, house prices rose by more than 70 percent in excess of the rate of inflation. There was no explanation for this in the fundamentals of the housing market, nothing on either the supply side or the demand side. And also, for those who need further confirmation, nothing in the rental market that was remotely corresponding to that.

Now, since the housing bubble began to decline, began to deflate in 2006, house prices have fallen back, but they still are somewhere between 15 to 20 percent above their trend levels. What happened was that Congress put in—or I should say government put in several policies last year to slow the decline in house prices, and it at least temporarily had that effect.

The three obvious ones are, first off, the first-time buyers tax credit, the $8,000 tax credit is about 5 percent—a little less than 5 percent—of the median house price. Second, the Fed's policy of quantitative easing that pushed mortgage rates to 50-year lows. And the third part of the story was the huge expansion of the Federal Housing Authority in the housing market, guaranteeing 30 percent of purchased mortgages in 2009.

All three of these supports are gradually being retracted from the housing market. The Fed ended its policy of quantitative easing last month. First-time buyer's credit, the extended credit, ends at the end of this month. And, of course, the FHA is being forced to cut back its role in the market, as a result of the fact that it's now below its minimum capital requirements.

For these reasons, I expect house prices to resume their fall, and there is some data that already suggests that. Other factors that would suggest house prices are going to continue to fall are record vacancy rates—these are the highest vacancy rates we have seen since the Commerce Department kept data in the early 1950's—and also, we know that rents are now falling for the first time that—at least the Consumer Price Index measure of rent is falling. Other measures of rent are falling more rapidly.

This leads to a situation where, as I say, I think it's virtually certain that in many, if not most markets, house prices will fall further. And any program that's not designed to take that into account will lead to serious problems.

What I would advocate, just very quickly, as an alternative, is a proposal, the Right to Rent proposal that's being introduced as a bill in Congress tomorrow by Representatives Grijalva and Kaptur, which would give people the right to stay in their home, as renters, paying the market rent for—I believe it's a 5-year period of time. This addresses the problem of giving homeowners who are underwater housing security, which I think is the most important thing we could do. It prevents the blight of vacancies that are afflicting many neighborhoods. And, thirdly, it does give banks incentive to act on their own to try to prevent foreclosure. And this costs no taxpayer money, requires no bureaucracy, and the day it goes into law, it immediately affects all underwater homeowners.

So, I will cut off there and end my time.

[The prepared statement of Mr. Baker can be found on page 44 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Cohen?

STATEMENT OF ALYS COHEN, STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. COHEN. Thank you, Chairwoman Waters. Thank you for inviting me to testify today regarding HAMP and its effect on foreclosures. I am a staff attorney at the National Consumer Law Center, and I am also testifying today on behalf of the National Association of Consumer Advocates.

HAMP has sought to change the dynamic that leads servicers to refuse even loan modifications that would be in the investor's best interests by providing both servicers and investors with payments to support successful loan modifications.

Yet, an entire year into the program, only a little over 200,000 modifications have been provided, and homeowners and their advocates still report a stunning degree of noncompliance with the program rules. Both SIGTARP and GAO have been critical of implementation and transparency issues. And to date, Treasury has not levied any penalties on servicers for noncompliance, and no loan level data have been released to the public.

While the Administration's recently-announced changes to HAMP acknowledge that no foreclosure prevention program can do its job without principal reduction, assistance for the unemployed, and stopping the foreclosure process during consideration for a modification, even these enhanced measures threaten to be an empty promise without meaningful transparency, accountability, and enforcement.

Moreover, until the HAMP program or legislation addresses servicers' incentives to foreclose rather than modify loans, and mandates program compliance, new initiatives are unlikely to dampen the country's economic distress.

I just want to pause here for a moment and respond to a couple of points in the MBA's testimony. One is that the foreclosure stops themselves are costly and should be reconsidered. If a loan is not referred to foreclosure, there are no costs on behalf of the servicer. And if the servicer gets their job done quickly, and the person qualifies, and it's NPV-positive, the investor is in a better situation. And if it's done quickly, and it's not NPV-positive, then they can move to foreclosure so the investor doesn't lose too much money.

Second, there is a claim in the MBA testimony that mandating principal reductions is a violation of the takings clause of the Constitution. We have looked at that question and we don't think there is any basis for that.

Back to the other measures that Treasury has passed, the unemployed measure itself offers short-term payment relief without any debt relief, and for a period far shorter than the current average period of unemployment. A Federal bridge loan program, or broadly available funding for State bridge loan programs would provide the type of relief needed.

The principal reduction program is based on voluntary principal write-downs, an approach that heretofore has not produced significant results, and that adds complexity without providing transparency or accountability. The proposal introduces a second net present value test, when even the simple one-step NPV analysis has been the subject of criticism for lack of transparency and poor implementation.

Because the principal reduction will result in a hit to the servicer's largest source of income, the monthly servicing fee, servicers have a strong incentive to avoid principal reductions. Modest incentives are unlikely to change this picture. Even the most promising initiatives—the mandatory stop of foreclosures and the access to HAMP for homeowners in bankruptcy—will not succeed without transparency and accountability.

Servicers' interests often do not align with those of investors or homeowners. Servicers, unlike investors or homeowners, do not necessarily lose money on a foreclosure. The result is that servicers are often indifferent, at best, as to whether a delinquency ends in a modification or in a foreclosure. Until this situation is addressed more directly, loss mitigation will favor the interests of servicers over those of homeowners and investors.

In addition to improving the program's transparency, accountability, and enforcement, several core program elements must be reformed. Trial modifications are leaving many homeowners in limbo, while increasing their principal balances and damaging their credit ratings. The Administration must mandate automatic conversions for homeowners who make the required payments, and apply all payments as specified under the permanent modification.

The program should also better meet the needs of homeowners with negative amortization loans, folks who re-default for a second time, including for unemployment, and those with debt below 31 percent of income, but who have high fixed expenses.

In order to overcome the misalignment of incentives between servicers and the other stakeholders, mortgage servicing needs to be regulated by Congress. That's why we support your bill. We also recommend that Congress take other additional steps to ensure that the current crisis is not repeated. That includes legislation to require loan modification offers to qualified homeowners, funding quality, foreclosure mediation, allowing bankruptcy judges to modify home loans, removing negative tax consequences of principal reduction, and ensuring that predatory lending is not legal in our country.

Finally, Congress should establish an independent consumer financial protection agency that can pass strong rules to govern the market.

Thank you for the opportunity to testify today.

[The prepared statement of Ms. Cohen can be found on page 61 of the appendix.]

Chairwoman WATERS. Thank you. We will call on our next witness. How do you pronounce your name?

Mr. FIORILLO. "Fiorillo."

Chairwoman WATERS. "Fiorillo?"

Mr. FIORILLO. Yes, ma'am.

Chairwoman WATERS. Mr. Vincent Fiorillo. Thank you.

STATEMENT OF VINCENT FIORILLO, TRADING/PORTFOLIO MANAGER, DOUBLELINE CAPITAL LP, ON BEHALF OF THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

Mr. FIORILLO. Thank you, Madam Chairwoman, and thank you for inviting me to testify today. My name is Vincent Fiorillo, and I am testifying on behalf of the Association of Mortgage Investors, or AMI, a trade group organized to develop investor consensus on current public policy initiatives. I have spent nearly 35 years working in the mortgage finance industry, and have seen the mortgage market from the perspective of investors, and from the perspective of brokers and issuers.

In general, mortgage investors include charitable institutions, endowments, foundations, universities, mutual funds, and sovereign wealth funds. My testimony today represents the views of the AMI. AMI supports a mortgage solution that will help homeowners stay in their homes, rebuild equity, address affordability, and provide a new and fully vetted and underwritten FHA mortgage.

The recent crisis demonstrates that the process of originating mortgages and securitizing those mortgages into marketable securities can and must be reformed to ensure greater transparency and integrity. In fact, the fact remains that, without a responsible and viable mortgage securities market, homeownership will be an unfulfilled dream.

The delayed implementation of HAMP resulted in a lower-than-projected number of permanent loan modifications. Investors and first leads have experienced a degradation of their position, while subordinate liens have been enriched in recent months. This has happened without benefitting the troubled homeowner who is still saddled with the excessive debt, and a mortgage far in excess of the home's value.

Based on our expertise in the mortgage finance industry, and our experiences with recent foreclosures avoidance programs, I would like to make two important points today regarding the current HAMP program.

First, there is a high risk of re-default, because calculations used to evaluate a borrower's application do not factor in the borrower's total debt obligation. Of the nearly 170,000 HAMP permanent modifications, half of them are saddled with extraordinary amounts of total debt, which leaves very little income to pay for necessities, such as food and clothing.

Second, the current mortgage modification program permits trial loan modifications on the HAMP without any income verification. The AMI endorses the changes in June that will require income verification prior to qualifying for a trial modification.

In our view, the most important impediment to the success of any program is the conflict that exists when bank-owned servicers hold second-lien mortgages. The four biggest banks service approximately 40 percent of our Nation's mortgages, and hold roughly $419 billion of second liens on their balance sheet as of December 31, 2009. Under temporary loan modification programs, banks have been able to defer the recognition of losses on the second lien portfolios. In fact, the current program actually improves the cash flow available to the second mortgage, at the expense of the first.

For over a year, mortgage investors have advocated that any successful solution to our housing crisis must address two key components: affordability; and negative equity. Everyone must share the burden.

Madam Chairwoman, we mortgage investors are willing to forgive principal at their expense, allowing borrowers to re-establish themselves and stabilize their housing situation. But solutions cannot be a windfall for certain stakeholders at the expense of others. Relief must come from significant principal forgiveness on both the first and the second lien, in connection with the refinancing of the overextended homeowner into a new low-interest mortgage.

AMI supports the framework of the FHA's new short refinancing program for homeowners who owe more on their mortgages than their home is currently worth. Taxpayers are protected, because investors are using their money to reduce principal, while homeowners must qualify for a fully underwritten FHA refinanced mortgage.

In order for the program to work, Treasury and FHA must specify its details and hold all parties accountable for its implementation. Our fear is that these details could easily be overlooked.

For example, it is unclear whether a servicer can approve a reduction in the first lien, and then have the holder of the second lien opt out, avoiding principal reduction. This is problematic because it is completely counter to the needs and the interest of the homeowner, ignores the priority of liens, and results in an unjust enrichment of the bank's second liens position.

This situation is not only bad for investors now, but projecting forward, investors in the mortgage finance marketplace will be reluctant to invest in mortgages because of this additional risk. This risk will ultimately result in increased borrowing costs for future home buyers.

In conclusion, mortgage investors believe that the Administration's newly announced program for principal reduction leading to an FHA refinance program is an important step forward, and can be a permanent solution to the homeowner's problem. The Nation's foreclosure crisis must be solved by addressing both the problem of ability to pay and willingness to pay. With the current lack of detail, investors are extremely worried there are significant execution risks to the program.

Madam Chairwoman, in order to ensure the program's success, the participation of both first and second lien holders is critical. Rebuilding the mortgage market of the future will only be more difficult, as long as the priority of liens is not respected. Investors will hesitate before investing the capital necessary to jumpstart consumer lending.

Thank you for the opportunity to share our views.

[The prepared statement of Mr. Fiorillo can be found on page 90 of the appendix.]

Chairwoman WATERS. Thank you very much. Mr. Andrew—is it "Jakabovics?"

Mr. JAKABOVICS. "Jakabovics."

Chairwoman WATERS. "Jakabovics?"

Mr. JAKABOVICS. Yes.

Chairwoman WATERS. Okay, thank you.

STATEMENT OF ANDREW JAKABOVICS, ASSOCIATE DIRECTOR FOR HOUSING AND ECONOMICS, CENTER FOR AMERICAN PROGRESS ACTION FUND

Mr. JAKABOVICS. Thank you very much, Madam Chairwoman, and Ranking Member Capito. It's an honor to be here today to discuss with you the recently-announced changes to the Home Affordable Modification Program, as well as the program's successes and failures to date. I will share my analysis of those changes, as well as recommendations for further action.

Through the end of March, approximately 1.2 million homeowners have been offered trial modifications under HAMP, but only 230,000 have successfully negotiated the seemingly Byzantine process for getting into a permanent modification. While there remain significant operational barriers to HAMP's full-fledged success, the Administration's new initiatives are likely to bring relief to an additional subset of homeowners struggling to pay their mortgages.

In moving to offer underwater but otherwise creditworthy borrowers an FHA refinancing, and in bringing principal write-downs into the HAMP modification process, the Administration is attempting to tailor its response to address the current problem of prime loans going bad. There are nearly a million more prime loans that are seriously delinquent or in foreclosure than subprime loans.

Writing down the amount of outstanding mortgages to bring them in line with the current values of the properties provides an opportunity to create the conditions for homeowners to keep paying their mortgages over the long term, while minimizing the walk-away risk that threatens their neighbors' financial health. Since the housing crisis began, we have argued that the best solution has been to restructure mortgages to reflect the current property values. And, indeed, the new FHA program is essentially a modern version of the New Deal's Home Owners Loan Corporation, which helped homeowners in the 1930's weather the Great Depression.

Commissioner Stevens, in his testimony, laid out the details of the FHA program, so I just want to touch on a few reasons why I believe it is an important step forward.

Given the much larger losses that lenders and investors face if borrowers in these underwater properties defaulted, cash in hand equal to 97.75 percent of value may be sufficiently attractive to allow these short refinancings to proceed. I would also note that this is actually a sweeter deal than they got under the Home Owners Loan Corporation, when they only got paid out $.80 on the dollar.

The new FHA refinance program will allow existing mortgagees to retain almost a fifth of the property's current value as a junior lien on the property, effectively giving them some upside beyond the cash in hand. Realistically, this program will likely help borrowers with a first lien only, given the challenges that we have already heard about—around extinguishing seconds.

In addition to the short refinances through FHA, principal reductions will be promoted in the HAMP waterfall. While current HAMP allows for principal reductions, the NPV test will now be run a second time to calculate the value of a modification that includes the principal write-down. The results of two NPV tests will be compared so that servicers will see the value of doing a write-down where appropriate. Principal write-downs will remain optional, even when the NPV results show it to be more valuable.

But servicers' existing legal obligations to lenders and investors to get the best possible returns from modifications should—and I emphasize should—make it difficult for servicers to choose the standard HAMP modification, when the principal write-down alternative yields better returns under the same NPV run. Unfortunately, the lack of transparency around servicers' activities makes it difficult, if not impossible, for investors to know if servicers are leaving money on the table by not doing the write-downs.

Principal write-downs will probably actually be more valuable, compared to the current HAMP modifications, because of the reduced re-default risk from a lower LTV, compared to the standard waterfall. Moreover, the program incentivizes borrowers to remain current in the modified loans, because the forgiveness will be phased in over 3 years, as long as the borrower does remain current.

As with the FHA short refinancing, this policy's success will also likely be determined with the ability to modify second liens or eliminate them. And if 2MP proves ineffective at eliminating those liens, it is unlikely that the first liens will be written down.

Crucially, neither Fannie Mae nor Freddie Mac has issued guidance to their servicers indicating that they are going to participate in the principal reductions when the NPV test shows them to be more valuable. But nearly 60 percent of all modifications to date have been made for GSE loans. Adopting a preference for principal reduction by the GSEs would ultimately benefit the enterprise's bottoms lines, and by the extension of taxpayers. And Treasury and FHA must direct the GSEs to participate, and certainly congressional pressure in that direction would be welcomed.

Another facet of the changes to HAMP is assistance for unemployed borrowers. But in the interest of time, I will refer you to my written testimony for my comments on that element.

But looking at HAMP in total, the biggest barrier to the program's success has been servicers' ability to quickly and accurately modify loans. And while Alys's testimony was focused on many of the outstanding issues, I want to use the remaining time that I have to strongly urge Treasury, with congressional support, to adopt or develop a Web portal as a single point of contact for borrowers and their advocates, as well as servicers. This will speed the rate of implementation of changes to the program, which has been a frustration for everyone, as well as implementing changes to the NPV model, and would dramatically improve the overall throughput of the program.

Compliance would also be much easier if Treasury developed and maintained a single point of contact for borrowers and participating servicers. Specifically, it would allow borrowers and their advocates to submit applications for modifications and allow people to know what their status is in the process. Servicers would securely access the applications for loans they control and would be able to quickly provide borrowers with a response. There are relatively few variables that servicers can change. So even the NPV tests could be run on this central platform, once borrowers and servicers have submitted their respective information. This also sidesteps the issue of servicer capacity.

In the interest of time—I am actually out of time—I will look forward to any questions that you might have.

[The prepared statement of Mr. Jakabovics can be found on page 97 of the appendix.]

Chairwoman WATERS. Thank you.

Dr. Arnold Kling?

STATEMENT OF ARNOLD KLING, MEMBER, MERCATUS CENTER WORKING GROUP ON FINANCIAL MARKETS, GEORGE MASON UNIVERSITY

Mr. KLING. Thank you, Chairwoman Waters, for the opportunity to testify. With your permission, I would like to submit my written testimony for the record, and speak to some questions that you and your colleagues raised this morning.

One of the—both you and Mr. Cleaver expressed some frustrations with how this program is working. And my comment on that is keep in mind that this program is taking two business processes—loan servicing and loan origination—combining them in a way that they have never been combined before, and redesigning them on the fly. So these are two well-developed business processes that you are attempting to redesign on the fly from Washington, when they have historically been done at a very local level. Particularly the loan servicing; it's done on a case-by-case local level.

I just don't think it's possible to do that effectively, and it doesn't surprise me that we are having frustrations and complaints. I think what we are trying to do is just too difficult to do from Washington. And that—it needs to be rethought, if for no other reason than that.

Representative Capito, you mentioned the issue of finding a housing market bottom, and I think that is an important issue. Dean Baker referred to that. If we modify loans and we have not yet reached a bottom, what we are doing is setting borrowers and lenders up to fail, once again. And I would guess that approximately half of them will. A very large percentage will fail again.

And so that—and I think we would be better off if we would put this housing crisis behind us. Trying to modify loans and keep the same borrowers in their homes means that the crisis is going to still be in front of us, and we may have another hearing like this in 5 years. Putting it behind us may be difficult and painful for some people. But I think, overall, we would be better to have it behind us, and allow the market to reach a natural balance of supply and demand, rather than have to guess where the bottom is.

And that finally brings me to Mr. Green's question—isn't there a benefit to this program for other homeowners, the people who are not receiving modifications? And my answer to that is that's very questionable.

Let's say I am in a neighborhood—and actually, my neighborhood does have a number of foreclosures—suppose that preventing foreclosures means that home values stay up for a while. That doesn't benefit me unless I happen to sell my home over the next couple of years. Because, presumably, in the long run, the market will reach its natural level whether there are modifications or not. So if I'm going to wait in my home for 8 to 10 years, then it doesn't matter to me whether house prices are temporarily above their natural level or not.

But if they temporarily raise prices by putting off foreclosures, at best what that means is that the people who happen to sell over the next 2 years will be lucky. And the people who happen to buy over the next couple of years will be unlucky. So I am thinking also of the people who would like to buy homes right now. And they deserve a chance to buy homes at the appropriate price. They shouldn't have to face prices that are artificially raised by these sorts of programs—or they certainly don't benefit from those programs.

So, I think, overall, there—it's not clear that there are benefits for other people from these mortgage modifications. And keep in mind that people who have been paying their mortgages every month, it's not just that they have been paying their mortgages every month. They are taking the same capital losses that the HAMP borrowers took. In fact, they are taking more, because since they have paid their mortgages, they take the full capital loss, whereas somebody somebody whose mortgage is underwater can walk away from it, and the bank takes most of the loss.

So, in dollar terms, the biggest losers are the people who have held on to their homes and made their mortgage payments. They have lost more in dollar terms than the people who have to go through foreclosure. So I think it's a pretty hard sell to say that they are the big beneficiaries of this program. And I will stop there. Thank you very much.

[The prepared statement of Dr. Kling can be found on page 105 of the appendix.]

Chairwoman WATERS. Thank you.

Mr. Robert Story?

STATEMENT OF ROBERT E. STORY, JR., CMB, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. STORY. Chairwoman Waters, Ranking Member Capito, thank you for the opportunity to testify this afternoon. MBA members are committed to helping financially troubled borrowers retain homeownership and avoid foreclosure. Many are participating in the Administration's Home Affordable Modification Program, and all servicers for Fannie Mae and Freddie Mac loans are participating in HAMP.

As we speak, servicers are working hard to implement the recent changes announced by the Administration. We are also working with Treasury to suggest improvements to HAMP, in order to increase efficiency and ensure better outcomes.

During these trying times, servicers continue to hire staff, reach out to borrowers, and employ new strategies to keep people in their homes. According to Treasury, more than 1.4 million borrowers have been offered trial modifications under HAMP, 1 million borrowers are in active modifications, of which almost 230,000 represent permanent modifications. An additional 100,000 permanent modifications are pending borrower acceptance. And servicers have substantially increased the pace in which the permanent modifications are being done.

In addition to HAMP, servicers are providing their own home retention solutions. Since July 2007, HOPE NOW data shows that the industry completed an estimated 2.7 million propriety modifications. During the month of February 2010, nearly 96,000 families received loan modification outside of HAMP. Combined with HAMP, a total of 148 permanent modifications were granted in February.

Servicers are also engaged in modification and loss mitigation activities through FHA and VA. These are additional and important efforts by the industry and the government to help distressed borrowers.

I would now like to turn to HAMP changes announced by the Administration. With the jobless rate near 10 percent, assisting unemployed borrowers must take priority. MBA fully supports the creation of a temporary forbearance program to address the unique circumstances of unemployed borrowers. Features outlined in the Administration's program are consistent with MBA's own recommendations represented to Treasury in February. That includes the recognition that borrowers should continue to pay a portion of their income toward their mortgage.

We also support allowing different periods of forbearance to help ease financial institutions' concerns with the accounting and regulatory treatment of assets that remain delinquent for 6 months or longer.

MBA recommendations have other important features that we hope are considered, as the Administration designs the details of the program. For example, there should be a source of loans to allow financial institutions to carry delinquent mortgages during the forbearance program. Servicers advance principal and interest payments to investors during this time, despite not receiving such payments from borrowers. They also advance funds to pay for the borrowers' taxes and insurance premiums.

While the servicer ultimately gets reimbursed for most of these advances, the carry time and cost is substantial. This is especially true for non-bank institutions that must borrow the funds. Servicers should be given the tools to succeed, and a loan program that is repaid with interest would not cost taxpayers.

MBA also recommends applying a cost sharing feature to offset the investor's risk of delaying foreclosure when a forbearance plan fails.

Treasury announced an optional principal write-down component to HAMP. While MBA is concerned that this may increase delinquencies, we are not opposed to it, provided it remains voluntary. We urge the Treasury to monitor the program to gauge whether it is causing strategic defaults, and to make adjustments if necessary.

One area of substantial concern is the announcement that servicers must re-underwrite all borrowers with modifications using the alternative net present value test. Given all the concerns about server capacity, this is a burden that will not yield the results anticipated. We suggest limiting such reviews only to borrowers and loan products that lien holders deem eligible for principal reduction.

With respect to FHA refinance and modification enhancements, the new rules will make it more attractive for underwater borrowers to refinance into affordable mortgages. MBA also supports the incentive payments proposed by Treasury.

Finally, on the important subject of second liens, the Administration's changes are likely to make modifications more attractive. The fact that the largest servicers are participating will have a positive impact on the number of borrowers receiving help. The 4 largest banks hold or service $427 billion in second liens, representing approximately 60 percent of outstanding second mortgages.

Chairwoman Waters, HAMP is a critically important effort that is assisting hundreds of thousands of homeowners. We hope to continue working with the Administration and this subcommittee on successfully implementing the new programs so that we can help the maximum number of financially distressed homeowners. Thank you.

[The prepared statement of Mr. Story can be found on page 118 of the appendix.]

Chairwoman WATERS. Thank you.

Mr. Alan White?

STATEMENT OF ALAN M. WHITE, ASSISTANT PROFESSOR, VALPARAISO UNIVERSITY SCHOOL OF LAW

Mr. WHITE. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the committee, for this opportunity to share some thoughts with you about the HAMP program and the foreclosure crisis more broadly.

I think at this point, the HAMP program overall can only be judged a failure if we consider the two overarching goals that this program obviously should be serving. The national foreclosure crisis means that at this point we are looking at foreclosures that are approximately quadruple their historical level, in unprecedented historical levels. So the first goal of this program, obviously, is to reduce the number of foreclosures. And that has not been achieved.

And the second—I think equally important—goal that we need to keep in mind is to bring down the overall level of mortgage debt that is hanging over the American consumer. Mortgage debt, in line with housing prices, experienced a huge bubble in the past 10 years, and went from something like $5 trillion to almost $11 trillion, a level of debt that's just simply not sustainable for the American homeowner, and that has all sorts of consequences for the economic recovery that we're all hoping for.

So, I think any intervention using taxpayer funds should be designed to achieve these two goals of reducing foreclosures and hopefully what I call the deleveraging of the American homeowner.

If we look at the level of foreclosures and modification activity over the last year, as far as I can determine, the HAMP program thus far has been a negative. It's important to keep in mind that, prior to the announcement of HAMP last March, the mortgage industry, servicing industry, was voluntarily modifying about 100,000 to 120,000 mortgages each month. The largest number reported so far, the number reported for the last month, for March, of HAMP modifications has been about 60,000. Even if we combine HAMP modifications with the other modifications servicers are doing completely outside of HAMP—which raises some separate questions—I think we are just now returning roughly to the level of modification activity we saw a year ago that, as I say, was being done entirely without taxpayer subsidy or incentive. And this is troubling.

Obviously, as other speakers have mentioned, setting up this program is a daunting task. It has involved huge administrative problems. But it still seems troubling that, at the end of a year, the overall level of modification activity has not risen. And I think it's also important to compare that number to the number of new foreclosures that are being filed every month. And that's about 200,000.

So, at this point, we are trying to bail water out of a bathtub, when there is water pouring in at about twice the rate that we're getting the water out.

And I think there are a number of reasons that HAMP has not produced an increase in modification activity and a reduction in foreclosures. I think, in hindsight, it may have been overly prescriptive in the types of modifications and exactly what was expected of servicers. It might make sense at this point to think about simply providing incentives and rewards for servicer performance, rather than specifying so prescriptively what type of modifications need to be done.

And in that respect, I think it's interesting that we still have about half of all modifications being done outside of HAMP without HAMP subsidies, and, in many cases, better quality modifications.

For example, when we look at principal reduction, so far I think only about one percent of all HAMP modifications have involved any actual write-down of principal. Meanwhile, something like 10 to 20 percent of propriety modifications done by lenders without HAMP subsidies have included principal write-downs. A lot of those may be option ARMs, they may be investor loans. There may be reasons for the differences. But I think it would be important, going forward, to look at why it is that servicers think that they can have greater success outside the HAMP program guidelines.

I do also want to briefly mention what's mentioned at greater length in my written testimony, that there is a serious issue with servicer performance under the HAMP contracts. And while participation in HAMP is voluntary, once servicers participate, they have mandatory contractual obligations that I think it's pretty clear at this point they are falling very short of meeting.

I cite, among other things in the testimony, the HAMP call center report that gives statistics on the number of borrower complaints about servicer activity, including such things as 5,000 people reporting that their documents have been lost, and so forth. And I think there is more than anecdotal evidence at this point that servicers are not meeting their obligations, and Treasury really ought to be doing something about that. Thank you.

[The prepared statement of Mr. White can be found on page 128 of the appendix.]

Chairwoman WATERS. Thank you very much. I will yield myself 5 minutes for a few questions.

First to you, Mr. Baker. You talked about a rental program possibility allowing homeowners who are defaulting or who have defaulted on their loans to work out some agreement with the mortgage holder for rental possibility. Are you referring to the banks coming up with rental programs where they now have to set up a situation inside the bank or with a subsidiary or a contractor to manage rental properties for them until they can go back on the market? What are you referring to?

Mr. BAKER. Well, the idea would be that you would temporarily change the foreclosure process, so that homeowners who are facing foreclosure—and you could put a cap on the house price that applied to the bill put forward by Representatives Grijalva and Kaptur puts the cap at the median house price—that they would have the right to stay in the house as a renter, paying the market rent. It would be up to the bank, how they chose to do that.

So, you would have—as part of the foreclosure process, you would have an appraisal where the appraiser would determine what the market rent is for a house at that point in time. And whether the bank opted to rent directly, whether they opted to contract with the management agency, that would be up to the bank. What would not be up to the bank is whether or not the person got to stay there as a renter. That would be a right given to them under the law for whatever period of time. Again, I believe it's 5 years—

Chairwoman WATERS. Who would be responsible for the upkeep of the property, for capital improvements, etc., etc.?

Mr. BAKER. That would be subject to the landlord-tenant laws that are in—it's the bank's property, the bank owns—the investor owns the property, so it is their property. But the specifics, in terms of have they done adequate maintenance, that would be dependent on the landlord-tenant laws in the jurisdiction.

Chairwoman WATERS. So your suggestion is that, with Mr. Grijalva's legislation—I have not seen it—that we would mandate a program that would cause the banks to have to allow the person to stay in their property under some kind of market rate rental agreement period.

Mr. BAKER. That's right, and the idea is this would be a temporary period, recognizing the extraordinary circumstances that we're faced with in the housing market today. And the idea is that, once that was in place, it immediately provides help for everyone in the situation, without having to go through a complex process.

Chairwoman WATERS. Ms. Cohen, you pointed out several weaknesses in the HAMP program, and talked about alternatives, and talked about support to my bill dealing with servicers—a number of issues involved with this mess that we're all in.

I agree with you, certainly, that we need to regulate the servicers. There is a lot that we have all learned, as we have had this meltdown, about the servicers, who they are and what they do, etc.

But what would be your basic foremost recommendation for dealing with this foreclosure problem? Mr. Baker just talked about rental agreements that would be mandated on the lenders, the mortgage holders. Do you agree with that? Or do you think that perhaps principal write-down would be more effective? What would be your one big recommendation that you would have to deal with this issue?

Ms. COHEN. First of all, I read Mr. Baker's testimony, and I think his proposal is very interesting. It is important to consider it, and for Congress to take a close look at it. That proposal may have an effect on people who are staying in their homes. It is, to some extent, focused more on people who are unable to stay in their homes.

One question is, what directly can we do to help people stay in their homes? Principal reduction is an issue that is focused on folks who can and cannot afford their mortgages. And the foreclosure crisis is primarily being fueled by people who cannot afford their mortgages. And so, I think it's interesting to think about what Professor White said, which is in the end what we care about is the result and not the details.

And so, the reason that requiring loan mod offers and allowing cram-downs in bankruptcy matters, is because it's the result. And we don't necessarily need to say it looks like this or it looks like that. HAMP is well-intentioned in looking at DTIs and at other things. But in the end, what we really want is for people to be given a chance to stay in their house before they're put in foreclosure. And right now, that isn't happening.

Chairwoman WATERS. Thank you. I think it was you, Mr. Story, who gave recognition to our frustration and some of the comments that were made by Mr. Green, myself, and others. Was that you, Mr. Story?

Mr. STORY. That wasn't me.

Chairwoman WATERS. Was it Mr. Kling? Who was it?

Mr. KLING. That was me.

Chairwoman WATERS. Oh, okay. Thank you very much. Mr. Kling, you correctly identified the frustration that we have obviously exhibited here today. If we were to come up with a way of dealing with this that was simpler, that would help to take care of more of the mortgage holders out—more of the homeowners out there who were in trouble, etc., do you think we should scrap all of this, the HAMP program and the changes that are made to the

HAMP program with the refinance possibilities with FHA and the five cities that—five States that now have available to them a program for unemployed people, and on and on and on?

Do you think that somehow we need to get a handle on a program that is clear, concise, and more helpful to more people, and scrap all of what we have been attempting?

Mr. KLING. Thank you, Congresswoman Waters. I guess that would be my instinct, because again, loan servicing and loan origination are complex business processes that are very difficult to redesign on the fly. And there—you are constantly going to run into things that you didn't expect, issues that you didn't have. And every time you change something to fix one problem, some new problem will crop up.

So, searching for simplicity, I think, is a good idea. It could be that Dean Baker's idea simplifies things for lots of people. It could be that just writing a check to troubled homeowners for a certain amount, which they could use for moving expenses, if they have to move, for making up their payments if they're only a little bit behind, that's a much simpler task than trying to build a whole new servicing origination process on the fly. That's just my opinion.

Chairwoman WATERS. Thank you very much. Mrs. Capito?

Mrs. CAPITO. Thank you. Mr. Kling, I would like to follow up with you. One of the issues that I think—when we had Mr. Stevens in before, and Mr. Donovan—was trying to find the time and when there is going to be less Federal involvement through Fannie, Freddie, or FHA in the housing market.

And I am curious to know if you think that the next iteration of this program obviously involves FHA more. And between the three of them, they continue to dominate the market, I don't know, 90 percent, or something of that nature. How do we inject and get more private capital back into the housing market?

Mr. KLING. So your question is, how do we get more private capital back into the housing market?

Well, certainly, if you have Freddie Mac and Fannie Mae using the government's borrowing rate to set rates, there is no way that there will be private capital in the market. So something has to be done to phase Fannie Mae and Freddie Mac out of the market to give room for private capital to come in. And this is one of those things that I am sure everyone wants to do, but not now. And now is never the time when you're going to want to do it.

But if you—one approach would be to take the loan limits for Freddie Mac and Fannie Mae, and over, let's say, a period of 3 years, bring them down by a couple hundred thousand a year and get to the point where they're no longer originating loans. You eventually bring the loan limits down to zero. And then you—that would allow private capital to work its way into the housing market.

Mrs. CAPITO. Thank you. Mr. Story, in your testimony you mentioned that servicers are offering their own modification and home retention solutions to borrowers who might not qualify for Federal programs. What do you think some of the reasons are why a borrower might not qualify for some of these Federal programs, but still qualify for a servicer program?

Mr. STORY. Some of the reasons are that the debt-to-income ratios are more flexible in the non-HAMP programs. I think that's probably one of the biggest reasons why they are going outside that program.

Mrs. CAPITO. Do you have any—

Mr. STORY. We have some more flexibility, in terms of what the payments may be.

Mrs. CAPITO. Do you have any sense of how it's breaking out, in terms of percentages, people going to the Federal—the numbers that we heard are pretty—I think maybe that was—I can't remember who it was—it's the end of the day here, but somebody had said the numbers being serviced by HAMP, and then the numbers being serviced by servicers outside of these programs is exponentially larger. Was that you, Mr. White, who had those figures?

Mr. WHITE. Yes, I think it is actually about half and half.

Mrs. CAPITO. Half and half?

Mr. STORY. We can probably get you better numbers. We will check to see what we have, in terms of the numbers.

Also, FHA and VA aren't included in HAMP, either. So that sometimes makes a difference there, as well.

Mrs. CAPITO. Until HAMP part two—

Mr. STORY. Yes.

Mrs. CAPITO. —then FHA is in that, which brings me to another—I will make a comment. If anybody wants to comment on it—and I think both the chairwoman and I mentioned this in our opening statements, that the capital reserve issue with FHA—and here we are, creating another avenue for access to FHA when we have a time when FHA is facing some problems financially, even though there have been some reactions to that by the Administration to try to help that, and we are trying to work on our own solutions. But at the same time, to me, that's another red flag of why we really need to scrutinize this particular effort.

Does anybody have a comment on that, on the FHA involvement with this? Yes? We will go with Mr.—if I can say his name—

Mr. FIORILLO. It's not that hard. We had a mayor in New York—

Mrs. CAPITO. Okay. Both of them.

Mr. JAKABOVICS. Okay.

Mrs. CAPITO. So I will go with Mr. Jakabovics first.

Mr. JAKABOVICS. Close enough. So, I think that you have to recognize that the piece that FHA would be responsible for under the short refinancings that are being allowed under the program are actually potentially less costly to FHA than their standard activities, because the first loss position would be held by TARP. So, my understanding—

Mrs. CAPITO. Wait a minute. That's the taxpayer.

Mr. JAKABOVICS. Right, but—

Mrs. CAPITO. TARP is the taxpayer.

Mr. JAKABOVICS. But it's a separate piece, and that money has already been set aside, so you're not further risking the capital. You asked about the capital ratios and capital—

Mrs. CAPITO. Right, on—

Mr. JAKABOVICS. No, I understand. But the other thing that's important is you're bringing these loans back down below 100 percent loan to value. And all the evidence that's out there is that the risk of walkaway exists when the loan is worth a lot more than the home.

So, I think that under the program, if you qualify, so you're creditworthy, you have to have been current on your mortgage to get into the FHA refinancing, so it's not people who have been delinquent. So if people can still qualify for the refinancing, they are choosing to refinance into a more affordable option.

So, if they are otherwise going to re-default, or default, I think that by allowing them to refinance into FHA, it's similar to the HARP program, in terms of allowing the Fannie/Freddie, but without the write-down in loan-to-value. So I think there is a lot of benefit for the FHA component.

Mrs. CAPITO. Okay. Mr. Fiorillo?

Mr. FIORILLO. Similar theme. What you're doing is basically taking a homeowner who is above 115, taking him down to 115, but only asking FHA to guarantee the 96.5 percent. So the loan has been performing, the loan has been under-written, all of the documentation has been filled out. They are actually getting a better loan than what they have had.

And, to be perfectly honest, after—

Mrs. CAPITO. Who is getting a better loan?

Mr. FIORILLO. FHA.

Mrs. CAPITO. Well, they didn't have the loan before.

Mr. FIORILLO. Well—but they are getting a loan that's probably better than one walking in off the street.

And, more importantly, in 35 years there have been enough FHA loans to understand and to know what the rules are. So if you can qualify—they're very stringent. So if you can qualify at 96.5 percent, which is what the goal is, it's probably a better loan than what, again, somebody who would be walking in.

And to answer your question about is there one simple way to handle this problem, over a year ago several investors sat around Treasury and said HAMP, help for homeowners can work, and help for homeowners is one loss, one time. The problem with the program was you had to extinguish seconds, and there was nobody willing to do that. But that's a simple way to handle it. But the losses could be pretty dramatic on the bank balance sheets.

Mrs. CAPITO. Thank you.

Chairwoman WATERS. Thank you. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. I just have one question, actually. Home prices have been devalued in my community in Missouri 30 percent in some areas and higher. I am just wondering, Mr. Kling, if we let the market determine who goes into foreclosure and eventually loses their home, do you have any view of what would happen to neighborhoods that are already devastated? And when you have a large number of foreclosures, does that not reduce the value of everyone's home, including the people who make their payments on time every month?

So, while we may say, you were bad, you have a bad loan, you're not a good person, and so you deserve to lose your home, what about the next door neighbor, and the neighbor on the other side, and on down the street? I live in a—our church is in a neighborhood where there are probably five foreclosures. Everybody is in trouble in the neighborhood, even the people who go to work every day. What is the solution to that?

Mr. KLING. Well, I don't think the solution is to say that people are bad because they go into foreclosure and they're not because they don't. I think—I don't know if you're from St. Louis, I'm from the St. Louis area, originally, myself.

Mr. CLEAVER. No, I'm from the largest city.

[laughter]

Mr. KLING. But I now live in Silver Spring, and there are a lot of foreclosures in our neighborhood.

I think it's possible that having loans in foreclosure—that keeping people out of foreclosure would temporarily keep home prices above what they would be. And, as I said before, that would certainly benefit anyone who needs to sell a house right now.

So, let's say I have made good on my mortgage, but I got a new job somewhere and I want to sell right now. And there are a bunch of foreclosures in my neighborhood. And, because of those foreclosures, when I sell I'm not going to get such a good price. And if you could prevent those foreclosures, I will get a good price.

But that means that somebody who buys my house when I sell it, because I have a new job in a new city, is actually overpaying for it. And so, at some point they are going to pay the price for that. And I have seen that. I saw it in my neighborhood, some neighbors had sold at a peak that—probably the house sold for $200,000 more than what it's worth now, and I feel very sorry for those borrowers. So we are—

Mr. CLEAVER. I do, too, because I have a 3 year old who would not take that deal.

Mr. KLING. Yes.

Mr. CLEAVER. That is not happening where we—

Mr. KLING. Well, but—

Mr. CLEAVER. That's not happening in Kansas City.

Mr. KLING. Right. The—I guess my point is it's a redistribution from people who have to sell now to people who are anxious to buy now. Or from—sorry, the—

Mr. CLEAVER. But you do understand that people are not selling because they can't even get their investment out of it.

Mr. KLING. Yes, that's true. And they—in the short run, those people would be helped by anything that artificially raises house prices. But the people—but eventually the price is going to hit a market level.

And if you—so, if I am somebody with more of a long-term horizon, that I'm in this neighborhood for 6 or 8 years, then I think what I would like is for my neighborhood to have people who genuinely own the home, who are not at risk of defaulting, I'm willing to have new immigrant families, other families, other people trying to climb the ladder come in and buy these foreclosed houses and live in them, and try to make their living, rather than tell those people, "No, we need to keep these original home buyers in, and we need to artificially boost prices and keep them out of reach for you, in order to temporarily boost my house price."

There is no way we can make this all good, and make house prices go back up to what they were 2 years ago.

Mr. CLEAVER. But are you suggesting that it's not—if we just allow everybody who is on the precipice of foreclosure to go into foreclosure, that is not as bad as somehow trying to go through this very difficult, complicated process of trying to save homes?

Mr. KLING. Again, there is no perfect solution. You can't bring those home prices back up to where they were.

Mr. CLEAVER. They will eventually get there, don't you—

Mr. KLING. Eventually, they will go back to where they belong. And in the meantime, I do think the least bad option is to get the foreclosures behind us, get the crisis behind us, get people in those neighborhoods who can afford the payments because they're buying them at lower prices, and to have everybody in the neighborhood know that this isn't hanging over us, that there aren't these people who are on the precipice—because they will stay on the precipice, if you keep them in there—but that everyone in our neighborhood is here for the long term. I think, ultimately, that actually could be better for the neighborhood.

Mr. CLEAVER. Okay. Mr. Baker?

Mr. BAKER. Yes. If I could just speak to that very quickly, because I think there is an important point to distinguish here, because I am sympathetic with this idea that prices have to adjust. I don't think you can keep a bubble inflated, and I don't think it's desirable.

But I think there is a second point here, that the fact that you have a neighborhood that's subject to a lot of foreclosures, that fact itself lowers the prices. You have vacant homes that are havens for crime; they can be drug houses. That lowers the price. That's an artificial lowering of the price. I think we have every reason in the world to try to prevent that.

So, I don't think we could maintain bubble prices indefinitely. I don't see any social value in trying to do that. There absolutely is a social value in trying to prevent a neighborhood from being run down because you have a lot of houses that are in this foreclosure process, where they are abandoned, boarded up, not properly maintained. And that, I think, is very much what Congress and this committee should be focused on.

Mr. CLEAVER. Yes. We are not doing it at the optimum level of success. But that's what we are trying to do. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. If I may, what Mr. Cleaver is referring to is what we are trying to do with the NSP program, neighborhood stabilization, where we have now funneled in about $6 billion. We're into a second round of funding.

Unfortunately, most of the cities don't know how to use the money. They have not been able to implement the program very well. And we are going to hold some hearings on that, and we are going to try and get some technical assistance. Because you're right, we are too interested in maintaining some kind of stability and not driving down the prices further because of the foreclosures and the abandonment and all of the problems that go with that.

Let me thank all of you for your patience today. It has been a long day. And I am very appreciative for the time that you have given to us. If I had my way, I would put all of you on this panel in a room, because I think you could come out with something that makes good sense. I have appreciated your testimony very much here today, and you obviously have given a lot of thought to this, and you understand very well what is and what is not happening with the HAMP program.

I feel if we continue to go in the way that we are going, that we are simply going to further complicate the process and we are not going to be able to forestall foreclosures, or to maintain people in their homes in the way that we are going.

So, I am hopeful that you will allow us to call on you. My staff has been here, listening very carefully and taking a lot of notes. And some of you traveled from afar, I know, and we can't ask you to keep doing that. But we can conference call with you and talk with you by telephone. And I think that we will continue to do that.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

The panel is now dismissed. Do we have any written submissions for the record?

[No response.]

Chairwoman WATERS. If not, the hearing is adjourned, and I thank you very much.

[Whereupon, at 5:49 p.m., the hearing was adjourned.]

A P P E N D I X

April 14, 2010

The Successes and Shortcomings of the
Homeowner Affordability Modification Program

Testimony to the Subcommittee on Housing and Community Opportunity of the
Financial Services Committee of the U.S. House of Representatives

April 14, 2010

Dean Baker, Co-Director
Center for Economic and Policy Research
1611 Connecticut Ave., NW
Washington, DC 20009
202-293-5380, 114
baker@cepr.net

Thank you, Chairwoman Waters, for giving me the opportunity to present my views to the subcommittee on the success of the Homeowner Affordability Modification Program (HAMP) and prospects for the recently proposed modifications to the program. I will begin my comments with a brief discussion of the state of the housing market. An understanding of this market is essential for assessing the merits of any mortgage modification program. Against this backdrop, I will provide an assessment of the extent to which HAMP has succeeded to date and the likely differences that the Home Affordable Foreclosure Alternatives Program (HAFA) will make for homeowners.

It is important to recognize the central role that the housing bubble has played in the mortgage crisis. While the proliferation of deceptive mortgages and the soaring unemployment rate of the last two years would have created problems for homeowners in any environment, the reason that we face a mortgage crisis, with millions of homeowners facing the loss of their home every year, is that we had a bubble in the housing market that is now in the process of deflating.

In many former bubble markets home prices are now down by more than 30 percent from their bubble peaks in the years 2005-2007. In some markets the declines exceed 50 percent. In these markets, even homeowners who got a traditional 30-year fixed rate mortgage are likely to be facing difficulties. Almost anyone who bought their home near the peak of the bubble will be underwater on their mortgage, owing more than the value of their home. This means that they have no equity to draw on to get them through a spell of unemployment or other serious economic setback.

Being underwater also means that homeowners have relatively little at stake in keeping their homes. Since they lack equity they will in many cases find it more attractive to default on a mortgage and seek rental housing than to continue to make payments on their mortgage. The fact that such a huge number of mortgages are underwater guarantees that there will be millions of homeowners facing default and foreclosure.

Unfortunately for struggling homeowners, home prices in most markets will almost certainly have further to fall in order to return to long-term trend levels. The Case-Shiller 10-City index is still almost 50 percent higher, after adjusting for inflation, than it was in June of 1996, before the bubble began to send house prices upward. This run-up in house prices followed a full century in which nationwide house prices had just tracked the overall rate of inflation. While the 10-City index is not fully representative, even the broader House Price Index (HPI) produced by the Federal Housing Finance Agency still shows a real increase in house prices of 30.8 percent since the second quarter of 1996.[1]

[1] This calculation chains the rise in the quarterly index from the second quarter of 1996 until the fourth quarter of 2007 with the rise in the monthly index from the fourth quarter of 2007. In addition to differences in geographical coverage, there are also methodological differences between the Case-Shiller index and the HPI. The most important difference is the exclusion of the non-conforming mortgages from the HPI. This exclusion likely caused the HPI to understate the increase in house prices prior to the peak of the bubble and to understate the decline in the years since the peak.

These rises indicate that house prices nationwide still have considerably further to fall before returning to trend levels.

In this respect, it is important to note that there were three important supports for the market put in place in 2009 that will be removed over the course of this year. Probably the most important support was the Federal Reserve Board's purchase of $1.25 trillion of mortgage-backed securities as part of its policy of "quantitative easing." This policy pushed mortgage rates to their lowest level in more than 50 years, with the 30-year fixed rate bottoming out at close to 4.7 percent last summer. This program was phased out as of March 31, 2010. Mortgage interest rates have already risen to 5.2 percent and are almost certain to increase more in the absence of further intervention. It is quite likely that the 30-year rate will soon cross 5.5 percent, and some economists have projected year-end rates as high as 6.0 percent.

At 6.0 percent, a monthly payment will be 15.6 percent higher than with a 4.7 percent mortgage. This means that, other factors being equal, the same household in the higher interest rate environment only could afford a home that costs 15.6 percent less. This will be an important factor putting downward pressure on prices.

The second major housing support put in place in 2009 was the first-time homebuyers tax credit. The $8,000 credit is just under 5 percent of the median price for an existing home. The credit was originally scheduled to expire at the end of November of last year. It was extended and expanded to include some current homeowners. But this new credit is scheduled to expire at the end of April. The end of this credit will pull out an important support for the market.[2]

The third important source of support for the housing market was the Federal Housing Authority (FHA), which insured 30 percent of purchase mortgages in 2009. This was a huge expansion of the FHA's role in the market, which had contracted to just 2.0 percent at the peak of the subprime boom in 2006. One consequence of such a rapid expansion in the context of declining home prices and high unemployment was large losses on its loans. As a result, the FHA has fallen below its minimum capital requirements and is now cutting back on its involvement in the market.

Many of the purchasers who received FHA-backed mortgages will be unable to otherwise obtain financing and therefore will be excluded from the market. If the FHA were to reduce its market share by 10 percentage points, and half of the excluded homebuyers were unable to get other financing, this would imply a reduction of 5 percent in the number of potential homebuyers. This could have a substantial impact on home prices.

---

2 Some states also have first-time homebuyers credits, most notably California. California's credits are capped at $10,000, but the state has appropriated only $200 million for its credits. This sum will be exhausted long before the end of 2010.

Other factors suggesting further declines in home prices include a continuation of record housing vacancy rates. In the fourth quarter of 2009, the most recent data available, the Census Bureau reported that 10.9 percent of all housing units were vacant year-round. This is more than 50 percent higher than the vacancy rates that would ordinarily be observed. The high vacancy rates are also leading to falling rents, with the rental components in the consumer price index falling for the first time since they were created. All of these factors suggest that further home price declines are very likely. Indeed, the HPI, after rising somewhat in summer and fall of 2009, fell 2.6 percent from November of 2009 to January of 2010, the most recent month for which data are available.

This backdrop of falling house prices is essential for understanding the extent to which HAMP and the HAFA are actually helping homeowners. The presumption of many participants in this debate is that it is desirable to always keep people in their homes as homeowners. This is not necessarily true. In many cases, families will face far higher housing costs as owners than they would if they were renting a comparable unit. This means that they are draining away income from other potential uses, such as providing food, clothes, education, and even proper upkeep of the home.

Higher monthly housing costs can perhaps be justified if families are accumulating equity in a home. However, if the price of the home is still falling, then it is unlikely that the homeowner will be able to accumulate equity. In such situations, even if homeowners receive the benefit of a modification, they are likely to still find themselves underwater when they do end up selling their home. This means that they could still face a strike on their credit record from a short sale and will have wasted all the excess money paid on a mortgage during their years of homeownership.

Unfortunately, none of the HAMP criteria involve assessing the housing market in which a home is located by considering the ratio of home prices to annual rents. A high ratio of price to rent means that the family could save money by renting a comparable unit. I recently did an analysis comparing ownership costs with rental costs with Hye Jin Rho.[3] We found that in several cities, homeowners who bought near the peak of the bubble could save more than $1,000 per month by renting a comparable home, even assuming a low-cost mortgage. This huge gap between ownership and rental costs suggests that homeowners may still be paying far more in housing costs than necessary, even if they received the benefit of a modification through HAMP.

Furthermore, the existence of a high price-to-rent ratio suggests the likelihood that the bubble has not fully deflated in a specific market. This increases the probability that the home price will fall further, leaving the homeowner in a situation where they will

[3] Baker, Dean and Hye Jin Rho, 2009, "The Gains from Right to Rent," Washington, DC: Center for Economic and Policy Research, available at http://www.cepr.net/index.php/publications/reports/gains-right-to-rent/. The calculations in this study compare housing costs for a home at 75 percent of the median house price with the fair market rent estimated by the Department of Housing and Urban Development for a two-bedroom apartment.

eventually have to sell their home for less than the outstanding principal on the mortgage.[4]

Since the HAMP fails to consider price-to-rent ratios, it is likely that many of the modifications have taken place in markets that are still bubble-inflated. It is difficult to see how keeping families in a situation in which they are paying more in housing costs than necessary, and in which they likely will never accumulate any equity, is helping them. In these situations, the money paid out through the HAMP programs is helping banks, not homeowners.

Of course the vast majority of delinquent homeowners facing foreclosure have not received permanent modifications through HAMP. The most recent data show that less than 200,000 homeowners have gotten permanent modifications. This is in a context in which close to 1.5 million families a year are leaving their homes through foreclosure or forced sales. In this context, the HAFA program seems more likely to provide a benefit to homeowners, although the cost per homeowner to the public could be substantial.

The proposal effectively gives money to servicers and first and second mortgage holders for allowing homeowners to make a short sale or to be released from their mortgage commitment without a strike against their credit record. The plan provides up to $2,000 to first lien holders to pay up to $6,000 to second lien holders to release the homeowner from their obligations.[5] It also provides up to $1,500 to servicers for their time in working out this arrangement. The proposal also gives homeowners up to $3,000 in relocation assistance.

This formula implies a potential cost of up to $6,500 for each homeowner who benefits from the program, with a division of $3,000 per homeowner and $3,500 for the investors and servicers. In effect, taxpayers will be paying the investors and servicers up to $3,500 to release each homeowner from their obligations without a strike on their credit record. In most cases, the cost is likely to be somewhat less than this amount, but even if the payments to the first lien holder average only half the maximum, the government will still be paying servicers and investors $2,500 per homeowner to prevent them from having a strike on their credit record.[6] Nonetheless, this is still likely a more realistic formula for helping homeowners in most cases than modifications through the HAMP program.

---

[4] The nationwide average for the ratio of home prices to annual rent would be in the neighborhood of 15 to 1, however there have been long-term divergences, especially in markets where they are rent controls or other restrictions on raising rents.

[5] The payment to the first lien holder is on a 1 to 3 basis for the payments made to the second lien holder in a short sale.

[6] It is also worth examining whether the second lien holders are likely to unduly profit from this arrangement. In principle, this plan allows them to get a return of up to 6 cents per dollar. Second liens on homes where the first mortgage was underwater have often sold at much lower prices.

As a less costly and more effective alternative, Congress could attempt to increase the bargaining power and security of homeowners by temporarily changing the rules on foreclosure to allow homeowners to remain in their homes as renters for a substantial period (e.g. 5-10 years) following a foreclosure. During this time homeowners would pay the market rent for the home as determined by an independent assessment.[7]

This proposal would have the benefit of immediately providing housing security to families facing foreclosure without forcing them to go through a lengthy review process. (The right can be restricted to only apply to some homeowners, such as those who bought a home for less than the median price in an area, so as to ensure that it is not benefiting wealthy homeowners who used bad judgment in paying too much for a home.)

This Right to Rent plan also would not require any taxpayer dollars. It only temporarily changes the rules on foreclosure, based on the extraordinary conditions in the housing market that occurred during the bubble years . Lenders can still foreclose and take possession on a home when the homeowner has defaulted on a mortgage, however, they will potentially have to accept the homeowner as tenant for a substantial period of time.

This immediately gives the homeowner security in their home. They will be allowed to stay there for a substantial period of time, allowing their children to stay in their schools and families to prepare for and plan their future moves. Right to Rent also would make foreclosure much less attractive to investors, since they would potentially have tenants for a substantial period of time. This gives investors more incentive to modify loans on their own, without the involvement of the government.

Right to Rent also would provide the right incentive to lenders in future market frenzies. If lenders realize that rules on foreclosure can be changed to their disadvantage in such cases, then they will likely be more cautious when they see extraordinary run-ups in home prices in the future. This is exactly the sort of rational behavior from investors that the government should want to encourage.

Conclusion

To date, the various loan modification programs that have been put forward, including HAMP, have offered limited benefit to homeowners in large part because there has been little interest in considering the underlying dynamics of the housing market. As it stands, we are in a bubble market that is in the process of deflating, but which almost certainly has another 10-20 percent to decline. This means that most homeowners who purchased their homes near the peak of the market are unlikely to ever see any equity in their home. In addition, even they are likely to be paying more in ownership costs than they would to

[7] This "Right to Rent" proposal is outlined in Baker, Dean, 2009. "The Right to Rent Plan," Washington, DC: Center for Economic and Policy Research, available at http://www.cepr.net/index.php/publications/reports/the-right-to-rent-plan/.

rent a comparable home, even if they were to benefit from a modification and receive a lower cost mortgage.

The HAFA program is a step forward in recognizing that many homeowners will be better off giving up their home, although a substantial portion of HAFA's costs are essentially payments to investors and servicers to prevent homeowners from getting a strike on their credit record. A much more efficient approach would be Right to Rent legislation that would temporarily change the rules on foreclosure to allow homeowners to stay in their homes, paying the market rent for a substantial period of time following foreclosure. By incentivizing lenders to negotiate, Right to Rent would immediately benefit all homeowners facing foreclosure. Finally, Right to Rent could be implemented at no cost to taxpayers and would require no new bureaucracy.

April 14, 2010

Testimony of Phyllis Caldwell
Chief Homeownership Preservation Officer
U.S. Department of the Treasury

Before the House Financial Services Subcommittee on Housing and Community Opportunity

"The Recently Announced Revisions to the Home Affordable Modification Program (HAMP)"

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee, thank you for the opportunity to testify today on the recently announced enhancements to the Home Affordable Modification Program (HAMP), a key component of the Administration's Making Home Affordable (MHA) initiative. These program enhancements will better assist responsible homeowners who have been affected by the economic crisis. The program modifications will expand flexibility for mortgage servicers and originators to assist more unemployed homeowners and to help more people who owe more on their mortgage than their home is worth because their local markets saw large declines in home values. These changes are a part of the Administration's comprehensive strategy to help stabilize housing markets and offer a second chance to up to three to four million struggling homeowners through the end of 2012. Costs will be shared between the private sector and the Federal Government; funding from the Troubled Asset Relief Program (TARP) will not exceed the $50 billion originally allocated for housing programs.

Housing Policy Overview

The Administration's goal is to promote stability for both the housing market and homeowners. To meet these objectives, the Administration has developed a comprehensive approach using state and local housing agency initiatives, tax credits for homebuyers, neighborhood stabilization and community development programs, mortgage modifications and refinancing, and support for Fannie Mae and Freddie Mac. With the record-low mortgage rates seen this past year and, thanks in large part to these programs, more than four million homeowners have refinanced their mortgages to more affordable levels helping to save more than $7 billion in the past year; more than one million are saving an average of around $500 per month through the Administration's mortgage modification program; home equity (wealth for homeowners) increased by more than $13,000 for the average homeowner in the last three quarters of 2009; and the economy is growing.

Even with this success, we continue to see challenges. Servicers were slow to implement HAMP, resulting in a slow start for the program. Recent improvements in the program have accelerated the pace of modifications. But our strategy to address the crisis must evolve because our challenges have also evolved. The enhancements announced on March 26, 2010 are responsive to the changing needs of homeowners across the country.

Our housing initiatives must balance the need to help responsible homeowners struggling to stay in their homes, with the recognition that we cannot and should not help everyone. The President has said: "We can't stop every foreclosure." And in fact, we can't maintain this balance if we try to assist every borrower. For example, investors and speculators should not be protected under our efforts, nor should Americans living in million-dollar homes or defaulters on vacation homes. Some people simply will not be able to afford to stay in their homes because they bought more than they could afford. Instead, the Administration must focus on providing responsible homeowners opportunities to obtain a modification or to refinance and prevent avoidable foreclosures and, when necessary, facilitate the transition to a more sustainable housing situation. The newly announced adjustments are tailored to accomplish these goals by helping a targeted group of borrowers.

Eligible homeowners for modifications under HAMP must, for example: live in an owner-occupied principal residence, have a mortgage balance less than $729,750, have monthly payments on their first mortgage that are greater than 31 percent of their income, and demonstrate a financial hardship. The new flexibilities for HAMP will enable us to better reach this target population.

The new Federal Housing Administration (FHA) refinance options will provide more opportunities for lenders to restructure loans for some families who owe more than their home is worth. This should help to create stabilizing incentives in the housing market. This is a voluntary program for lenders. To be eligible for refinancing through FHA, borrowers must be current on their mortgage.

Taken together, the Administration's broad housing initiatives and the newly announced flexibilities will offer a second chance to millions of responsible, middle-class American families struggling to stay in their homes and will help stabilize and rebuild wealth for our households, neighborhoods and communities.

Background on Housing Program Initiatives to Date

The Administration has taken a broad set of actions to stabilize the housing market for the benefit of American homeowners. These efforts are having an impact on our housing markets – we are seeing signs of stabilization. Just over one year ago, stress in the financial system had severely reduced the supply of mortgage credit, limiting the ability of Americans to buy homes or refinance mortgages. Millions of responsible families who had made their monthly payments and fulfilled their obligations saw their property values fall, and found they were unable to refinance at lower mortgage rates.

In February 2009, less than one month after taking office, President Obama announced the *Homeowner Affordability and Stability Plan*. As part of this plan and through other housing initiatives, the Administration has taken the following actions to strengthen the housing market:

Actions Supporting Market Stability and Access to Affordable Mortgage Credit

- The Administration has provided strong support to Fannie Mae and Freddie Mac to ensure continued access to affordable mortgage credit across the market;
- Together, Treasury and the Federal Reserve have purchased more than $1.4 trillion in agency mortgage-backed securities, which have helped keep mortgage rates at historic lows, allowing homeowners to access credit to purchase new homes and refinance into more affordable monthly payments; and
- The FHA and Ginnie Mae have played an important counter-cyclical role, providing liquidity for housing purchases and refinancing at a time when private lending has declined.

Actions Helping Homeowners Purchase Homes, Refinance and Modify Mortgages to More Affordable Payments, Prevent Foreclosures and Stabilize Communities

The Administration has:

- Launched a modification initiative to help homeowners reduce mortgage payments to affordable levels and to prevent avoidable foreclosures. Homeowners in active modifications are saving around $500 per month on average;
- Supported temporarily expanding the limits for loans guaranteed by Fannie Mae, Freddie Mac, and FHA from previous limits up to $625,500 per loan to $729,750 to provide needed support to keep markets functioning during this crisis;
- Expanded refinancing flexibilities for the Fannie Mae and Freddie Mac loans, particularly for borrowers with negative equity. Combined with historically low mortgage rates, this has helped more than four million American homeowners to refinance, saving an estimated $150 per month on average and more than $7 billion cumulatively in the past year;
- Launched a $23.5 billion Housing Finance Agencies Initiative which is helping more than 90 state and local housing finance agencies (HFAs) across 49 states provide sustainable homeownership and rental resources for American families;
- Supported the First-Time Homebuyer Tax Credit, and the subsequent extension and expansion of the credit to also assist move-up buyers, which has helped hundreds of thousands of responsible Americans purchase homes.
- Through the Recovery Act, provided over $5 billion in support for affordable rental housing through low-income housing tax credit programs and $2 billion in additional support for the Neighborhood Stabilization Program (NSP), on top of the first round of $4 billion of NSP funds, to restore neighborhoods hardest-hit by concentrated foreclosures; and
- On February 19, 2010, announced the $1.5 billion HFA Hardest-Hit Fund for five state HFAs in the nation's hardest-hit housing markets to design innovative, locally targeted foreclosure prevention programs. On March 29, 2010, we announced a $600 million expansion of that program for an additional five HFAs.

Together, these initiatives are having an impact – strengthening the housing market, helping responsible homeowners prevent avoidable foreclosures and rebuilding communities and neighborhoods. Today mortgage rates remain near historic lows – the primary interest rate is now about 5.20 percent. We are also seeing encouraging signs in housing indicators – home prices and the pace of home sales have stabilized in recent months.

HAMP Performance in Context

At the time we launched HAMP in March 2009, President Obama said that the program would "enable as many as three to four million homeowners to modify the terms of their mortgages."

- The target of "three to four million homeowners" includes both agency loans (owned or guaranteed by the Government-Sponsored Enterprises, Fannie Mae and Freddie Mac) and non-agency loans.
- We have continued to report offers of trial modifications, because the offer is the servicer's commitment to extend a trial modification subject to the borrower's agreement. At this point, a homeowner is provided an opportunity to reduce his or her monthly mortgage payment.
- There will be fewer permanent modifications than trial modifications, as modifications are only offered permanent status once the homeowner has accepted a trial modification, has performed for at least three months in a trial modification, and has met the full documentation requirements for the permanent modification. By requiring borrowers to demonstrate their ability and willingness to meet their monthly obligations, the trial modification helps ensure that taxpayer dollars are not spent on unsustainable modifications.
- Loan modifications have a risk of re-default. Among the permanent modifications, some will re-default and that factor is incorporated into the program's design.
- In fact, we designed our program specifically to protect the taxpayer in cases where re-default occurs – payments to servicers, investors, and borrowers are conditional on actual performance over time.
- The projection of three to four million homeowners helped is based on our best estimate of the number of HAMP-eligible households that are likely to require assistance during the four-year program. The number of households that actually require assistance from HAMP during the remaining three years may diverge from our expectations if economic conditions or home prices evolve differently than projected.

More than 1.4 million borrowers have been extended a modification offer, with approximately 1.2 million of these approved offers resulting in modification trials. In a program scheduled to last nearly four years (March 2009 through December 2012), either figure places the program well on schedule to meet the goal announced by President Obama.

HAMP also continues to demonstrate real progress, as evidenced in our March public report:

- Homeowners in active modifications have had their payments reduced substantially – around $500 for the typical homeowner.

- Of the homeowners who have been in trial modifications for three months or more, 36 percent had received permanent modifications or had been approved for permanent modification. This conversion rate from trial to permanent modifications has been improving but is still below desired or anticipated program levels.

- In March alone, 60,594 borrowers in modifications received permanent status.

- There are now a total of 227,922 homeowners with permanent modifications and another 108,212 whose permanent modifications await only their signature.

- Even those borrowers who do not obtain a permanent modification (for example, those who do not complete a trial modification but instead pursue a foreclosure alternative such as a short sale) still benefit from reduced payments during the trial phase and the time the trial affords them to find an appropriate solution.

Despite the progress, we have encountered a number of policy and operational issues that have been much more challenging to address than anticipated. The process of converting trial modifications to permanent was hindered by several factors, including slow ramp up and insufficient capacity and execution at most servicing shops, a lack of willingness or ability to provide necessary documentation on the part of some borrowers, and a conversion and implementation process more complex administratively than originally conceived. We found that the parallel nature of the foreclosure process during a HAMP trial period has been confusing to borrowers and many have complained about conflicting signals regarding the status of their mortgage. Also, unemployment and negative equity continue to pose significant challenges for homeowners.

Given these challenges, we believed that adjustments to the program were necessary for us to more effectively assist struggling borrowers. As we determined how best to address these challenges, we have moved aggressively to implement program changes and expansions to help at-risk homeowners.

HAMP and Other Enhancements Help Us More Effectively Meet Housing Goals

Upfront Documentation and Verification of Income

At the outset of 2010, Treasury began the process of implementing these program enhancements. First and foremost, we revised the program to ensure that borrowers will not be caught in a long trial period. The new rules (Supplemental Directive 10-01) we issued on January 26 require servicers to begin offering trial modifications based on verified documentation at the front end of the process. We clarified documentation rules for the program so that borrowers now must submit a simple, standard package of documents to begin the evaluation process for a trial modification. Further, we require servicers to abide by certain response timeframes so that borrower decisions on eligibility are made in a timelier manner. These changes will begin taking effect on April 15, 2010, although some servicers have already begun to implement them.

Borrower Protections and Outreach

On March 24, Treasury released guidance (Supplemental Directive 10-02) that provides borrowers with a number of new protections in the HAMP evaluation process to help address some of the confusion and anxiety that some borrowers reported surrounding their rights during the evaluation process.

The guidance addresses borrower solicitation, borrower response timelines, the foreclosure process, and bankruptcy changes. Supplemental Directive 10-02 requires and defines reasonable outreach efforts to homeowners by servicers and establishes a timeframe for borrowers to respond to these efforts. This guidance also clarifies that servicers must consider borrowers in active bankruptcy for HAMP if a request for modification is received.

Supplemental Directive 10-02 also addresses the HAMP evaluation process with respect to foreclosure. Currently, servicers may not refer a mortgage to foreclosure if the borrower is in a trial modification. The guidance would prohibit foreclosure referral for all potentially eligible loans unless the borrower does not respond to the solicitation, was not approved for HAMP, or failed to make their trial modification payments on time. Servicers will be required to provide borrowers with clear written communications explaining the concurrent foreclosure/modification processes and stating that a foreclosure sale will not take place during the trial period. If a borrower is found ineligible for HAMP, a foreclosure sale cannot be scheduled sooner than 30 days after the date of a Non-Approval Notice so that the borrower has a chance to respond. Servicers must also certify to their foreclosure attorneys that a borrower is not eligible for HAMP before a sale may be conducted.

Additionally, on March 26, 2010, we announced increased incentives for servicers to provide permanent modifications to homeowners. By increasing upfront servicer incentive payments for permanent modifications, we are better enabling servicers to increase outreach and counseling efforts, covering the costs of implementing updated program elements, and focusing on converting borrowers to a permanent solution.

Assistance for Unemployed and Underwater Borrowers

Among the series of enhancements rolled out on March 26 was a change to provide unemployed borrowers with temporary assistance and a pathway to a permanent modification. Unemployed borrowers meeting certain HAMP eligibility criteria will have an opportunity to have their mortgage payments temporarily reduced to an affordable level for a minimum of three months, and up to six months for some borrowers, while they look for a new job. Borrowers who become re-employed by the end of this temporary assistance period and whose mortgage payment is greater than 31 percent of their new gross monthly income must be considered for a *permanent* HAMP modification. If homeowners do not find a job before the temporary assistance period is over, servicers may consider them for the Home Affordable Foreclosure Alternatives Program (HAFA), which includes the option of obtaining a short sale or a deed-in-lieu of foreclosure to transition to a more affordable living situation.

Additionally, servicers will be required to consider an alternative modification approach that helps borrowers achieve principal relief over time through earned forgiveness of principal that is forborne in the initial loan modification. For HAMP-eligible borrowers that owe more than 115 percent of the current value of their home, servicers will be required to run the standard Net Present Value (NPV) test and an alternative NPV test that includes incentives for each dollar of principal write-down. If NPV under the alternative approach compares favorably to the result under the standard approach, the servicer will have the option to use it. In this way, servicers are able to demonstrate to investors that using principal write-down likely results in a higher yielding modification.

Under the alternative approach, servicers assess the NPV of a modification that starts by forbearing principal balance as needed over 115 percent loan-to-value (LTV) to bring borrower payments to 31 percent of income, maintaining the overarching program standard of affordability. Servicers will then forgive the forborne amount in three equal steps over three years, as long as the homeowner remains current on payments. This principal write-down schedule ensures prudent expenditure of taxpayer resources, with incentives earned by the borrower and lender on a pay-for-success basis.

Implementation details for the principal write-down option is expected by early Fall 2010, with the unemployment forbearance component likely within the next two months. Treasury is also increasing the incentives that it provides for second liens extinguished or partially extinguished even when the alternative principal write-down waterfall is not utilized.

Strengthening FHA Programs for Underwater Borrowers

The Administration has taken additional steps to provide assistance to underwater borrowers. Adjustments have been made to FHA programs that will permit lenders to provide additional refinancing options to homeowners who owe more than their home is worth because of large falls in home prices in their local markets. These adjustments will provide more opportunities for qualifying mortgage loans to be responsibly restructured and refinanced into FHA loans as long as the borrower is current on the mortgage and the lender reduces the amount owed on the original first lien loan by at least 10 percent. Funds from TARP will be made available for incentives to encourage write-downs of any existing second liens and to encourage participation by servicers. TARP funds will also be used to provide coverage to lenders for a share of potential losses on these loans, mitigating detrimental impacts to FHA's capital reserve to ensure that the FHA does not take on any additional cost to support these refinanced loans. No TARP funds will go to the FHA itself for any loans. Total TARP support provided through incentives and coverage will not exceed $14 billion. We expect this option to be available by Fall 2010.

Additional Incentives for Servicers to Modify Loans Already Insured by FHA

HAMP has also been expanded to provide incentives for servicers to modify FHA-insured loans. This program was initially developed last July by FHA and became effective August 15, 2009. With the issuance of new rules on March 26 (Supplemental Directive 10-03), TARP-funded pay-for-success incentives will be available to borrowers and servicers whose loans are modified under the FHA-HAMP guidelines. These incentives improve the quality of this modification option for borrowers and offer a path toward some principal relief. FHA-HAMP incentives are retroactive for all corresponding modifications already offered and therefore we expect the first pay-for-success incentive payments to be paid as early as September 2010.

Greater Assistance for Homeowners to Transition to More Affordable Housing
For borrowers who continue to struggle and are unable to complete a modification, the March 26 announcement also increased incentives to help homeowners move to more affordable housing. Relocation assistance payments to borrowers who use HAFA will be doubled to $3,000 and incentives will be increased for servicers and lenders to raise participation. These incentives will help these homeowners transition more quickly to housing they can afford and increase the likelihood that subordinate lien holders will release borrowers from their debt obligations and thereby help borrowers achieve a faster, less costly exit from their home than they would experience with a foreclosure. This change is effective immediately.

Assisting the Hardest-Hit Housing Markets
The Administration has also recognized that key factors causing severe distress in certain markets could be addressed in a more targeted fashion by agencies most familiar with the dynamics of those markets. In response, the Administration announced the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets (the "HFA Hardest-Hit Fund") for state HFAs to design innovative, locally targeted foreclosure prevention programs. Focusing on these areas will allow limited funding to be deployed with enough scale to have a more significant impact.

The first sequence of funding, announced on February 19, 2010, is designed to provide limited additional resources – a total of $1.5 billion – to states that experienced home price declines of 20 percent or more, using the Federal Housing Finance Agency (FHFA) Purchase Only Seasonally Adjusted Index. Such large declines in home prices have been enough to erode the equity of even the most responsible borrowers, many of whom made large down payments on their homes. The states receiving allocations in this sequence are Arizona, California, Florida, Michigan, and Nevada.

The second sequence, announced on March 26, 2010, allocates $600 million to states with high concentrations of people living in economically distressed areas, defined as counties in which the unemployment rate exceeded 12 percent, on average, over the months of 2009. Less than 15 percent of the U.S. population lives in such high unemployment rate counties. As a result, we encourage state HFAs to use these funds to develop targeted solutions for those communities. The states receiving allocations in this sequence are North Carolina, Ohio, Oregon, Rhode Island and South Carolina.

How Enhancements Affect HAMP Budget and Goals

When HAMP was announced in February 2009, Treasury set a goal to offer reduced monthly payments for up to three to four million at-risk homeowners, enabling these homeowners to modify their mortgages and helping them avoid foreclosure. This projection is based on the best available estimate of the number of HAMP-eligible households that are likely to require assistance during the four-year period between 2009 and 2012. The number of households that actually require assistance from HAMP during the remaining three years may diverge from our expectations if economic conditions or home prices evolve differently than projected. The announced changes to HAMP in part respond to this changing economic environment as well as to lessons we have learned about improving program functionality. They will help the Administration more effectively meet its goal of stabilizing housing markets by offering a second chance to up to three to four million struggling homeowners through the end of 2012.

We anticipate that the budget costs for these new enhancements will not exceed the original allocation for HAMP, with costs to be shared between the private sector and the Federal Government. Funding from TARP for the announced programs will not exceed the $50 billion originally allocated for housing programs. This includes budgets for:

- First lien HAMP modifications, including Home Price Decline Protection (HPDP) payments, alternative principal relief waterfall, and FHA-HAMP;
- Second lien modifications (2MP);
- Foreclosure alternatives (HAFA);
- HFA Hardest-Hit Funds for state HFAs; and
- Incentives and loss coverage for FHA Refinance options.

Despite program enhancements and the rapidly expanding number of conversions to permanent modifications, so far, HAMP has paid a very small share of long-term expected program costs. This is largely because HAMP is designed to protect taxpayers with an innovative pay-for-success framework, which means that the taxpayer does not pay a penny for trial modifications where the borrower does not complete the trial. Even after the trial period, continued servicer, investor and homeowner incentive payments are contingent on continued borrower payment performance over the five-year modification.

Even with the addition of new and increased incentives for the programs mentioned above, this back-loaded payment structure means that, to date and likely over the next few months, a relatively small share of incentives are actually paid out to servicers and investors.

Conclusion

HAMP is the largest mortgage modification program our nation has seen, in size, scope and impact. In addition to the relief it provides directly, it has impacted the broader industry by motivating mortgage servicers to build up systems to meet unprecedented demand and streamlining and standardizing modification processes across the industry. While significant progress has been made in the first year of program implementation, the enhancements announced on March 26 of this year demonstrate this Administration's commitment to apply lessons learned, strengthen program implementation and broaden the program's impact.

In addition to the program improvements outlined here, the Administration remains dedicated to the many other housing market stabilization efforts that work in concert with HAMP, including substantial support for the housing markets through support of Fannie Mae and Freddie Mac to stabilize those institutions and help ensure that affordable mortgage credit is available; refinancing opportunities that have allowed more than four million borrowers to refinance since the launch of MHA; and an initiative to provide support and financing to state and local housing finance agencies, which in turn provide tens of thousands of affordable mortgages to first-time homebuyers and help develop tens of thousands of affordable rental units for working families, including those displaced by the housing crisis and foreclosures.

The Administration is on track to meet the stated program goals and – most importantly – to help prevent avoidable foreclosures for as many eligible American families as possible.

Substantial progress has been made, but the Administration recognizes that real and complex challenges to achieving these important goals still exist. We look forward to these enhancements improving the program's ability to meet these challenges and contribute to the stability of housing markets.

**The Recently Announced Revisions to the
Home Affordable Modification Program (HAMP)**

Written Testimony

of

**Alys Cohen
National Consumer Law Center**

**also on behalf of
National Association of Consumer Advocates**

**Before the United States House of Representatives
Subcommittee on Housing and Community Opportunity
of the House Committee on Financial Services**

April 14, 2010

I. Introduction

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, thank you for inviting me to testify today regarding the Making Home Affordable Program and its effect on foreclosures.

I am a staff attorney at the National Consumer Law Center (NCLC).[1] In my work at NCLC, I provide training and technical assistance to attorneys across the country representing homeowners who are facing foreclosure, and I also bring the concerns of those homeowners to policymakers in Washington. Prior to my work at the National Consumer Law Center, I focused on mortgage lending issues as an attorney at the Federal Trade Commission's consumer protection bureau, where I was involved in investigations and litigation regarding lending abuses. I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. I also testify here today on behalf of the National Association of Consumer Advocates.[2]

---

[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

Today's hearing is about the recently announced changes regarding the Home Affordable Modification Program (HAMP). While we applaud the Administration for acknowledging that no foreclosure prevention program can do its job without principal reduction, assistance for the unemployed, and stopping the foreclosure process while considering whether a loan modification is possible, even these enhanced measures threaten to be an empty promise without meaningful transparency, accountability, and enforcement. These changes, introduced more than a year into the program, are still inadequate to address the scale of the continuing foreclosure crisis. Until the program addresses servicers' incentives to foreclose rather than modify loans and mandates program compliance, new initiatives are unlikely to dampen the country's economic distress.

HAMP must be further revised to provide substantially increased transparency and accountability, as well as reformed program rules:

- **Increase HAMP transparency.**
    - **Make public the net present value ("NPV") test used by servicers.**
    - **Require that servicers issuing HAMP denials provide more detailed information.**
    - **Establish a formal appeals process.**
    - **Make loan-level data available to the public, including data for fair lending analysis.**
- **Change the terms of the trial modification program to mitigate adverse effects on homeowners.**
    - **Require that trial modification payments be applied to principal and interest as specified under the permanent modification.**

- **Convert homeowners who make three on-time trial modification payments automatically to permanent modifications.**
- **Allow homeowners who fail a trial modification an opportunity to pay back the arrears through regular monthly installments consistent with an affordable payment.**
- **Ease credit reporting requirements so that homeowners who enter a trial modification as current and make all trial modification payments as agreed do not suffer adverse credit reporting.**

- **Designate Treasury official(s) available to assist with Court or other required mediation cases.**
- **Expand HAMP eligibility and coverage.**
  - **Provide additional modifications for homeowners who experience unforeseeable future drops in income.**
  - **Establish a revised analysis of affordability for homeowners with interest-only and option ARMs.**
  - **Provide modifications for homeowners with unaffordable payments, even when the first mortgage payment is 31% or less of current income.**

To overcome the misalignment of incentives between servicers and the other stakeholders—investors, homeowners, and communities—mortgage servicing needs to be further regulated by Congress. We also recommend that Congress take other additional steps to ensure that the current economic crisis is not repeated. We recommend that Congress:

- **Pass legislation to mandate loan modification offers to qualified homeowners prior to foreclosure where the modification is consistent with net present value.**
- **Fund quality foreclosure mediation.**

- **Allow bankruptcy judges to modify home loans in bankruptcy.**
- **Ensure that homeowners receiving mortgage modifications do not find their new financial security undermined with a burdensome income tax bill.**
- **Pass strong legislation prohibiting the abusive mortgage lending practices that precipitated today's economic crisis.**
- **Establish an independent Consumer Financial Protection Agency that can establish strong rules to govern the market.**

II. HAMP Is Still Hindered by Noncompliance and a Lack of Transparency and Accountability

The program announced by President Obama's administration on March 4, 2009, was a welcome attempt to overcome servicers' long-standing reluctance to perform large numbers of sustainable loan modifications. It sought to change the dynamic that leads servicers to refuse even loan modifications that would be in the investors' best interests by providing both servicers and investors with payments to support successful loan modifications.

Yet, an entire year into the Home Affordable Modification Program (HAMP), homeowners and their advocates still report a stunning degree of noncompliance, including wrongful denials, provision of unsustainable payment plans without proper HAMP review, conclusion of foreclosure sales prior to complete HAMP review, and general confusion among and misinformation from servicer personnel.

These problems are magnified by the program's continuing failure to establish basic transparency and accountability.[3] The core eligibility analysis under HAMP, which is the net present value analysis, is not available to the public, thus depriving homeowners of the ability to verify whether a servicer's analysis is accurate. Many servicers deny homeowners based on allegations of "investor non-participation," while refusing to identify the provisions of the contracts with investors that forbid participation. The escalation hotline sponsored by Treasury seldom offers beleaguered homeowners relief, usually offering homeowners nothing more than a restatement of the servicer's unsupported assertions. One year into the program, Treasury still has not announced whether and what type of penalty a servicer would suffer for noncompliance, and it is not clear whether any meaningful penalties for noncompliance could be imposed under the contracts Treasury drafted.

In recent reports, both the GAO and SIG TARP have identified numerous concerns. The GAO report[4] found inconsistencies in implementation as well as widespread instances where borrowers were given inaccurate program information by servicer personnel—including prominent misinformation on websites and other easily-managed public information channels. According to the GAO, servicers do not consistently track complaints or their resolution and few complaints are referred to the servicers' in-house escalation process. In general, only those homeowners lucky enough to have a contact at the highest levels of management can count on having their complaints resolved. The SIG TARP report[5] found similar problems in the provision of incorrect and

---

[3] Additional HAMP policy issues include, among others, the structure and payment rules regarding trial modifications, failure to provide an independent appeals process for homeowners, failure to consider homeowners for additional modifications where circumstances changed beyond the homeowner's control, and limited assistance to homeowners with negative amortization loans. These are discussed further in Section IV, below.
[4] Government Accountability Office, Home Affordable Modification Program Continues to Face Implementation Challenges (Mar. 25, 2010), *available at* http://www.gao.gov/new.items/d10556t.pdf.
[5] Office of the Special Inspector General for the Troubled Asset Relief Program, Factors Affecting Implementation of the Home Affordable Modification Program (Mar. 25, 2010), available at http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf.

inconsistent information to borrowers. Strikingly, SIG TARP reported inconsistencies between the code and the written parameters of the key eligibility test, the NPV test.

SIG TARP also pointed to a fundamental flaw in the Administration's current measurement of the program's success. As SIG TARP noted, only permanent modifications, not temporary modifications, are a legitimate measure of HAMP's success. Yet even temporary modifications are falling off.

By Treasury's estimates, 1.8 million homeowners should be eligible for permanent modifications under HAMP. This figure is probably too conservative and may reflect double-counting in determining ineligible borrowers (for example, the numbers depend on servicer self-reporting as to restrictions in investor documents and reduce eligible borrowers both for "jumbo" loans and investor property, which may overlap). This figure is also dramatically lower than Treasury's initial estimates of 3-4 million to be helped by the program. Worse, these numbers are wholly outsized by the magnitude of the crisis. One in seven homeowners is delinquent on their mortgage or already in foreclosure.[6] Projected foreclosure totals number anywhere between 8 and 13 million.[7] Over 2 million homes already have been lost to foreclosure, according to the Hope Now Alliance.[8]

---

[6] MBA National Delinquency Survey, Feb. 19, 2010. The combined percentage of loans in foreclosure or at least one payment past due was over 15 percent on a non-seasonally adjusted basis, the highest ever recorded in the MBA delinquency survey.

[7] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected,* Credit Suisse (Dec. 4, 2008) (projecting 10 million foreclosures by 2012 depending on current unemployment rates); Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan. 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

[8] Hope Now Phase I National Data (Nov. 2009), *available at* https://www.hopenow.com/industrydata/Summary%20Charts%20Nov%202009%2020100104%20v2.pdf. (Approximately 2.1 million foreclosure sales have been completed between 2007 and November 2009.)

Yet even measured against these facially inadequate goals, HAMP is falling behind. A year into the program, only 170,000 homeowners had received permanent modifications[9]—less than 10% of Treasury's scaled back expectations of the number to be helped.

III. Recently Announced Changes to HAMP Do Not Alter Core Problems in Mortgage Servicing

On March 24 and 26, 2010, the Administration announced several new measures that will be adopted as part of its foreclosure prevention program. While the package of "enhancements" acknowledges the importance of certain keys issues to fighting foreclosures—helping the unemployed, providing for principal reductions, stopping the foreclosure process during loss mitigation, and offering modifications to homeowners in bankruptcy—none of these measures seems likely to effectively address the key issues. The Administration has not yet addressed servicers' fundamental unwillingness to modify loans, although this comes at the expense of investors, and seems unable or unwilling to address servicers' significant profit motivations to foreclose.

The unemployment measure offers only short-term payment relief without any debt relief and for a period far shorter than the current average period of unemployment. The principal reduction program is based on voluntary principal write-downs, an approach that heretofore has not produced significant results and that adds complexity without providing transparency or accountability. Indeed, homeowners are instructed in the Consumer FAQ's published by the Administration that they should not talk to their servicer with questions about the principal reduction program and that

[9] U.S. Dept. of Treasury, *Home Affordable Modification Program, Servicer Performance Report Through Feb. 2010.*

their servicer will contact them if they are eligible.[10] Even the most promising initiatives--the mandatory stopping of the foreclosure process and the access to HAMP for homeowners in bankruptcy—cannot succeed unless HAMP significantly increases transparency and accountability.

A. Foreclosure Stops and Access to HAMP for Homeowners in Bankruptcy

On March 24, 2010, the Administration released Supplemental Directive 10-02.[11] Effective June 1, 2010, servicers may not refer a loan to foreclosure until either the borrower's eligibility is determined or reasonable efforts at solicitation have failed. After the servicer sends a non-approval notice, there is an additional 30-day hold on the foreclosure sale unless the borrower is not approved because the property or mortgage is ineligible, the borrower withdraws, or the borrower failed to make payments under a trial or permanent HAMP modification. In addition, once a borrower is in a trial modification based on verified income as described in Supplemental Directive 10-01, all foreclosure activity in the case must cease, even if the loan had previously been referred to foreclosure. Foreclosure activity may resume if the borrower fails to make trial modification payments.

Further, borrowers in an active chapter 7 or chapter 13 bankruptcy proceeding must be considered for HAMP if the borrower, borrower's counsel or bankruptcy trustee submits a request to the servicer. Servicers cannot object to confirmation of a chapter 13 plan, move for relief from the automatic stay, or move to dismiss the chapter 13 case on the basis that the borrower paid only the trial period plan payments rather than the scheduled mortgage payments. Borrowers in a chapter 13

[10] *See* Consumer FAQs, 2-3, *available at* http://makinghomeaffordable.gov/docs/Consumer%20FAQs%20032510%20FINAL.pdf.
[11] Supplemental Directive 10-02, Borrower Outreach and Communication, available at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd1002.pdf.

case who are determined eligible for HAMP may be converted to a permanent modification without completing a trial period plan.

These changes will broaden access to HAMP, make it more likely that proper HAMP reviews are completed, and reduce the risk that a home is sold in foreclosure without a HAMP review. Most importantly, the new rules preventing foreclosure referrals before HAMP review for all HAMP servicer participants establishes the principle that evaluation for an appropriate loan modification is a proper prerequisite to foreclosure. Loan modifications provided prior to the commencement of foreclosure are more affordable to homeowners, because all foreclosure-related fees and costs would otherwise be capitalized into the loan principal for the modified loan, and they can save investors money as well. Moreover, homeowners trying to obtain modifications during foreclosure receive confusing, seemingly contradictory correspondence from the servicer and the foreclosure attorney, and in too many instances find that their home has been sold before the modification analysis has been completed, and hopefully these new measures will help prevent those situations from arising.

In November 2009, NCLC and NACA informally surveyed NACA members about the prevalence of foreclosure sales in violation of HAMP.[12] Almost 95% of the 113 consumer advocates[13] responding from over 24 states[14] represented homeowners in cases where the servicer attempted to proceed with a foreclosure sale without a completed HAMP review. Nearly 50% of the respondents represented 10 or more households in this situation.[15]

---

[12] http://www.consumerlaw.org/issues/foreclosure/content/NCLC-NACA-Foreclosure-Sale-Survey-ResultsJan2010.pdf.
[13] 40% of the survey participants responded on behalf of an office; 60% responded on individual experience.
[14] AL, AZ, CA, CO, DC, FL, IL, IN, IA, LA, MD, MA, MI, MN, MS, MO, NV, NJ, NY, NC, OH, PA, SC, and VA.
[15] 113 NACA members from 24 states participated in the survey.

While homeowners already in foreclosure who are eligible to be evaluated for HAMP cannot avail themselves of a foreclosure stop during a HAMP review, those obtaining trial modifications based on verified income will be able to secure a stop to the entire foreclosure process. Nevertheless, over 2 million households currently face foreclosure[16] and many still will face the costs, confusion and potential wrongful sale of the family home prior to completion of the trial modification review.

This announcement also addresses the failure of servicers to provide HAMP modifications to homeowners in bankruptcy, despite their discretion to do so. The addition of a mandatory requirement to provide HAMP access to bankruptcy debtors highlights the limited utility of incentives. The evidence from HAMP to date, along with other information about the structure of the servicing market discussed below, strongly suggests that voluntary, incentive-based programs will not work. As the Administration has recognized with respect to borrowers in bankruptcy, servicers respond most effectively to mandates.

The additional guidance regarding borrower communication and communications between a servicer and a foreclosure attorney provided by Supplemental Directive 10-02 is welcome. To date, servicer outreach to homeowners has been inconsistent and often ineffective. Servicer communications with foreclosure attorneys are mostly computerized and often lack the level of detail and safeguards to ensure that homeowners have been reviewed for HAMP or any loss mitigation prior to foreclosure. Whether this guidance is sufficiently clear and enforceable to remedy these failures remains to be seen.

[16] Mortgage Bankers Association, National Delinquency Survey, Feb. 19, 2010.

B. Unemployed Homeowners

Unemployment figures remain high. According to the Bureau of Labor Statistics, the current rate of unemployment is 9.7%.[17] Historically, periods of very high unemployment were accompanied by essentially flat foreclosure figures, with only a modest increase in delinquency levels.[18] The combination of high rates of foreclosures and persistently high unemployment presents a challenge not seen since the Great Depression and requires similarly paradigm-shifting proposals.

The temporary assistance for unemployed homeowners announced on March 26 aims to reduce mortgage payments to 31 percent of current monthly income (such as unemployment insurance) or less through a forbearance plan for all borrowers otherwise eligible under HAMP. This plan, available to homeowners who seek assistance within the first 90 days of delinquency, will be available for at least three months and up to six months where available under investor agreements and regulatory guidelines. At the end of the assistance period, borrowers who are re-employed and whose mortgage payment is greater than 31 percent of their monthly income must be considered for HAMP. At that point, unemployment insurance no longer will be included in HAMP's qualification process. Homeowners who do not obtain re-employment at the end of the temporary assistance period will be routed to a path for surrendering homeownership under HAFA, where a short sale or deed in lieu of foreclosure may be available, along with minimal moving expenses.[19]

---

[17] Press Release, The Employment Situation—March 2010, Bureau of Labor Statistic (Apr. 2, 2010), *available at* http://www.bls.gov/news.release/pdf/empsit.pdf.

[18] Testimony of Julia Gordon, Center for Responsible Lending, Before the U.S. House of Representatives, Committee on Oversight and Government Reform, Subcommittee on Domestic Policy, "*Foreclosures Continue: What Needs to Change in the Government Response?*" (Feb. 25, 2010) (citing statistics from the Mortgage Banker's Association National Delinquency Survey and the Bureau of Labor Statistics).

[19] This testimony focuses on the announced measures that aim to save homes. Short-sales and deeds-in-lieu are often touted as providing a "soft" landing for homeowners. Even under the Administration's enhanced payment standards, short sales and deeds-in-lieu continue to offer more benefit to investors—who save significantly on foreclosure costs—than homeowners, who suffer loss of their home, impaired credit, and, under the Administration's plan, are required to

While the proposal recognizes the importance of unemployment to the current rate of foreclosures, it is unlikely to provide adequate assistance to many unemployed homeowners. For most, it will not cover their likely period of unemployment. The median length of unemployment in March 2010 was 20 weeks,[20] eight weeks longer than the baseline time frame for the Administration's program. Half of all unemployed workers are unemployed for even longer before they re-gain employment. While some of these homeowners might benefit from six months of forbearance, that amount of coverage is not mandated and is dependent on investor approval. Servicers routinely use investor non-participation as the basis for denying HAMP participation to borrowers without providing any supporting documentation whatsoever; nothing in the current proposal encourages servicers to be more straightforward and careful in determining investor restrictions under this new proposal.[21]

The program's forbearance approach also does not reflect the financial reality of many who are unemployed. The forbearance itself will raise a homeowner's debt during this period of assistance. The difference between the homeowner's reduced monthly payment and regular monthly payment during the forbearance period will be immediately capitalized at the end of the assistance period, thus increasing the homeowner's debt and decreasing the chances that a homeowner will qualify for a HAMP modification, even if the homeowner has re-gained employment.

While a three month forbearance, or six month forbearance, will help some homeowners stay in their homes, many will need more assistance. The Administration has announced grants totaling no more than $2.1 billion that will be targeted to state-designed programs to relieve foreclosures in 10

---

continue making mortgage payments while the servicer negotiates the terms of the short sale or deed-in-lieu. Many homeowners would be able to achieve a softer landing for themselves by saving their mortgage payments for the duration of the foreclosure and then moving than agreeing to one of the Administration's foreclosure alternatives.

[20] Economic News Release, Table A-12: Unemployed persons by duration of unemployment, Bureau of Labor Statistics (Apr. 2, 2010), *available at* http://www.bls.gov/news.release/empsit.t12.htm.

[21] While Supplemental Directive 10-02 requires servicers to turn over investor participation information for compliance purposes, it does not require any information to be shared with homeowners.

states.[22] Even though these grants will help some unemployed homeowners facing foreclosure, many states and whole regions are not eligible for the targeted grants, nor is it clear that the funds allotted will cover the need in the targeted states.

Historically, the most successful assistance for unemployed homeowners has been a bridge loan program. The program most often discussed is the Homeowners' Emergency Mortgage Assistance Program in Pennsylvania. The program provides up to two years of assistance with mortgage payments or a maximum of $60,000.00, whichever comes first. When unemployment averages 6.5% or above for three months, assistance may be extended to three years. HEMAP loan recipients pay at least $25 a month and up to 40 percent of their net monthly income, as determined by HEMAP, towards their total housing expense. The difference between the regular monthly payment and the payments made by the homeowner accrue in an interest-free loan. Homeowners are obligated to make payments on their loan once their monthly income rises such that their housing expenses are less than 40 percent of their income, at which time interest will begin accruing on the loan. Upon sale or refinancing of the home, the entire loan must be paid in full. During HEMAP's existence, the amount repaid, with interest, has exceeded appropriations.

The Administration should promote similar bridge loan-style programs, both through the existing state grants and through the use of TARP money. The Administration could use TARP money to establish its own bridge loan program, where a person pays 31% of their income, as under HAMP, and the loan pays the rest for up to two years. The loan would be paid back when the mortgage is paid off, as is done with HUD partial claims.

[22] Press Release, U.S. Dept. of Treasury, Making Home Affordable, Administration Announces Second Round of Assistance for Hardest-Hit Housing Markets (Mar. 29, 2010), *available at* http://www.makinghomeaffordable.gov/pr_03292010.html.

C. Principal Reduction

The Administration's proposal to promote principal reductions has two components, one within HAMP and the other through FHA, discussed below. Under HAMP, servicers will be required to consider (although they will not be required to provide) principal reductions to HAMP-eligible borrowers who owe more than 115 percent of the current value of the home. Servicers will be required to run two NPV tests: the standard waterfall model; and one that places principal reduction first in the waterfall. If the NPV is higher under the alternative approach, servicers will have the option of using it as the basis for a loan modification.

The program starts by assuming principal forbearance, not reduction. The forborne amount then would be written down in three equal portions over three years, as long as the borrower remains current on modified payments. Furthermore, no principal reduction would be available at all unless second lien principal reductions are provided in conjunction with the first lien adjustments (Treasury is increasing incentive payments for its second lien program in an effort to promote such action). Second liens that are greater than six months delinquent, regardless of loan-to-value ratio ("LTV"), will be paid at the rate of six cents on the dollar; others will be paid in a range between ten and 21 cents on the dollar, depending on LTV.[23] For borrowers who are current on permanent or trial modifications at the time this new program becomes operational, servicers will be required to re-run the NPV analysis, using the new two-step framework. Servicers will not, however, be required to offer principal reduction, regardless of the results of the NPV analysis.

---

[23] Addressing second liens is a critical piece of the puzzle in promoting affordable modifications. There is limited transparency and participation in the HAMP second lien program, which undermines its effectiveness. Moreover, eligibility needs to be expanded for modifications where the first and second lien payments together are greater than 31% of the borrower's income.

Servicers may choose to offer a principal reduction, as indeed servicers have been authorized to do from the beginning of HAMP. Potentially, the new two-step NPV analysis may produce more positive results than the earlier one-step NPV analysis. However, program experience to date and the general structure of the servicing industry give little cause for optimism that the voluntary, two-step procedure will result in greater use of principal reductions, even with modest servicer payments for doing so.

First, even the simpler, one-step NPV analysis currently in use has been the subject of criticism for lack of transparency by SIG TARP, servicers, and consumer advocates. Homeowners, attorneys and counselors nationwide report widespread failure to use the NPV model correctly, ranging from not running the NPV analysis at all to inputting incorrect information, including income, property location, and amount of the unpaid principal balance into the NPV model. SIG TARP, in its recent report, details multiple problems with implementation of the existing model, including widespread confusion among servicers as to how to use the model and problems with the underlying code in the model.

Second, these implementation challenges are magnified by the lack of transparency and accountability endemic in the HAMP program. The NPV test remains unavailable to the public. This means both that the entire model is immune from review by outside evaluators and those homeowners seeking modifications are unable to verify that the NPV model was applied correctly. While certain NPV inputs are available to homeowners who ask for them after a HAMP denial, this system is inefficient, time-consuming and less likely to lead to the proper flow of information due to the burden on the homeowner and the short timeline involved. Moreover, significant inputs, including home valuation, are not automatically made available to homeowners under Treasury's guidance, which means that only homeowners already embroiled in litigation with their servicers are able to ascertain and correct those errors in the servicer's inputs.

Third, the new program assumes that principal reductions that provide for higher NPV values will result in servicers voluntarily opting to adopt the forbearance/reduction modification model (and accept incentives for doing so). Yet, servicers previously had the option to providing NPV-positive modifications to homeowners in bankruptcy and to be paid for doing so, and generally they did not pursue this path. As discussed below, servicers do not necessarily profit more from providing NPV-positive modifications over pursuing foreclosure. Indeed, because a principal reduction will result in a hit to the servicer's largest source of income, the monthly servicing fee, servicers have a strong incentive to avoid principal reductions. Modest incentives are unlikely to change this picture.

Servicers have not heretofore been willing to make NPV-positive modifications—modifications that, by definition, should return more to investors than pursuing a foreclosure. Nor have investors heretofore shown much, if any, interest, in forcing servicers to pursue NPV-positive modifications. Investors have little direct authority over servicers, receive virtually no usable data on modifications, and suffer from their own competing interests, as between different investor classes and as between a modification with reduced payments or a foreclosure with certain costs.

The new principal reduction approach (which will not even be implemented until close to the end of this calendar year) is unlikely to coax many servicers into reducing principal. Where servicers do adopt this approach, lack of transparency will make it impossible for homeowners to advocate for principal reduction opportunities on their own loans and indeed Treasury has, so far, actively discouraged homeowners from doing so.

D. FHA Program Option

The recently announced FHA-based program provides further options for homeowners who are current on their mortgage but who owe more on their loan than the home is worth. Qualifying refinancings will reduce the amount owed on the first lien by at least 10 percent to an LTV of no more than 97.75 percent, while limiting all mortgage debt to no more than 115 percent of the current value of the home, thus requiring write-downs of many second liens. Because this option is only available for homeowners who are current on their mortgage, homeowners with unsustainable mortgage payments will receive no assistance.

This new program improves upon the FHA's Hope for Homeowners program by permitting lower FICO score, taking a more streamlined approach to paying down second liens, and by avoiding the complexities and mixed incentives of shared appreciation. Yet the new program still suffers from the same fatal flaw: a misguided belief that servicers will voluntarily do the right thing and agree to principal reductions. Moreover, in the existing credit climate, it is not clear that there will be new lenders willing to refinance these high LTV loans.

IV. Servicers' Lack of Alignment with the Interests of Investors or Homeowners Contributes to the Failure to Do More Loan Modifications.

Servicers' interests often do not align with those of investors or homeowners. Servicers, unlike investors or homeowners, do not necessarily lose money on a foreclosure. Nor do the large servicers currently have any difficulty replacing servicing rights lost to foreclosure at attractive prices.[24] The result is that servicers are often indifferent at best as to whether a delinquency ends in a modification or foreclosure. Until this situation is addressed more directly, loss mitigation will favor the interests of servicers over those of homeowners and investors.

A. Servicers Have Different Interests Than Investors.

Servicers are not investors. Investors hold the note, or a beneficial interest in it, and are, in general, entitled to repayment of the interest and principal. Servicers collect the payments from the homeowners on behalf of the investors. The bulk of their income comes from a percentage payment on the outstanding principal balance in the pool; the bulk of their net worth is tied to the value of the mortgage servicing rights they purchased. A servicer may or may not lose money—or lose it in the same amounts or on the same scale—when an investor loses money. And it is servicers, not investors, who are making the day-to-day, on the ground, decisions as to whether or not to modify any given loan.

Investors do stand to lose money, at least collectively, when there is a foreclosure. The available data suggests that investors lose ten times more on foreclosures than they do on modifications.[25] In particular, leading investor groups have advocated broader use of principal reductions as part of the anti-foreclosure arsenal, but only a handful of servicers have obliged.[26]

[24] Jeff Horwitz, *Mortgage Sellers Are Fed Up with Megaservicers' Oligopoly*, Am. Banker, Apr. 9, 2010.
[25] "Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?" Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 111th Cong. (2009) (testimony of Alan M. White).
[26] "Preserving Homeownership: Progress Needed to Prevent Foreclosures," Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs, 111th Cong. (July 16, 2009) (testimony of Curtis Glovier, on behalf of the Mortgage Investors Coalition).

Servicers, on the other hand, are entitled to repayment of all their expenses off the top when there is a foreclosure,[27] while recovery of their costs in a modification is much less clear.[28] Worse, performing large numbers of loan modifications would cost servicers upfront money in fixed overhead costs, including staffing and physical infrastructure. Creating affordable and sustainable loan modifications for distressed homeowners on a loan-by-loan basis is labor intensive.[29] Under many current pooling and servicing agreements, additional labor costs incurred by servicers engaged in this process are not compensated by the loan owner. By contrast, servicers' costs in pursuing a foreclosure are compensated. Under this cost and incentive structure, it is no surprise that servicers continue to push homeowners into less labor-intensive repayment plans, non-HAMP loan modifications, or foreclosure.

B. Servicers' Business Model Involves As Little Service As Possible.

As with all businesses, servicers add more to their bottom line to the extent that they can cut costs.[30] Servicers have cut costs by relying more on voicemail systems and less on people to assist homeowners, by refusing to respond to homeowners' inquires, and by failing to resolve borrower disputes. Servicers sometimes actively discourage homeowners from attempting to resolve matters.

[27] *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K), at 4 (Mar. 17, 2008) (advances are "top of the waterfall" in a foreclosure and get paid first); Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sep. 10, 2009) (same.

[28] American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 1 (June 18, 2009).

[29] Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 7(Oct. 3, 2007), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

[30] *See* Joseph R. Mason, Servicer Reporting Can Do More for Modification than Government Subsidies 17 (Mar. 16, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361331(noting that "servicers' contribution to corporate profits is often . . . tied to their ability to keep operating costs low").

As one attorney in Michigan attempting to arrange a short sale with Litton reported, the voice mail warned, "If you leave more than one message, you will be put at the end of the list of people we call back."

Servicers, despite their name, are not set up to perform or to provide services.[31] They are set up to accept payments from the borrower and distribute those payments—to the insurance company or taxing authority, in case of escrow payments, or to a trustee for distribution to investors, in the case of principal and interest payments. The receipt and distribution of payments is largely automated, with accounting functions delegated to software programs.[32] In general, interaction with borrowers is minimal and discouraged.

Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate.[33] As a result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed to address the current foreclosure crisis. Instead homeowners are being pushed into short-term modifications and unaffordable repayment plans.

---

[31] *Cf.* Joe Nocera, *Talking Business; From Treasury to Banks, An Ultimatum on Mortgage Relief*, N.Y. Times, July 11, 2009 (characterizing work of servicers as "relatively simple" whose default servicing consisted largely of either "prodd[ing] people" to pay or "initiat[ing] foreclosure").

[32] *See In re* Taylor, 407 B.R. 618 (Bankr. E.D. Pa. 2009) (describing the extreme reliance on a computer system to perform the servicing, to the point that the computer system was personified by the actual living employees of the servicer).

[33] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities* 9-10 (Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs Working Paper No. 2008-46); State Foreclosure Prevention Working Group, Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3 at 8 (2008), http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf; Preston DuFauchard, California Department of Corporations, Loss Mitigation Survey Results 4 (Dec. 11, 2007); *cf.* Aashish Marfatia, Moody's, U.S. Subprime Market Update November 2007 at 3 (2008) (expressing concern as to servicers' abilities to meet staffing needs).

C. Servicers Maximize Income in Ways that Hurt Both Homeowners and Investors.

In the interest of maximizing profits, servicers have engaged in a laundry list of bad behaviors, which have considerably exacerbated foreclosure rates, to the detriment of both investors and homeowners.[34]

Most pooling and servicing agreements permit servicers to retain fees charged to delinquent homeowners and to collect those fees post-foreclosure before the investors receive any recovery.[35] Examples of these fees include late fees[36] and fees for "default management" such as property inspections.[37]

The profitability of these fees can be significant.[38] Late fees alone constitute a significant fraction of many subprime servicers' total income and profit.[39] Worse, the very presence of these fees may later

---

[34] *See* National Consumer Law Center, Foreclosures, Ch. 6 (2d ed. 2007 & Supp.) (describing the most common mortgage servicing abuses).

[35] See, e.g., Prospectus Supplement, Chase Funding Loan Acquisition Trust, Mortgage Loan Asset-Backed Certificates, Series 2004-AQ1, at 34, (June 24, 2004), available at http://www.sec.gov/Archives/edgar/data/825309/000095011604003012/four24b5.txt ("[T]he Servicer will be entitled to deduct from related liquidation proceeds all expenses reasonably incurred in attempting to recover amounts due on defaulted loans and not yet repaid, including payments to senior lienholders, legal fees and costs of legal action, real estate taxes and maintenance and preservation expenses.").

[36] See, e.g., Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005-J12, Issuer 56 (Oct. 25, 2005) ("In addition, generally the master servicer or a sub-servicer will retain all prepayment charges, assumption fees and late payment charges, to the extent collected from mortgagors).

[37] See, e.g., ., Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007-FLX5, at S-73 (June 27, 2007):

> **Default Management Services**
>
> In connection with the servicing of defaulted Mortgage Loans, the Servicer may perform certain default management and other similar services (including, but not limited to, appraisal services) and may act as a broker in the sale of mortgaged properties related to those Mortgage Loans. The Servicer will be entitled to reasonable compensation for providing those services, in addition to the servicing compensation described in this prospectus supplement.

[38] *See In re Stewart*, 391 B.R. 327, 343, n.34 (Bankr. E.D. La. 2008) ("While a $15.00 inspection charge might be minor in an individual case, if the 7.7 million home mortgage loans Wells Fargo services are inspected just once per year, the revenue generated will exceed $115,000,000.00."), *aff'd*, 2009 WL 2448054 (E.D. La. Aug. 7, 2009).

[39] *See, e.g.*, Ocwen Fin. Corp., Annual Report (Form 10-K), at 34 (Mar. 12, 2009). (revenue from late charges reported as $46 million in 2008 and made up almost 18% of Ocwen's 2008 servicing income); Gretchen Morgenson,

make a modification unaffordable to the homeowner.[40] Neither homeowners nor investors profit from the imposition of these fees, but servicers do.

D. Servicers Have Disincentives to Perform Principal Reductions, Even When Doing So Would Benefit the Trust

Some servicers, notably Ocwen, have made some principal reductions. But other servicers—including those who are also major lenders—have not. In part, this represents nothing more than experience: Ocwen has more experience modifying loans than many other servicers. In part, it reflects the varying incentives servicers have weighing against loan modifications.

Of key importance is whether or not the loss of a principal reduction is recognized immediately or if it is delayed. Most PSAs are silent on the treatment of principal reductions or forbearance.[41] If recognition of the loss is immediate, servicers face reduced income in two ways, their monthly servicing fee and income from any subordinate tranches. Because recognition of the loss is not delayed, servicers are unlikely to be neutral or even positive towards principal reductions.[42] This

Dubious Fees Hit Borrowers in Foreclosures (Nov. 6, 2007) (reporting that Countrywide received $285 million in revenue from late fees in 2006).

[40] *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* 87 Tex. L. Rev. 121 (2008) (reporting that servicers appear to be imposing often improper default-related fees on borrowers in bankruptcy proceedings). Under the Department of the Treasury's Home Affordable Modification Program, servicers are required to waive unpaid late fees for eligible borrowers, but all other foreclosure related fees, including, presumably, paid late fees, remain recoverable and are capitalized as part of the new principal amount of the modified loan. *See* Home Affordable Modification Program, Supplemental Directive 09-01 (Apr. 6, 2009).

[41] *See* American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 1 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

[42] *See generally* American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions (June 18, 2009), available at http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf (discussing impact of accounting for principal forbearance).

accounting nicety accounts, in part, some industry analysts believe, for the high rate of loan modifications with principal reductions performed by Ocwen in 2007.[43]

Worse, servicer's largest source of income is the monthly servicing fee. The monthly servicing fee is set as a percentage of the outstanding loan principal balance in the pool. Once a principal write down is recognized, the outstanding principal balance of the pool declines and so does the servicer's monthly fee, permanently.

Servicers will also take a hit against their residual income if the loss is recognized immediately. Commonly, servicers also derive some income from the lowest level investment interests in the pool, called residuals.[44] Residuals represent payment of the surplus income after the senior certificate holders have been paid. If the pool shrinks, through foreclosure, prepayment, or principal reduction, or the interest rate drops on the loans in the pool due to modifications, there will be less of a surplus, and the servicer will suffer a loss. Once a pool suffers a certain level of loss, further payments out of residual income are cut off. If the loss is recognized immediately, the subordinate tranches in most cases bear the entire cost.[45] Since industry practice, despite the silence in the PSAs,

---

[43] Ocwen was apparently not recognizing the loss immediately, and thus shifting more of the pain to senior bond holders and away from the subordinate tranches. Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 7-8 (2008).

[44] *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K), at 20 (Mar. 17, 2008); Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 8 (Oct. 2007) (servicers who own residual interests always lose money when loans are modified). In some cases, the servicer may even bet against itself, by purchasing a credit default swap on the pool, in which case it makes money if there is a foreclosure. *See* Patricia A. McCoy & Elizabeth Renuart, The Legal Infrastructure of Subprime and Nontraditional Home Mortgages 36 (2008), *available at* http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit

[45] *See* American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 3-6 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

has now moved towards recognizing the principal write down as an immediate loss, many servicers may be doubly reluctant to write down principal, regardless of the investors' desires.[46]

V. The Core HAMP Program Still Needs Substantial Revision

While the Administration has taken laudable steps to standardize loan modification procedures, HAMP still needs substantial program improvements. We recommend the following changes to HAMP:

1. Increase HAMP Transparency. Servicers routinely deny HAMP modifications for what appear to be arbitrary or unfounded reasons. Recent guidance requiring notice to borrowers is some progress, but does not provide sufficient detail to enable homeowners to evaluate the legitimacy of denials. Some servicers consistently disregard existing notice rules. Fundamentally, the HAMP program itself wholly lacks accountability for servicers; servicers routinely assert that they are not required to follow HAMP guidelines or offer HAMP modifications, even to qualified borrowers. It is essential that the Administration:

a. Make public the net present value ("NPV") test used by servicers. The NPV model must be accessible to homeowners and advocates in order to determine whether the servicer used the test accurately in denying a HAMP modification. Without access to the NPV analysis, including all inputs used by the servicer, homeowners are entirely reliant on the servicer's good faith.

b. Require that servicers issuing HAMP denials provide more detailed information. When the basis of denial is a failure of the NPV test, all NPV inputs and outputs must be provided as part of the initial denial letter. Key investor information should be provided where that is the basis of the

---

[46] *See* Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 7-8 (2008).

turndown. Basic information including the investor or guarantor's name, identification of the controlling documents, and a summary of efforts taken to secure investor approval for the proposed loan modification specifically and participation in HAMP generally should be provided in each relevant denial notice.

c. Establish a formal appeals process. Homeowners need recourse beyond the servicer. The Administration must institute a formal appeals process by an independent government entity for borrowers who believe their HAMP application was not handled properly. The current Freddie Mac compliance process does not effectively address individual complaints; the escalation process available through either the HOPE hotline or escalations@hmpadmin.com provides little more, in our experience, than a restatement of the initial denial. In order for HAMP to be effective, homeowners must be able to seek and obtain redress when a servicer has failed to comply with the Supplemental Directives.

d. Make loan level data available to the public, including data for fair lending analysis. A core component of any government program is public accountability. To date, no raw data has been made available for independent analysis. The availability of such information will allow researchers to review the reach and affects of the program, and will give community advocates a means to examine the role of HAMP in their areas. No analysis of this sort is complete without a fair lending analysis; it is essential that the Administration ensure that the program is subject to robust review.

2. Change the terms of the trial modification program to mitigate adverse effects on homeowners. Homeowners are left worse off after entering into a trial modification. The reporting of payments under trial modifications means that even homeowners who are current upon entering a trial modification and make every trial modification payment in full and on time, still emerge with a negative mark against their credit, which can result in lost jobs and rental housing, as well as higher-priced credit. Moreover, since the trial modification payments are by definition less than the full contract payment under the mortgage, and the terms of the mortgage are not altered during the trial modification, homeowners finish a trial modification owing more on their homes than when they started. We have seen servicers use these arrears, accumulated during the trial modification, as the basis for initiating a foreclosure against a homeowner, post-trial modification. The Administration should:

a. Require that trial modification payments be applied to principal and interest as specified under the permanent modification. Treasury has already recognized the harm that can be done by servicer delay in requiring any arrearages accumulated between the official end of the trial modification and the beginning of the permanent modification to be treated as principal forbearance. Treasury should go further and specify that all payments made during the duration of the trial modification be applied, retroactively if necessary, to principal and interest as specified under the terms of the permanent modification.

b. Convert homeowners who make three on-time trial modification payments automatically to permanent modifications. Servicer delays in converting trial modifications to permanent modifications are unacceptable. They increase costs to homeowners and create significant periods of uncertainty. An automatic conversion would address those problems.

c. Allow homeowners who fail a trial modification an opportunity to pay back the arrears through regular monthly installments consistent with an affordable payment. No lump sum payment should be required.

3. Designate Treasury official(s) for assistance with Court or other required mediation cases. Court-supervised mortgage mediation programs help borrowers and servicers find outcomes that benefit homeowners, communities and investors. Servicers, however, often do not negotiate in good faith, even with a mediator present. For example, representatives of servicers often attend mediations without the necessary authority to provide a modification, without any information about the matter at all and without any consideration of HAMP. Moreover, many judges and mediators often have questions regarding HAMP and seek input from counsel. For those communities with mediation programs, Treasury should designate an official or officials to provide assistance to mediators to ensure that HAMP is properly considered in mediation sessions, answer questions, and serve as a point of contact for escalated disputes. Designating a Treasury Department contact for such inquiries would substantially assist public officials seeking to interpret HAMP.

4. **Expand HAMP eligibility and coverage.** HAMP must recognize the realities of re-default and the limits of its program and revise its guidelines accordingly. The Administration should:

a. Provide additional modifications for certain homeowners with unforeseeable future drops in income. Many homeowners who receive HAMP loan modifications will suffer subsequent drops in income through no fault of their own. Under current HAMP policy, these homeowners are precluded from applying for a new loan modification. This policy should be changed for borrowers with involuntary reductions in income, such as unemployment, divorce or death of a co-borrower, or increases in expenses such as medical debt.

b. Establish a revised analysis of affordability for homeowners with interest-only and option ARMs. For interest-only and option ARMs, current payments do not reflect the long-term affordability of the loan. An evaluation should be made using a fully amortizing payment, calculated at the interest rate currently being assessed on the mortgage loan, regardless of when the payments will reset under the loan terms. Determination of affordability should not be made on the basis of a negatively amortizing, minimum payment.

c. Provide modifications for homeowners with unaffordable payments, even when the first mortgage payment is 31% or less of current income. Second mortgages or high medical debt can render a first mortgage payment of 31% or less unaffordable. Homeowners' actual, reasonable living expenses may mean that 31% is not, in fact, a sustainable and affordable payment when the total dollars available are quite low. Treasury should require and subsidize modifications below 31% where the homeowner has low residual income or high fixed expenses.

VI. Conclusion

Thank you for the opportunity to testify before the Subcommittee today. The foreclosure crisis is continuing to grow. Despite recently announced enhancements to the HAMP program, the program still lacks fundamental transparency and accountability. Further program changes also are needed to enable the program to reach many more homeowners who can benefit from the program. In addition, it is clear that HAMP can not do the job on its own and thus additional steps that do not rely on voluntary measures by the mortgage industry are in order.

Congress should pass legislation to mandate loan modification offers to qualified homeowners prior to foreclosure where the modification is consistent with net present value, and also should allow bankruptcy judges to modify home loans in bankruptcy. Congress also should ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined with a burdensome tax bill and should fund qualify mediation programs. Further, it should pursue further reform of the servicing industry and pass strong legislation prohibiting the abusive mortgage lending practices that precipitated today's economic crisis. Finally, Congress should establish an independent Consumer Financial Protection Agency that can establish strong rules to govern the market. We appreciate the Committee's interest in these pressing matters and look forward to working with you to address the challenges that face our nation's communities.

TESTIMONY OF

VINCENT FIORILLO
DOUBLELINE CAPITAL LP

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS

BEFORE THE

SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT
OF THE
HOUSE COMMITTEE ON FINANCIAL SERVICES

APRIL 14, 2010

Introduction
Chairwoman Waters, Ranking Member Capito, thank you for inviting me to testify today. My name is Vincent Fiorillo and I am a part of the Mortgage-Backed Security Portfolio Management and Trading Department at Doubleline Capital in Los Angeles, California. I am testifying today in my capacity as a member of the Association of Mortgage Investors, a trade group organized to develop investor consensus on current public policy initiatives and to provide policy makers with the mortgage investor's point of view.

Allow me to start, Chairwoman Waters, by commending you, Ranking Member Capito, Chairman Frank, Ranking Member Bachus and the other members of the Financial Services Committee for your leadership in pursuing responsible and effective programs to help keep Americans in their homes, even before the financial crisis.

The Association of Mortgage Investors shares your frustration with the slow pace of efforts to provide homeowners and the entire housing market with meaningful and permanent relief. We are hopeful that substantial relief can be implemented more effectively and quickly. The Association believes that an effective solution is one that addresses the needs of homeowners with unsustainable mortgages that exceed their home's value. In short, we support a mortgage refinance program designed to help homeowners stay in their homes and rebuild equity.

My testimony today represents the views of the Association of Mortgage Investors. Our members are entrusted to make investment decisions on behalf of charitable institutions, endowments, foundations, universities, mutual funds, as well as hedge funds and sovereign wealth funds.

The Association of Mortgage Investors aims to play a primary role in the analysis, development, and implementation of mortgage and housing policy that keep homeowners in their homes and provide a sound framework that promotes continued home purchasing.

My Background
I have spent nearly 35 years working in the mortgage-finance industry and have a broad experience working across product types and for various clients. Over my career, I have seen the mortgage market and, in particular, the mortgage securities market, from the perspective of investors (the "buy side") and from the perspective of brokers and issuers (the "sell side").

It is important to recognize that mortgage finance has been instrumental in reducing housing costs and helping citizens achieve the American dream of homeownership. When I first began working in this industry in the 1970s, the mortgage finance industry was in its infancy. In fact, the market consisted solely of two products – those backed by Ginnie Mae and Freddie Mac.

The advent of the mortgage-backed securities market resulted in de-regionalizing or nationalizing real estate investment risk, increasing liquidity to mortgage originators, and lowering barriers to home ownership. Securitization was a key factor in improving regional real estate markets. New York State is a case in point. In the 1970s, most New York depositories were flush with cash but had a hard interest rate limit on mortgages. This resulted in a flow of California mortgages to New York and a flow of dollars to California. New York was an unattractive and non competitive local market. With securitization, the New York market became national and mortgage funds were more readily available. Since the 1970s, mortgage backed securities have increased lending levels, with even state housing agencies benefiting from the mortgage securities structuring techniques.

The Role of Mortgage Investors in the Marketplace

The maintenance of a healthy securitization market is a vital source of private capital for mortgages as well as autos and credit cards. Moreover, an efficient securitization market provides more and cheaper capital to originators, which allows them to issue more loans to additional borrowers. The use of mortgage-backed securities equitably distributes risk in the mortgage finance industry, and prevents a build-up of a specific geographic region risk or type of underlying asset. These features, and many others, are those of a market which makes access to capital cheaper and thus spurs more mortgage lending. Without a responsible and viable securities market, home ownership will be an unfulfilled dream of many more people.

Today's mortgage market consists of approximately $11 trillion in outstanding mortgages. Of that $11 trillion, $5.4 trillion are held on the books of the GSE's as agency mortgage-backed securities (issued by one of the agencies) or in whole loan form. Another $3.6 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which $1.1 trillion are second liens (home equity loans/lines of credit or closed end second mortgages). Of the $1.1 trillion outstanding second mortgages, only 3.7% of the total (or $41 billion) is held by private investors in securitized form. The remaining $1.8 trillion in first lien mortgages reside in private label mortgage-backed securities.

Those "private label" (non-Federal agency) securities are put together by investment banks that pool the mortgages into a trust. That trust is built around a document called a Pooling and Servicing Agreement that provides investors the rights and protections relating to the mortgages that make up the securitization and the terms and duties that are owed to the investors by the trustee of the security and the servicer of the individual mortgages. Within this Agreement, there are numerous representations and warranties regarding the quality of the mortgages that are included in the trust and the lending practices that were followed in the mortgage origination process.

It is important to note that, historically, investment in these mortgage products has been appropriate, in part, because they are governed by binding contracts that lead to the stability and predictability investors desire. Like any purchaser, investors expected the sellers of mortgage securities (which were often large banks) to stand behind their promises. Unfortunately, in the current environment, this critical component of mortgage securities market seems to have broken down.

Problems Causing Increased Foreclosures

While the Administration's HAMP was delayed in implementation and the number of permanent modifications does not appear to be on track to meet its stated goals, there were several specific issues that impacted investors' interests.

Income Documentation Problems

The current mortgage modification program has trial loan modifications for homeowners under the HAMP program that were permitted without any verification of the income stated on the modification application. This policy will change in June, and while investors applaud the new policy requiring income verification prior to the start of a trial modification, extending a trial modification without any proof of ability to pay resulted in many trial modifications that were doomed to fail from the outset. This lack of documentation has made it extremely difficult to convert trial modifications to permanent modifications. We believe the recent change in policy requiring all documentation prior to a trial modification will lead to a higher yield of trial to permanent modifications. However, the HAMP gave some borrowers a false sense of optimism and may result in them being forced to sell homes at lower prices than they may have received one year ago.

Furthermore, the calculations used to evaluate a borrower's application do not factor in the borrower's home equity loan, second lien or other non-mortgage debts to the payment calculation. Such an approach lacks the holistic view needed to ensure that a borrower has an actual ability to pay a modified mortgage, and again is likely to lead to a redefault in the near future.

In fact, the most recent report on the current HAMP program underscores this difficulty. Of the nearly 170,000 successful permanent modifications, half of them are saddled with extraordinary amounts of total debt service with the median level of total debt to income (pre-tax) being 58.9 percent. This leaves very little room to pay for other necessities including food, clothing, and transportation and will likely lead to a future default. As such, we're delaying the problem instead of creating a permanent fix.

Second Liens Issue

The major impediment to the viability of the program is the servicing conflicts that exist when servicers hold second lien mortgages. There is significant uncertainty as to how those second liens will be handled under the program. Traditionally, there is no such uncertainty because first lien mortgage holders had a clear understanding of their priority status over second liens. The second lien problem exists because many banks and their affiliated servicers offered additional forms of financing to consumers, such as home equity loans and other second mortgages. The vast majority remain on the balance sheets of our nation's largest financial institutions and these second mortgages are a major financial burden for homeowners.

In fact, the four banks that service approximately 40 percent of mortgages held roughly $419 billion of second liens on their balance sheets as of December 31, 2009. Under temporary loan modification programs such as Making Home Affordable, banks are able to defer the recognition of losses on the second lien portfolios. In fact, the current HAMP program actually improves the cash flow available to the second mortgage at the expense of the first mortgage and defers the immediate loss that would be recognized in a foreclosure, short sale or short refinance. Although the largest institutions have now signed up for the 2MP second lien modification program under HAMP, that one year old program has yet to be implemented.

In these negative equity scenarios, the second lien would receive no proceeds in a foreclosure action. On the other hand, the modification program allows this uncollateralized obligation to remain outstanding and on the books of the financial institution as a performing asset, even though the homeowner has no equity in their home. Our analysis of 44.1 million first lien loans from a primary credit bureau database indicated that, of all second lien mortgages, only 3 percent are current with a corresponding first lien mortgage that is delinquent.

Investors' Solutions to Foreclosure Crisis
Mortgage investors believe that any successful solution to the housing crisis must address two key components: affordability and negative equity.

Negative equity and near negative equity mortgages account for nearly 28 percent of all residential properties nationwide. There are approximately 15 million borrowers who owe more than their homes are worth. About a third of those mortgages are already in default and potentially in need of assistance.

The nation's foreclosure crisis must be solved by addressing both the problems of "ability to pay" and "willingness to pay". The interests of homeowners and mortgage investors are completely aligned. A homeowner who cannot afford his mortgage AND who owes more than his home is worth runs a very serious risk of losing the home through foreclosure. Furthermore, there is serious risk that even a homeowner who is current on their mortgage payments, but owes more than the home is worth, could leave the home instead of continuing to pay what amounts to "high interest rent" on the home. In order to provide relief to both homeowners facing possible foreclosure and the entire housing market, a program must be introduced that reduces principal to provide affordability and equity to homeowners that are underwater in their mortgage and in financial distress.

To be successful, a loan modification or principal reduction program must be designed to ensure that the risk of default is minimized. The only way to effectively accomplish this is to reduce the homeowner's overall debt to ensure that their "debt to income" ratio is sustainable. This involves reducing mortgage balances on all liens on the property, first mortgage, and other subordinate liens.

Furthermore, as provided in the Administration's recently announced FHA short refinancing program, this involves a rigorous qualification process and underwriting that ensures that the homeowner has the best chance to make their payments and stay in the home.

Mortgage investors maintain that any true relief must come from significant principal forgiveness on first and second lien mortgage debt in connection with the refinancing of the overextended homeowner into a new, low interest rate mortgage. This is a position that we have communicated to key policymakers from Capitol Hill, to the Departments of Treasury and Housing and Urban Development, and with Community Housing Advocates.

The solutions offered prior to Treasury's announcement last month failed to address the entire consumer debt burden, and overlooked entirely the impact of negative equity. While a loan modification involving principal forbearance, term extension or temporary rate reduction, as provided in the original HAMP program, may provide temporary relief, by not addressing negative equity, homeowners would be trapped in a mortgage that cannot be refinanced and a house that cannot be sold. Further, for those who seek mobility to pursue new employment opportunities, they would no longer feel "trapped" by their mortgage and would be able to sell without enduring a life-altering loss on the sale.

Administration's Newest Proposal: Principal Reduction, FHA Short Refinance
The Association of Mortgage Investors supports the framework of FHA's recent announcement to reduce principal through a refinancing program for homeowners who are "underwater" on their mortgage. This program, if properly implemented, can provide relief for qualifying homeowners and contribute to the housing market's stabilization and the economy as a whole. Successful implementation cannot be presumed, because numerous details need to be determined by the Treasury and HUD/FHA that could either minimize or increase the execution risks of the entire program. We fear that these implementation logistics could easily be overlooked.

As we have noted in our proposals for principal reduction over the last year, any market solution must involve all market participants. Everyone must share the burden. Solutions cannot be a windfall for certain stakeholders and terrible for others. In this regard, the Association agrees that taxpayer funds should not be used for principal writedowns.

In essence, the most recent Administration FHA refinancing proposal has focused on three primary principles:

- First, the qualifying homeowner must be eligible for a HAMP modification and have a mortgage that is "underwater" (where the combined loan-to-value ratio is greater than 100 percent).
- Second, the mortgage investor would agree to permanently reduce (forgive) principal necessary to get the homeowner's mortgage to a 97.75 percent loan to value (LTV) ratio, therefore "restoring equity" at the same time the borrower is refinanced into a new agency-compliant fixed rate mortgage with an agency-compliant monthly payment. Furthermore, if the property has a second lien, the combined debt of the first and second liens cannot exceed 115 percent of loan to value ratio and also cannot exceed 31 percent of the homeowner's debt to income ratio.
- Third, this is a voluntary program.

Mortgage investors have been willing to realize significant losses in existing RMBS investments to facilitate the refinancing of borrowers from distressed mortgages into newly originated fixed rate mortgages based on the current value of the property. In this proposal, the cost of reducing principal on primary mortgages held by investors would be borne by the investor.

Obstacles to Success of New Administration Proposals
The Administration's proposal is overly vague on how second and other subordinate liens will be treated under the program. For example, it is not clear whether the mortgage servicer can approve a reduction in the homeowner's first lien only to have the holder of the second lien, which is typically the parent company of the mortgage servicer, opt out of the program and thereby avoid any principal reduction.

The problem with that scenario is threefold:

- First, it will ultimately hurt the homeowner, because their total debt to income will still be excessive and the risk of default will remain clear.
- Second, it completely ignores the priority of liens and enriches the bank's second lien position at the expense of the senior first lien positions which are held by investors who represent pension funds and foundations. This situation is negative for the mortgage marketplace now and in the future because investors will be reluctant to invest in mortgages with uncertain rules that create additional risk. This risk will ultimately result in increased borrowing costs for future homebuyers.

- Third, despite the concept of FHA's refinance program having maximum benefit to homeowners and investors, we fear servicers will not implement this new program and will instead choose a modification that benefits their own interests and leaves the homeowner in a distressed financial position, likely to default in the future.

It is very difficult to see how the inherent conflicts that exist within largest financial institutions are adequately managed given their role as both servicer of the majority of investor owned mortgages and holder of the majority of second liens.

The experiences in the HAMP program suggest that management of these conflicts is inadequate. We are concerned that second lien holders will balk at participating in the new principal reduction programs, as evidenced from their reluctance to sign up and then implement the 2MP program or other obstructive aspects of the current HAMP program. These same tactics would lead to program failure.

One of the best ways to deal with moral hazard is to ensure that the homeowner actually qualifies for the new mortgage and has a greater opportunity of staying current on the new mortgage. By engaging in an FHA refinancing, the homeowner will have to qualify for the new mortgage. This involves income verification and dealing with excessive debt issues.

If policy makers believe that more needs to be done to deal with a "moral hazard" issue, mortgage investors would be happy to be a part of such dialogue.

Conclusion

Mortgage investors believe that the Administration's newly announced program for principal reduction leading to an FHA refinancing program is an important step forward. However, with the current lack of detail, investors are extremely worried that there are significant execution risks to the program that are similar to some of the experiences that we have seen in the current HAMP program. This program will need clear instruction to servicers that participation of both first and second liens in the principal reduction/refinancing program is necessary and must take priority over other options that are in the servicer's self interest, but harmful to homeowners and investors. Anything short of participation by both first and second lien holders will surely prevent the program from meeting its goals. If second or other subordinate liens are not active participants in a principal reduction program, the homeowner will remain saddled with excessive debt. Furthermore, by not respecting the priority of liens, rebuilding the mortgage market in the future will only be more difficult.

Thank you for the opportunity to share my views and those of the Association of Mortgage Investors with the subcommittee.

I welcome any questions that you might have.

Testimony of Andrew Jakabovics, Associate Director for Housing and Economics, Center for American Progress Action Fund

Before the

House Financial Services Committee
Subcommittee on Housing and Community Opportunity

April 14, 2010

Madame Chairwoman, Madame Ranking Member, and distinguished members of the subcommittee, it is an honor to be here today to discuss with you the recently announced changes to the Home Affordable Modification Program as well as the program's successes and failures to date. My name is Andrew Jakabovics, and I am the Associate Director for Housing and Economics at the Center for American Progress Action Fund. Since testifying before this committee last March about expectations for HAMP, I have been analyzing the program and providing recommendations for improvement. I have directly engaged with Treasury and other administration officials about the program and have written extensively about it. Today, I will share my analysis of recent program changes and recommendations for further action.

Through the end of February, approximately 1.1 million homeowners have been offered trial modifications under HAMP, but only 170,000 have successfully negotiated the seemingly Byzantine process for getting into a permanent modification. While there remain significant operational barriers to HAMP's full-fledged success, the administration's new initiatives are likely to bring relief to a subset of homeowners struggling to pay their mortgages.

New policies to help underwater borrowers

The most potentially wide-ranging new policies are those designed to address the problem of "negative equity" (homeowners owing more than their homes are worth) by bringing the amount owned on mortgages down to the current value of the properties. HAMP has been criticized by its overseers for essentially trying to address last year's bad mortgages—subprime and other exotic loans whose terms were largely unsustainable from the start. In moving to offer underwater but otherwise creditworthy borrowers an FHA refinancing and in bringing principal writedowns into the HAMP modification process, the administration is attempting to tailor its response to address the current problem of prime loans going bad.

As of the end of last year, 30.6 percent of subprime loans were at least 90 days past due or in foreclosure. By comparison, only 7 percent of prime loans were in the same category.[1] However, when looking at absolute numbers, it is clear that addressing the problems faced by borrowers with prime mortgages is critical: The Mortgage Bankers Association survey covers 33.5 million prime loans outstanding, compared to fewer than 4.6 million subprime mortgages. In other words, there are nearly a million more prime loans that are seriously delinquent or in foreclosure than subprime loans.

When borrowers face job losses, illness, death, or divorce, delinquency often results. But as long as borrowers have some equity in their home or are not too far underwater, they will often do everything in their power to keep their homes. When these common default factors are coupled with significant negative equity, however, the decision to simply walk away from the home (and its mortgage) becomes much easier.

The decision to walk away, leaving the home vacant and abandoned, harms the value of neighboring properties, hurting people who may still be struggling to keep up with their own mortgages. That's a major problem for communities across the country when an estimated 24 percent of all houses with mortgages are worth less than the remaining balance on those mortgages.[2] Writing down the amount of outstanding mortgages to bring them in line with the current values of the properties provides an opportunity to create the conditions for homeowners to keep paying their mortgages over the long term and minimize the walkaway risk that threatens their neighbors' financial health.

FHA refinancing for underwater borrowers

Since the housing crisis began, CAP has argued that the best solution is to restructure mortgages to reflect current property values.[3] Drawing on the experience of history, the new initiative announced by the Obama administration involving the Federal Housing Authority and the $700 billion Troubled Asset Relief Program fits the bill. Indeed, the new program is essentially a modern version of the New Deal's Home Owners' Loan Corporation, which helped homeowners in the 1930s weather the Great Depression.[4]

Under the Obama administration's program, borrowers who are current on their loans but owe more on their homes than they are currently worth can refinance into an FHA loan for 97.75 percent of the property's current value, assuming the borrowers meet all other FHA underwriting criteria. Incentives will be paid to the mortgage service companies handling the flow of mortgage principal and interest payments to lenders and investors in these mortgages so that borrowers can refinance for less than the outstanding amount.

Given the much larger losses lenders and investors would face if borrowers defaulted, cash in hand equal to 97.75 percent of current value may be sufficiently attractive to allow these refinancings to proceed. This is actually a somewhat sweeter deal for lenders and investors than was offered by FDR's administration by the Home Owners Loan Corporation; back then, the new mortgage was for only 80 percent of current value and the lenders were given corporate bonds paying 4 percent in the amount of the new HOLC loan, not a cash buyout.

Moreover, the new FHA refinance program will allow a total indebtedness of 115 percent of the home's current value, so existing lenders and investors will still be able to retain almost a fifth of the property's current value as a junior lien on the property, effectively giving them some ongoing cash flow if the loan performs and some upside if property values rise before foreclosure. In cases where there is an existing second lien on the home (in the form mostly of a home equity loan) then the first- and second-lien holders would need to negotiate how to divide losses down to the 115 percent loan-to-value limit.

About half of all homes have second liens on the property. Given the difficulties faced by the administration's first effort to help responsible homeowners refinance their mortgages through its Making Home Affordable program because of second liens, this program will be most useful for borrowers with only a first mortgage. (See below for more on the second-lien program.)

To finance this new program, $14 billion from the Troubled Asset Relief Program will be set aside. Even though these refinancings will be FHA loans in all respects and must qualify on those terms, TARP will be on the hook for future claims in a first-loss position. The new program also will bolster FHA's insurance fund, whose excess reserves are below their statutory minimum, since premiums will be paid into the fund but claims will first be drawn down from TARP.

Principal reductions within HAMP

For HAMP-eligible borrowers—meaning those borrowers already determined to be eligible for mortgage refinancings—the Net Present Value test will now be run a second time to calculate the value of a modification that includes a principal writedown. Under the existing HAMP NPV test, the monthly payment target of 31 percent of a borrower's income is reached by reducing the interest rate to as low as 2 percent, extending the length of the loan to as much as 40 years, or forbearing part of the loan so that no interest is due on that amount.

To qualify for the new program, the results of the two NPV tests will be compared so that mortgage service companies will see the logic of participating in the program. The mortgage service companies will be under no programmatic obligation within HAMP to modify mortgages using a principal writedown even when the NPV results show it to be more valuable, yet servicers' existing legal obligations to lenders and investors to get the best possible returns from modifications would make it difficult for servicers to choose the standard HAMP modification when the principal writedown alternative yields better returns under the same NPV model.

Furthermore, in most instances, principal writedowns will probably be more valuable compared to the current HAMP modifications, because of the reduced redefault risk from a lower loan-to-value ratio. The propensity for borrowers to walk away from severely underwater loans improves the NPV calculation for principal balance writedowns compared to interest-rate adjustments for the same targeted monthly payment. Moreover, the program incentivizes borrowers to remain current because the amount forgiven will be deducted from the loan balance over the course of the next three years, as long as the borrower remains current on their loan.

Despite the strong rationales for shifting towards principal reductions, however, there is no transparency for investors to determine that servicers are choosing to reduce principal when that option is more valuable. Thus, while running an apples-to-apples comparison of the NPV results from the standard HAMP waterfall and the principal reduction case should result in the servicer choosing the more valuable outcome, writedowns remain voluntary and there is no mechanism to force them to happen.

Similarly, this policy's ultimate success will likely be determined by the success of the administration's so-called 2MP program, which is designed to buy out second-lien holders for pennies on the dollar but has yet to get off the ground. The four largest banks, which collectively hold about 80 percent of all second liens, are also the four largest mortgage servicers. Only very recently did all four agree to participate in the 2MP program. And under the new administration program to encourage the elimination of second liens prior to the principal writedowns, which will necessarily generate losses for first-lien holders, the incentive payments to the second-lien holders under 2MP will be doubled. If 2MP proves ineffective at eliminating second liens, however, it is unlikely that first liens will be written down.

But there is reason for optimism. Commercial banks that still hold the mortgages they originated are now beginning to offer principal reductions for loans they originated and hold in their portfolios, recognizing the value in reducing the risk of redefault. Indeed, nearly all principal reductions reported in the most recent Mortgage Metrics Report were done for loans held in servicers' own portfolios.[5] More than a quarter of all portfolio loans modified in the fourth quarter of last year involved some degree of principal reduction. Assuming that the distribution of modifications to date reflect the broader pool of HAMP-eligible mortgages, however, fewer than 10 percent of eligible loans are held in portfolio.[6]

Recently, Bank of America announced its own program of principal reductions for borrowers with certain exotic mortgages.[7] Bank of America's new program is expected to reach only 45,000 borrowers, but the rationale behind principal reductions should argue for the program's rapid expansion to all 1 million-plus estimated HAMP eligible mortgages in their servicing portfolio.

To date, neither Fannie Mae nor Freddie Mac has issued guidance to their servicers indicating that they are going to participate in principal reductions when the NPV test shows them to be more valuable. Nearly 60 percent of all modifications to date have been made for GSE loans. If FHFA in its role as conservator of the GSEs directed them to participate, HAMP would look very different, as principal reductions would likely become the norm. Furthermore, adopting a preference for principal reduction would ultimately benefit the Enterprises' bottom lines and, by extension, the taxpayers.

Treasury must quickly issue a supplemental directive telling servicers exactly how to implement principal reductions within the HAMP waterfall and how to treat the forgiven amount during the three-year writedown period. This should be done immediately and irrespective of forthcoming changes to the NPV model.

Assistance for unemployed borrowers

As indicated above, one of the major causes of delinquency is job loss or diminished wages. While HAMP does allow unemployment benefits to be counted for the NPV test, in many cases, by the time borrowers fall behind on the mortgage and apply for assistance, there is not enough time left on the benefits to allow them to be included in the income calculation. Treasury recently announced a forbearance program that would give unemployed borrowers three, and possibly six, months of forbearance before being considered for a HAMP modification. While this will be of use to some borrowers, the average worker is taking 20 weeks, or about five months, to find a new job, and a record-breaking 44.1 percent of unemployed workers have been actively looking for a new job for more than six months.[8] Thus, the announced assistance for unemployed homeowners is unlikely to help many affected borrowers.

It has been argued that forbearance periods longer than six months may have accounting implications for lenders and investors, who might be forced to write down the value of those loans, but if Treasury provided TARP funds to pay part of the forborne amount, those writedowns might be avoidable. One option would be for the homeowner to be responsible for principal payments during the period of unemployment, with TARP covering part of the interest payment. Investors would forgo the remaining interest.

Outstanding issues

The biggest barrier to program success has been the ability of servicers to quickly and accurately modify loans. Unfortunately, as HAMP has been implemented, Treasury has largely relied on large carrots to get servicer participation and has generally, if not entirely, eschewed sticks. The Servicer Participation Agreement contains no real penalties for noncompliance, save withholding incentive payments. But since those payments are only generated from modifications, when servicers fail to modify loans, there are few payments to withhold. Borrowers and their advocates frequently find servicers are making mistakes on a range of program elements but there is no consistent, independent mechanism for redress, despite calls for developing a robust appeal process since the program's beginning. (We have argued that mandatory mediation prior to foreclosure can provide an appeal for a wrongful HAMP denial as well as an opportunity to negotiate a short sale or deed-in-lieu-of-foreclosure.[9])

I testified before this committee a little over a year ago and argued that if servicers proved unable to meet the reasonable levels of modification activity expected, the time will have come to move from carrots to sticks.[10] Treasury must consider transferring servicing rights from servicers unable to meet their obligations to Treasury under the participation agreements to those who have demonstrated capacity to get it right. While borrowers wrongfully denied assistance under HAMP have been given no standing to sue for servicer noncompliance, servicers' breach of contract should be met with a Treasury lawsuit seeking specific performance. Remedies could include the appointment of a special master and/or transfer of servicing rights.

Another issue that has plagued the program from the beginning is the lack of transparency across a range of program elements. The NPV test that lies at the heart of HAMP analysis has never been publicly released, limiting the possibility of an open dialog or debate about the model. Keeping the NPV model out of the public's eye also means that borrowers do not know on what criteria they are being evaluated or whether the reasons given for denials are valid. For example, FICO scores are used in the NPV test, but borrowers are not told to make sure their credit reports are accurate before applying for HAMP. Similarly, Social Security income should be "grossed up" before being run through the model, but there is no way for a borrower to verify that that was done.

When MHA Compliance officers find systemic problems with HAMP compliance at a servicer, they immediately send a letter halting all foreclosures by that servicer until the problems are rectified. (These letters now conform with recent guidance clarifying that referrals to foreclosure must also cease, not just foreclosure sales.) However, the lack of transparency around compliance violations means that borrowers are never notified not only that they may be reconsidered for HAMP but that the letter saying their home will be put up for foreclosure sale is now null.

Improving HAMP with a web portal

One consistent shortcoming of the HAMP program has been the lengthy delay between announced improvements and implementation. Unfortunately, Treasury has essentially outsourced implementation and oversight of the program to the individual services and the GSEs. For example, much borrower confusion stems from the fact that until recently, there were no standardized HAMP documents, so every borrower had a seemingly different set of requirements to qualify. Even now, servicers are obligated to accept the official HAMP documents but can continue to use their own as well.

Changes to the program and overall throughput and compliance would be much easier if Treasury developed and maintained a single point of contact for borrowers and participating servicers. Specifically, they should develop a HAMP portal where borrowers and their advocates could securely submit applications for modification. Servicers would securely access applications for loans they control and be able to quickly provide borrowers with a response. There are relatively few variables that servicers can change (to date, none has requested permission to use an alternate default model), so even the NPV tests can be run on a central platform once borrowers and servicers have submitted their respective information.

A central, Treasury-controlled platform would allow for quick rollouts of updates to the NPV model (as of now, servicers who do not send their data to Fannie Mae for evaluation must write new computer code and then have it approved by MHA Compliance before putting it in place). More importantly, it would eliminate the "he said, she said" nature of many disputes between borrowers and servicers. Despite copious evidence from borrowers and housing counselors that servicers frequently lose or misdirect applications and other submissions, there is still no process to challenge a servicer who claims never to have received a document or that an application was incomplete.[11] With a Treasury-controlled portal, every document and activity would be date stamped, thereby eliminating any ambiguity. This also allows for real-time monitoring of servicers' compliance with new obligations for timely responses to borrower requests and allow for simplified escalation and compliance checking.

A portal would also allow the conversion of modifications from the trial to permanent to be simplified. Currently, the trial modification is legally treated only as a forbearance rather than as a true modification. Optimally, the trial modification would be a real modification but the loan terms would reset to the pre-HAMP ones in cases of default in the first three months. With receipt of the third monthly payment under the trial period, the modification would automatically become permanent. The portal would make it easier to track dates and borrower status. The servicer would need to provide proof of delinquency before rejecting a conversion to a permanent modification.

Several HAMP portals have already been developed and implemented with some degree of scale, but Treasury should competitively source an official portal. All HAMP servicers would then simply be required to accept documents submitted through the Treasury-controlled portal. Servicers could still accept and process applications directly, but they would likely find it easier to upload those applications to the portal for processing as well.

Conclusion

In short, the new changes to HAMP and the new role for FHA in addressing the needs of underwater borrowers are necessary and beneficial improvements to public policy that have significant potential to address the current housing crisis. However, without significant process improvements, HAMP is at risk of failing to assist many eligible families. And while the failures may be the servicers', the frustration felt by many may have political implications.

Endnotes

[1] Mortgage Bankers Association, "National Delinquency Survey from the Mortgage Bankers Association, Q409" (2010).
[2] Calculated Risk, "Q4 Report: 11.3 Million U.S. Properties with Negative Equity," available at http://www.calculatedriskblog.com/2010/02/q4-report-113-million-us-properties.html.
[3] Andrew Jakabovics, "Throwing Homeowners a Lifeline" (Washington: Center for American Progress, 2007), available at http://www.americanprogress.org/issues/2007/12/pdf/holc_paper.pdf.
[4] Andrew Jakabovics, "History Lesson," *The New Republic*, September 10, 2007, available at http://www.tnr.com/article/history-lesson.
[5] Office of the Comptroller of the Currency and Office of Thrift Supervision, "OCC and OTS Mortgage Metrics Report, Fourth Quarter 2009" (U.S. Department of the Treasury, 2010), p. 27, available at http://www.ots.treas.gov/_files/482126.pdf.
[6] The actual share of total outstanding mortgages held in portfolio is closer to 15 percent, but that would include jumbo mortgages and other mortgages not eligible for HAMP. See James B. Lockhart III, "Subsidizing the Mortgage Market" (Federal Housing Finance Agency, 2009), available at http://www.fhfa.gov/webfiles/2309/FINAL_for_web-Urban_Land_Institute-05-07-09.pdf.
[7] CNBC, "BofA to Start Reducing Mortgage Principal," March 24, 2010, available at http://www.cnbc.com/id/36012522.
[8] Heather Boushey, "Good News Amid Fragile Recovery" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/04/fragile_recovery.html.
[9] Andrew Jakabovics and Alon Cohen, "It's Time We Talked: Mandatory Mediation in the Foreclosure Process" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/06/pdf/foreclosure_mediation.pdf.
[10] Andrew Jakabovics, "Examining the Making Home Affordable Program," Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity, March 19, 2009, available at http://www.americanprogressaction.org/issues/2009/03/jakabovics_testimony.html.
[11] Apparently, servicers are already pushing back against participating in HOPE Now's pilot portal specifically because they don't want the accountability of timely responses that come from a process that time and date stamps all activities or losing the ability to claim incomplete submissions.

TESTIMONY
U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTE ON HOUSING AND COMMUNITY OPPORTUNITY

APRIL 14, 2010

BY DR. ARNOLD KLING
MEMBER, MERCATUS CENTER WORKING GROUP ON FINANCIAL MARKETS
GEORGE MASON UNIVERSITY

Thank you, Chairwoman Waters and members of the Subcommittee, for the opportunity to appear before the subcommittee today to discuss revisions to the Home Affordable Modification Program (HAMP).

I come to this committee hearing not with answers, but with a question:

What is the public purpose that is served by this program?

I believe that the sponsors of this program have good intentions. I believe that the civil servants attempting to implement this program are dedicated professionals. But I do not see why the American public should want this sort of program.

I do not want to overstate my concerns. My opposition to mortgage modification programs is mild relative to my opposition to the bailouts of AIG, Citigroup, and other large financial institutions that took place in 2008. The TARP program was an outrage. The HAMP program is merely misguided.

My opinions are not really those of a housing expert. Rather, I speak today as a homeowner, an investor, and a taxpayer. I live in a middle-class development in Silver Spring, Maryland, where house values have declined by roughly 30 percent since the peak of the bubble. The loss in my family's home's value is something that we bear ourselves, because unlike those eligible for mortgage modifications, we do not share the risk of our home with a bank. In dollar terms, American families like mine have lost much more than just about anyone eligible for loan modifications under HAMP.

I am not saying that anyone should feel sorry for me, or that people who face foreclosure deserve no sympathy. Still, we need to keep in perspective the fact that all of us who buy homes are in some sense housing speculators, and yet programs like HAMP benefit only a few.

Yes, every homeowner is a speculator. Like it or not, when the price of our house goes up our wealth rises, and when the price of our house goes down, our wealth declines.

American homeowners whose mortgages are under water are speculators who have lost money on their investments. I am not saying that they should be ashamed. I am not saying that all of them consciously set out to gamble on higher house prices. However, by putting so little money down and taking on debt that they could not afford, they were putting themselves in a position where their ability to remain in their homes depended entirely on the opportunity to refinance, which in turn required continued appreciation of house prices. Whether they meant to or not, they made highly leveraged bets. It is not clear why the rest of us should reward them with new speculative opportunities.

Today's troubled mortgage borrowers are no better and no worse than the many Americans who throughout history have taken risks to try to achieve the American dream. These borrowers are no better and no worse than the '49ers who thronged to California during the Gold Rush. They are no better and no worse than the ordinary people who bought stock on margin in the 1920's. They are no better and no worse than the investors who bought the Dotcom darlings of the 1990's. They are no better and no worse than the rest of us who either bought or held onto our houses in the first half of this decade.

When people speculate in housing or in anything else, some win and some lose. It might be nice to have an economy in which everyone who speculates can win. But not even the United States government has the capacity to arrange it so that every lottery ticket is a winner.

Every year, millions of Americans start their own businesses. Some of these people will get rich. In fact, studies suggest that the largest source of millionaires in America is entrepreneurship. However, by the same token, many business startups fail.

What is the difference between someone who speculates by starting a business and someone who speculates by buying a house? One difference is that entrepreneurs typically put more of their own resources at risk. When people bought houses in the past decade, they often were financed over 95 percent by banks. When you put down less than five percent of the purchase price of the house, you have very little to lose. You are a home borrower as opposed to a home owner. In contrast, entrepreneurs who start new businesses have to invest much more of their own time and money. Their failures are much more costly in terms of personal wealth than the losses of people who purchased homes that failed to appreciate in value. Why should we bail out home borrowers, who lose relatively little, rather than unsuccessful entrepreneurs, who sacrifice so much more?

A mortgage modification enables a housing speculator to make a new bet. If, subsequent to the mortgage modification, the price of the house rises significantly, the housing speculator will make a profit. On the other hand, if the price of the house declines further, the speculator is likely to default, with most of the losses borne by others.

What will be the result of awarding unfortunate mortgage borrowers with new gambles? When mortgages are modified to enable people to stay in their homes, it is inevitable that some house prices will rise and some will fall. The increases in some house prices will create winners. Will those winners be particularly deserving? Meanwhile, other people with mortgage modifications will see the prices of their houses fall, and those borrowers are likely to default, creating new losses for taxpayers and shareholders in financial institutions. Why do we as taxpayers or investors in banks, who do not want to take these new gambles, deserve to bear the losses?

Perhaps one goal of the mortgage modification program is to keep homes off the market that otherwise might be subject to foreclosure and sale. The idea might be to keep home prices higher than they would be if foreclosures were to proceed. This attempt to maintain artificially high prices for houses also will create arbitrary winners and losers.

Suppose that mortgage modifications succeed in temporarily boosting home prices. That is, suppose that in a neighborhood where the price of homes would be $180,000 if foreclosures took place, the mortgage modifications allow prices to be maintained at $200,000. What that means is that people who sell homes now will do better than they would otherwise, while people who buy homes now will do worse. Somebody who buys a house at $200,000 has much less chance of enjoying appreciation than someone who pays $180,000.

Maintaining home prices by preventing foreclosures does not create wealth. Instead it simply takes away wealth from those who at the moment are seeking to buy and gives that wealth to those who are seeking to sell. How do we know that today's sellers are more deserving than today's buyers?

The plain fact is that housing is a speculative investment. It is particularly speculative when borrowers are putting little or no money down to purchase homes. About five years ago, speculation in housing got out of hand. The cure for that is not to give those borrowers new opportunities to gain from future house price appreciation while forcing others to bear the risk. The cure is to return to a natural housing market, with fewer speculators, meaning fewer people buying homes with little or no money down. If people took too much risk as housing speculators before, then the solution is not to give them a new set of dice to roll. The best approach is to get their houses onto the market and move on.

Written Testimony of David H. Stevens
Assistant Secretary for Housing / Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development

"The Recently Announced FHA Refinance Option for Underwater Borrowers and Revisions to the Home Affordable Modification Program (HAMP)"

Hearing before the Subcommittee on Housing and Community Opportunity
U.S. House Committee on Financial Services
April 14, 2010

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee, thank you for the opportunity to testify today on the recently announced adjustments to Federal Housing Administration (FHA) programs that will permit lenders to provide additional refinancing options to homeowners who owe more than their home is worth because of large falls in home prices in their local markets.

These adjustments will provide more opportunities for qualifying mortgage loans to be responsibly restructured and refinanced into FHA loans as long as the borrower is current on the mortgage and the lender reduces the amount owed on the original loan by at least 10 percent. A second lien writedown program will be paired with these changes to encourage further writedown of second liens to further assist homeowners reduce the amount of negative equity they have in their homes. These program adjustments will better assist responsible homeowners who have been affected by the economic crisis. The program modifications will expand flexibility for investors, mortgage servicers and originators to assist more people who owe more on their mortgage than their home is worth because their local markets saw large declines in home values.

These changes, in addition to changes to the Home Affordable Modification Program (HAMP), will help the Administration meet its goal of stabilizing housing markets by offering a second chance to up to three to four million struggling homeowners through the end of 2012. Costs will be shared between the private sector and the Federal Government; funding from the Troubled Asset Relief Program (TARP) will not exceed the $50 billion originally allocated for housing programs.

Housing Policy Overview

The Administration's goal is to promote stability for both the housing market and homeowners. To meet these objectives, the Administration has developed a comprehensive approach using state and local housing agency initiatives, tax credits for homebuyers, neighborhood stabilization and community development programs, mortgage modifications and refinancing, and support for Fannie Mae and Freddie Mac. With the record-low mortgage rates seen this past year and, thanks in large part to these programs, more than four million homeowners have refinanced their mortgages to more affordable levels helping to save more than $7 billion in the past year; more than one million are saving an average of around $500 per month through the Administration's mortgage modification program; home equity (wealth for homeowners) increased by more than $13,000 for the average homeowner in the last three quarters of 2009; and the economy is growing.

Even with this success, we continue to see challenges. Servicers were slow to implement HAMP, resulting in a slow start for the program. Recent improvements in the program have accelerated the pace of modifications. But our strategy to address the crisis must evolve because our challenges have also evolved. The enhancements announced on March 26, 2010 are responsive to the changing needs of homeowners across the country.

Our housing initiatives must balance the need to help responsible homeowners struggling to stay in their homes, with the recognition that we cannot and should not help everyone. The President has said: "We can't stop every foreclosure." And in fact, we can't maintain this balance if we try to assist every borrower. For example, investors and speculators should not be protected under our efforts, nor should Americans living in million dollar homes or defaulters on vacation homes. Some people simply will not be able to afford to stay in their homes because they bought more than they could afford. Instead, the Administration must focus on providing responsible homeowners opportunities to obtain a modification or to refinance and prevent avoidable foreclosures and, when necessary, facilitate the transition to a more sustainable housing situation. The newly announced adjustments are tailored to accomplish these goals by helping a targeted group of borrowers.

The new Federal Housing Administration (FHA) refinance option will provide more opportunities for lenders to restructure loans for some families who owe more than their home is worth. This should help to create stabilizing incentives in the housing market. This is a voluntary program for lenders. To be eligible for refinancing through FHA, borrowers must be current on their mortgage..

Eligible homeowners for the new FHA refinance option must, for example live in an owner-occupied principal residence and have a mortgage balance less than $729,750. As I will describe at greater length later in this testimony, their lenders must agree to write down the balance on their underwater loan to a sustainable level, and their new monthly mortgage payments must be affordable (not greater than 31 percent of their income). This new option, and the new flexibilities for HAMP program, will enable us to more effectively reach this target population.

Taken together, the Administration's broad housing initiatives and the newly announced flexibilities will offer a second chance to millions of responsible, middle-class American families struggling to stay in their homes and will help stabilize our households, neighborhoods and communities.

Background on Housing Program Initiatives to Date

The Administration has taken a broad set of actions to stabilize the housing market for the benefit of American homeowners. These efforts are having an impact on our housing markets – we are seeing signs of stabilization. Just over one year ago, stress in the financial system had severely reduced the supply of mortgage credit, limiting the ability of Americans to buy homes or refinance mortgages. Millions of responsible families who had made their monthly payments and fulfilled their obligations saw their property values fall, and found they were unable to refinance at lower mortgage rates.

In February 2009, less than one month after taking office, President Obama announced the *Homeowner Affordability and Stability Plan.* As part of this plan and through other initiatives, the following actions have been taken to strengthen the housing market:

Actions Supporting Market Stability and Access to Affordable Mortgage Credit

- The Administration has provided strong support to Fannie Mae and Freddie Mac to ensure continued access to affordable mortgage credit across the market;
- Together, Treasury and the Federal Reserve have purchased more than $1.4 trillion in agency mortgage backed securities, which helped keep mortgage rates at historic lows, allowing homeowners to access credit to purchase new homes and refinance into more affordable monthly payments; and
- The FHA and Ginnie Mae have played an important counter-cyclical role, providing liquidity for housing purchases and refinancing at a time when private lending has declined.

Actions Helping Homeowners Purchase Homes, Refinance and Modify Mortgages to More Affordable Payments, Prevent Foreclosures and Stabilize Communities

The Administration has:

- Launched a modification initiative to help homeowners reduce mortgage payments to affordable levels and to prevent avoidable foreclosures. Homeowners in active modifications are saving around $500 per month on average;
- Supported temporarily expanding the limits for loans guaranteed by Fannie Mae, Freddie Mac, and FHA from previous limits up to $625,500 per loan to $729,750 to provide needed support to keep markets functioning during this crisis;
- Expanded refinancing flexibilities for the Fannie Mae and Freddie Mac loans, particularly for borrowers with negative equity.
- Combined with historically low mortgage rates, this has helped more than four million American homeowners to refinance, saving an estimated $150 per month on average and more than $7 billion in the past year;
- Launched a $23.5 billion Housing Finance Agencies Initiative which is helping more than 90 state and local housing finance agencies (HFAs) across 49 states provide sustainable homeownership and rental resources for American families;
- Supported the First-Time Homebuyer Tax Credit, and the subsequent extension and expansion of the credit to also assist move-up buyers, which has helped hundreds of thousands of responsible Americans purchase homes;
- Through the Recovery Act, the Administration is providing over $5 billion in support for affordable rental housing through low-income housing tax credit programs and $2 billion in additional support for the Neighborhood Stabilization Program (NSP), on top of the

first round of $4 billion of NSP funds, to restore neighborhoods hardest-hit by concentrated foreclosures; and
- On February 19, 2010, the Administration announced the $1.5 billion HFA Hardest-Hit Fund for five state HFAs in the nation's hardest-hit housing markets to design innovative, locally targeted foreclosure prevention programs. On March 29, 2010, we announced a $600 million expansion of that program for an additional five HFAs.

HAMP has provided more than one million struggling homeowners a second chance to stay in their homes, with each homeowner in a modification saving around $500 per month on average. Often overlooked, an additional 650,000 families experiencing financial difficulty were assisted through FHA's variety of loss mitigation options since the beginning of FY 2009.

Together, these initiatives are having an impact – strengthening the housing market, helping responsible homeowners prevent avoidable foreclosures and rebuilding communities and neighborhoods. Today mortgage rates remain near historic lows – the primary interest rate is now about 5.20 percent. We are also seeing encouraging signs in housing indicators – home prices and the pace of home sales have stabilized in recent months.

The Challenge of Underwater Homeowners
An estimated 11 to 15 million mortgages, or approximately one-fourth of outstanding mortgages, are for amounts that exceed the value of the underlying home. However, it is important to put this number into context as this includes owner-occupied homes as well as mortgages on second homes and investment properties. While it is difficult to estimate the precise percentage of underwater mortgages that are on owner-occupied homes, it is important to note that the Administration's efforts are specifically targeted to assisting borrowers to remain in their primary residence. As stated earlier in this testimony and elsewhere, the President and the Administration has repeatedly said that we cannot and should not stop every foreclosure. The recently announced program enhancements to FHA and HAMP that we are discussing today are available only for mortgages on owner-occupied homes.

Many such homeowners now find themselves owing more on their home than its current market value. Many of these homeowners are underwater due to sharp price declines in their local housing markets due to no fault of their own – some happened to buy at the peak of the boom, while others have suffered from the impact of foreclosures on properties in their neighborhoods. In many cases, neighbors lost their jobs or suffered other types of financial distress, leading to resale at much lower prices, sharply lowering the market value of the other homes in the neighborhood. Underwater homeowners are often facing unaffordable monthly payments, putting them at an increased risk of default, which would lead to further destabilization of the housing market and the local economy. Facilitating principal writedowns for homeowners who are now in mortgages that place them dangerously close to default will enable them to restructure their debt, refinancing into more sustainable loans. By lowering their risk of default, these efforts will also improve prospects for their neighbors by lowering the likelihood that the local housing market will suffer from more foreclosures.

It is also important to note that the majority of underwater homeowners are still current on their mortgage. While many underwater borrowers are at imminent risk of foreclosure, the majority of underwater borrowers are still making their monthly mortgage payments. Of the 11 to 15 million mortgages that are estimated to be underwater, a far smaller number of families are at imminent risk of losing their homes to foreclosure. The Administration is keenly aware of the potential for moral hazard in principal reduction and has carefully designed the guidelines of the principal writedown enhancements to FHA and HAMP to discourage borrowers from purposefully becoming delinquent on their loan, otherwise known as strategically defaulting, solely to receive a principal writedown. To this end, borrowers are required to be current on their existing loan to be eligible to refinance into a FHA-insured mortgage.

FHA Refinance Option

To address the challenge of underwater homeowners, we have made adjustments to Federal Housing Administration (FHA) programs that will permit lenders to provide additional refinancing options to homeowners who owe more than their home is worth because of large falls in home prices in their local markets. These adjustments will provide more opportunities for qualifying mortgage loans to be responsibly restructured and refinanced into FHA loans as long as the borrower is current on the mortgage and the lender reduces the amount owed on the original loan by at least 10 percent.

The new FHA loan must have a balance less than the current value of the home, and total mortgage debt for the borrower after the refinancing, including both first and any other mortgages, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and an affordable monthly payment. By requiring a meaningful principal write-down in conjunction with the newly refinanced loan, borrowers will have a more sustainable loan that will be more affordable. Additionally, borrowers will have an opportunity to refinance into current interest rates, which remain low.

This refinancing will help homeowners by setting monthly payments at affordable levels and decreasing the mortgage burden for families owing significantly more than their homes are worth. Keeping more responsible families in their homes should support the continued recovery of the housing market.

Rationale for Expanded Efforts to Encourage Principal Writedowns

As the housing crisis has evolved, so have the challenges – negative equity is an important cause of foreclosures, along with affordability and unemployment. As such, facilitating principal writedowns by private investors and lenders is an additional tool that will be useful to stem the tide of foreclosures.

Many analysts have identified a strong correlation between loan-to-value ratios of homeowners and the likelihood that they will default. In many cases, providing a principal writedown to a borrower is more economically rational for an investor or lender than not doing so, as lenders lose significant value when a home goes to foreclosure. Many first-lien investors and analysts of loan defaults have shown that providing principal writedowns for loans that are more than 20% underwater significantly improves loan performance and reduces the potential for those loans to default. As a result, the cost of providing the principal writedown, which is borne by the private sector, is lower than the eventual loss if the loan were to default and the home go to foreclosure. The FHA refinance option provides a vehicle for many investors and lenders to reduce their expected losses while also providing responsible borrowers with meaningful debt relief and better enabling them to afford to remain in their home.

The FHA refinance option is voluntary and both homeowners and investors must agree to the transaction. Early in the housing crisis, principal writedowns were limited, due in part to uncertainty about where house prices would stabilize. Now that housing prices have been more stable for an extended period, lenders can make more accurate calculations about the expected returns from principal writedowns. In this new phase of recovering from the housing crisis, principal reduction should offer an important additional path to interest rate reductions or forbearance to effectively prevent foreclosure -- even when the different approaches might result in the same monthly payment for the homeowner. In short, providing homeowners with a path to positive equity can be a very helpful factor to prevent loan defaults.

Options are Designed to Alleviate Obstacles to Market Coordination and Built To Leverage Existing Market Incentives and Mortgage Finance Infrastructure

The vast majority of the burden of writing down these loans will fall where it belongs, on the lenders and investors, not on the taxpayer. As mentioned earlier, the private sector has increasingly recognized that a principal writedown can be an economically rational alternative to a foreclosure to preserve value in their mortgage holdings. The adjustments to the FHA refinance program and HAMP support the efforts already underway in the market and offer incentives to expand their reach to loans in which the servicer of the loan may differ from the investor and to overcome obstacles to market coordination, including the presence of a second lien and stresses on the capacity of servicers to perform modifications.

Second Liens

It is estimated that approximately half of underwater homeowners have a second lien in addition to their primary mortgage, contributing to the total amount of mortgage debt on the home (their combined loan-to-value, or CLTV). Some second lien holders have been willing to write-down a portion of their lien in exchange for the increased security of a lower-risk refinance. But many second lien holders have not been willing to do so, and as a result the existence of a second lien has effectively prevented principal writedown transactions, even when the first lien holder has been willing to do so. Relatedly, many first lien holders have been unwilling to offer principal writedowns to borrowers unless the second lien holder has been willing to do so as well. This has resulted in many homeowners not receiving offers of principal writedowns simply due to this lack of coordination, even when it is the economic best interest of all parties involved. If this coordination problem could be resolved, both first and second lien holders would have less risky investments due to increased borrower equity and the borrower would benefit from lower monthly payments and greater economic security.

To address this challenge, both the FHA refinance option and the enhancements to HAMP include incentives payments ranging from 10 cents to 21 cents on the dollar, depending on the borrower's loan-to-value, to encourage the extinguishment of second liens. These incentives will be paid through TARP funds allocated to supporting the housing recovery. In the particular case of the FHA refinance option, while the new FHA-insured first lien after principal writedown cannot exceed 97.75% of the current value of the home, FHA permits a combined maximum loan-to-value of 115% to enable borrowers to still benefit from a principal writedown offered by their first lien holder so long as any other lien does not take the combined loan-to-value of all mortgage debt above 115% of the home's current value.

The Administration welcomes and supports the leadership of the House Financial Services Committee in evaluating the scope of this challenge, including yesterday's hearing on "Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program" as we work to better assist homeowners.

Stress on Servicers and Excess Capacity of Originators

Refinancing into a new FHA-insured first mortgage requires a borrower to originate a new mortgage that complies with FHA's underwriting criteria. This approach relies primarily on loan originators as opposed to servicers. We believe that the nationwide system of FHA mortgage originators will provide much greater capacity to process applications than homeowners experienced with previous efforts that relied exclusively on loan servicers.

As we have seen with the initial startup of HAMP, many servicers were overwhelmed and ill-equipped to respond to the volume of homeowners needing assistance. While the complexity of the programs challenged the capacity of servicers, it is also true that many institutions were slow to make the investments in systems and staff needed to process applications. We are encouraged that most servicers have begun to correct this problem to better facilitate HAMP modifications. Nonetheless, many lenders are still experiencing a significant strain on their capacity to address the needs of borrowers through their servicing operations, while they retain excess capacity in their mortgage origination operations. The structure of the FHA refinance option is thus intended to more effectively utilize the resources available in the existing infrastructure of the mortgage finance system.

Expanding the Reach of Principal Writedowns Offered by the Private Sector

As mentioned earlier, as housing prices have stabilized, servicers have been more willing to offer principal writedowns on whole loans owned by the lender. On March 24th, Bank of America announced a new initiative to offer principal writedowns to borrowers who took out complicated mortgage products (subprime, Pay Option ARM, prime 2-year hybrid ARM), and where the loan is already eligible for HAMP. Other banks have selectively reduced balances on certain loans, including Wells Fargo, who reported that it modified loans for 52,600 borrowers with "option-ARM" loans last year, totaling $2.6 billion in principal write-downs.

We are encouraged that lenders are increasingly offering mortgage relief through principal writedowns for struggling borrowers. Their initiatives reinforce the Administration's broader efforts to provide relief to homeowners and are consistent with our housing policy to prevent avoidable foreclosures of owner-occupied homes. We encourage banks to move forward with programs aimed at providing more affordable and sustainable mortgages for homeowners.

In addition to Bank of America and Wells Fargo, Citibank, and J.P. Morgan Chase – the four largest mortgage-holders and servicers – as well as other lenders, have expressed support for the Administration's efforts to assist homeowners and have indicated that they are in the process of evaluating a larger portfolio of underwater borrowers for principal writedowns through the FHA refinance option and enhanced HAMP modification efforts. The program adjustments to FHA and HAMP to facilitate principal writedowns are available to all participating mortgage servicers.

It is also encouraging to see that major mortgage investors have expressed support for these housing programs. Following the announcement of the Administration's expanded housing efforts, the Association of Mortgage Investors stated that "the Association of Mortgage Investors supports the program announced by the Obama Administration to provide a path for reduced principal through a refinancing program for homeowners who are 'underwater' on their mortgage. The Association commends the officials at the Treasury, HUD, FHA and the White House for their efforts to develop this program. Investors have long felt that the only way to provide homeowners long term relief is to address the problem of both affordability and negative equity. This is not only important for the homeowner, but also critical to the housing market and the economy as a whole."

Borrower Eligibility and Selection by Lenders or Investors for a FHA Refinance
To qualify for a FHA refinance, the borrower must meet FHA underwriting requirements: the new first loan must be no greater than 97.75% of the current value of the home; borrowers must be current on their loan; and FHA underwriting requirements must be met through full documentation. Additionally, there must be a minimum principal writedown by the mortgage holder of at least 10 percent of the unpaid balance of the original loan, and the combined mortgage debt must be written down to a maximum of 115 percent of the current value of the home.

It is worth noting that FHA's standard underwriting criteria includes all mortgage debt (first liens and any second or other mortgage debt) in front-end qualifying ratios, which means that borrowers who qualify will receive a new loan that is much more sustainable, as the total monthly mortgage payment, including all mortgage debt, will not be greater than approximately 31 percent of income, and total debt service including all forms of household debt will not be greater than approximately 50 percent, except for some borrowers with especially strong credit histories.

Homeowners must be current on their existing mortgage payment, occupy the home as their primary residence, and fully document their income. As with any loan forgiveness, the short refinancing should be reflected on borrowers' credit score.

Expected Loan Performance and Impact to FHA's Capital Reserves
The new loan must conform to FHA's underwriting requirements, so performance would likely fall within acceptable risk thresholds for FHA. That being said, there is reasonable concern that there may be a performance differential – these loans may perform worse than refinanced loans that were not previously underwater. As such, loans that conform to all guidelines of the FHA

refinance option will be counted separately towards lender performance monitoring through Credit Watch- the system by which FHA suspends or terminates lenders for high default rates. Originating these loans will not hinder a servicer's ability to pursue other lines of business, mitigating a potential barrier to servicers' and investors' willingness to offer principal writedowns to borrowers.

Of the $14 billion of TARP funds allocated to support the FHA refinance option, a portion will be made available to provide coverage to lenders for a share of potential losses on these loans, mitigating detrimental impacts to FHA's capital reserve as a result of facilitating the private sector to provide principal writedowns to underwater borrowers in conjunction with these refinancings. No TARP funds will go to the FHA itself for any loans.

Additional Incentives for Servicers to Modify Loans Already Insured by FHA
HAMP has also been expanded to provide incentives for servicers to modify FHA-insured loans. This program was initially developed last July by FHA and became effective August 15, 2009. With the issuance of new rules on March 26 (Supplemental Directive 10-03), TARP-funded pay-for-success incentives will be available to borrowers and servicers whose loans are modified under the FHA-HAMP guidelines. These incentives improve the quality of this modification option for borrowers and offer a path toward some principal relief. FHA-HAMP incentives are retroactive for all corresponding modifications already offered and therefore we expect the first pay-for-success incentive payments to be paid as early as September 2010.

Additional Assistance for Underwater Homeowners through HAMP Revisions
The FHA Refinance option is part of the broader set of policy adjustments announced on March 26th. This also included revisions to HAMP that will require servicers to consider an alternative modification approach that helps borrowers achieve principal relief over time through earned forgiveness of principal that is forborne in the initial loan modification. For HAMP-eligible borrowers that owe more than 115 percent of the current value of their home, servicers will be required to run the standard Net Present Value (NPV) test and an alternative NPV test that includes incentives for each dollar of principal write-down. If NPV under the alternative approach compares favorably to the result under the standard approach, the servicer will have the option to use it. In this way, servicers are able to demonstrate to investors that using principal write-down likely results in a higher yielding modification.

Conclusion

As mentioned before, while we have enhanced our foreclosure prevention programs through these refinements to FHA and HAMP programs, the Administration believes that the role of government should be appropriately limited to assisting homeowners to remain in their primary residence. That being said, we acknowledge that there will be circumstances where particular borrowers will not be able to remain in their home. In such cases, we have also developed initiatives to help homeowners make the transition to more affordable housing by providing incentives to encourage servicers and investors to make wider use of short sales and deeds-in-lieu.

In the wake of the housing crisis, FHA and Ginnie Mae have played an important countercyclical role to ensure liquidity in the mortgage finance system, including an increased role in supporting mortgage originations, refinances, and foreclosure prevention. Additionally, HAMP is the largest mortgage modification program our nation has seen, in size, scope and impact. In addition to the relief it provides directly, it has impacted the broader industry by forcing mortgage servicers to build up systems to meet unprecedented demand and streamlining and standardizing modification processes across the industry. While significant progress has been made in the first year of program implementation, the enhancements announced on March 26 demonstrate this Administration's capacity to apply lessons learned, strengthen program implementation and broaden the program's impact.

The Administration remains committed to the many other housing market stabilization efforts that work in concert with HAMP and FHA, including substantial support for the housing markets through support of Fannie Mae and Freddie Mac to stabilize those institutions and help ensure that affordable mortgage credit is available; refinancing opportunities that have allowed more than four million borrowers to refinance; an initiative to provide support and financing to state and local housing finance agencies which in turn provide tens of thousands of affordable mortgages to first-time homebuyers and help develop tens of thousands of affordable rental units for working families, including those displaced by the housing crisis and foreclosures.

The Administration is on track to meet the stated goals of offering a second chance to 3 to 4 million homeowners and – most importantly – to help prevent avoidable foreclosures for as many deserving American families as possible.

Substantial progress has been made but the Administration recognizes that real and complex challenges to achieving these important goals still exist. We will continue to assess the Administration's ability to meet these challenges and contribute to the stability of housing markets.

MORTGAGE
BANKERS
ASSOCIATION
Investing in communities

Statement of

Robert E. Story, Jr., CMB

Chairman, Mortgage Bankers Association

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

Hearing on

"The Recently Announced Revisions to the Home Affordable Modification Program (HAMP)"

April 14, 2010

Chairwoman Waters, Ranking Member Capito, members of the subcommittee, I am Robert E. Story, Jr., CMB, Chairman of the Mortgage Bankers Association (MBA) and President and Chief Executive Officer of Seattle Financial Group, parent company to Seattle Mortgage, Seattle Savings Bank, Seattle Capital and Seattle Escrow. I appreciate the opportunity to appear before you today on behalf of MBA to discuss the recent announcements related to the Making Home Affordable (MHA) program and Federal Housing Administration (FHA) refinance and loss mitigation programs.

Our member servicers are committed to helping financially troubled borrowers retain homeownership whenever possible and otherwise avoid foreclosure. Many of MBA's members are participating in the administration's Home Affordable Modification Program (HAMP) for private label and portfolio servicing and all servicers for Fannie Mae and Freddie Mac loans are participating in HAMP as directed by the GSEs. Servicers are working hard implementing recently announced changes to the HAMP program in Supplemental Directive 10-02 and the Home Affordable Foreclosure Alternatives program that became effective April 5, 2010.

Our members continue to work with the administration to suggest improvements to HAMP processes and requirements in order to increase efficiency and provide better outcomes. Servicers strive to ensure a positive customer experience and improved consumer contact in these high-volume and often very emotional times. The challenge is daunting, but servicers continue to hire staff, redeploy personnel to the loss mitigation function, contract with third-party experts to reach out to borrowers, work with HUD-approved counselors, and employ new technology and strategies to communicate with borrowers.

According to the U.S. Department of the Treasury's Making Home Affordable Program Servicer Performance Report Through February 2010, more than 1.3 million borrowers have been offered trial modifications since the inception of the program. Currently, one million borrowers are in active trial and permanent modifications of which 168,708 represent active permanent modifications. An additional 91,843 permanent modifications have been approved by servicers and are pending borrower acceptance. The report further indicates that borrowers are on average saving $500 a month on their mortgage payments, a 36 percent median monthly payment decrease. Borrowers in active HAMP trial modifications and permanent modifications have saved more than $2.7 billion. Servicers have substantially increased the pace with which permanent modifications are being done and we agree that such pace needs to continue.

In addition to HAMP, servicers are providing their own modification and home retention solutions when the borrower does not qualify for the administration's modification program. The HOPE NOW Data Report dated March 31, 2010, indicates that from July 2007 through February 2010, the industry completed a total of 6.7 million workout solutions, including almost 2.7 million loan modifications. During the month of February, 95,586 homeowners received proprietary loan modifications outside of HAMP. When combined with HAMP modifications, homeowners received a total of 148,000 loan modifications in February 2010.

Recent Administration Announcements

Between March 24 and March 26, the Obama administration announced several new programs, including:

- Forbearance program for unemployed borrowers;
- Principal reduction option for certain underwater loans under HAMP;
- Increased relocation incentives for borrowers, increased incentives to servicers for HAMP modifications and for extinguishment of subordinate liens;
- Incentive payments to execute FHA's HAMP;
- Additional procedural requirements for borrower solicitations, performance timeframes for servicers and borrowers, foreclosure referrals and intervening foreclosure steps;
- Requirement for offering HAMP to borrowers in bankruptcy;
- Changes to FHA's refinance options to encourage principal write downs of the existing mortgages; and
- Revisions to the second lien program.

Unemployment and Delinquency Statistics

Before discussing the recent additions to the MHA program, we would like to discuss the current housing market conditions in order to put into perspective the challenges the industry and government faces.

According to MBA's National Delinquency Survey, the delinquency rate for mortgage loans on one-to-four unit residential properties fell to a seasonally adjusted rate of 9.47 percent of all loans outstanding as of the end of the fourth quarter of 2009, down 17 basis points from the third quarter of 2009, and up 159 basis points from one year ago. The delinquency rate includes loans that are at least one payment past due but does not include loans in the process of foreclosure. The percentage of loans in the foreclosure process at the end of the fourth quarter was 4.58 percent, an increase of 11 basis points from the third quarter of 2009 and 128 basis points from one year ago. The combined percentage of loans in foreclosure or at least one payment past due was 15.02 percent on a non-seasonally adjusted basis, the highest ever recorded in the MBA delinquency survey. The percentage of loans on which foreclosure actions were started during the fourth quarter was 1.20 percent, down 22 basis points from last quarter and up 12 basis points from one year ago.

The pattern of mortgage delinquencies very much follows the pattern of unemployment. Just as short-term delinquencies have fallen during the latter part of 2009, first-time claims for unemployment insurance have declined by about a third since their peak in March 2009. As long-term delinquencies now dominate total mortgage delinquencies, long-term unemployment now dominates the total unemployment number. People who have been unemployed for six months or more now constitute more than 40 percent of the total unemployed, the highest share in the history of the unemployment survey. In addition, during the last several months we have seen a large number of people simply drop out of the work force, many who are discouraged about being able to find work. Until the issue of this large segment of long-term unemployed is resolved, many of the longer-term mortgage delinquencies will remain a problem with a strong likelihood of turning into foreclosures.

Nonetheless, we are likely seeing the beginning of the end of the unprecedented wave of mortgage delinquencies and foreclosures that started with the subprime defaults in early 2007, and continued with the meltdown of the California and Florida housing markets due to overbuilding and weak underwriting. With fewer new loans going bad, the pool of seriously delinquent loans and foreclosures will eventually begin to shrink once the cure rate exceeds the pace of new delinquencies. Despite the drop in short-term delinquencies, foreclosure rates are likely to climb, as more borrowers enter forbearance and modification programs. A sizable number of the loans in the 90-plus day delinquent category are in trial loan modification programs. Loans in forbearance and trial modifications are carried as delinquent until borrowers become current through permanent modifications or cure.

Forbearance Program

MBA believes assisting unemployed borrowers should be a priority. According to the Bureau of Labor Statistics, the number of unemployed persons remained relatively unchanged from February to March, at approximately 15 million people or a rate of 9.7 percent.

To address the record unemployment numbers, the administration introduced a forbearance program that will benefit unemployed borrowers. We fully support this initiative. While the specific details are not yet published, the administration indicates that the program would reduce an eligible borrower's first mortgage payment to an affordable level for a minimum of three months, and up to six months. Most borrowers' payments will be reduced to 31 percent of their monthly income, or less. At the end of the forbearance period or when the borrower becomes reemployed, borrowers with first mortgage payments above 31 percent of their income will be considered for a permanent HAMP modification. The program is required for servicers who are participating in the MHA program. Unemployed borrowers must meet basic HAMP eligibility criteria.

MBA supports the creation of a temporary forbearance program to address the unique circumstances of unemployed borrowers. In many cases, these borrowers fail to make sufficient income to qualify for a HAMP modification. In other cases, borrowers are granted a permanent solution for a temporary situation that fails to reflect their true economic needs.

Features outlined in the administration's forbearance program are consistent with MBA's own recommendations presented to the Treasury Department in February 2010 for a forbearance program for unemployed borrowers, including the recognition that, in appropriate cases, borrowers should continue to pay a portion of their income toward their mortgage. We also support allowing different periods of forbearance to help ease financial institutions' concerns with the accounting and regulatory treatment of assets that remain delinquent for six months or longer.

Our recommendations, however, have additional important features. We hope these will be considered to facilitate implementation of the new requirements. Specifically MBA recommends:

- **A low cost source of loans** to banks and non-bank financial institutions to allow them to carry delinquent mortgages for the additional three to six months called for by the forbearance program. Servicers must advance principal and interest payments to private label investors during this time despite not receiving such payments from borrowers. Servicers of GSE loans must advance such payments until they are four months past due. In addition, the servicer advances funds to pay delinquent borrowers' tax and insurance premium obligations. While the servicer ultimately gets reimbursed for these advances from the security, the carry time and costs are substantial. This is especially true for non-bank institutions that must borrow funds from commercial lenders. These "servicing advances" are not always readily available and are often subject to caps and dollar limitations. In order to comply with the forbearance program, servicers must be given the tools to succeed. Such funds would be repaid with interest to the Treasury Department and thus would not be a cost to taxpayers. The Treasury Department should establish lending parameters of such funds.

- **Application of a risk sharing feature** to offset the investor's risk of delaying foreclosure when a forbearance plan fails. One option is to apply the Home Price Decline Protection Incentives to the forbearance program so that investors are not accepting greater risk of loss in a declining market by granting forbearances that unfortunately fail.

<u>Principal Reductions</u>

The Treasury Department announced a revised principal write down component to HAMP. Over the next several months, Treasury will develop an alternative Net Present Value (NPV) model placing principal write downs first in the waterfall of borrower assistance options. Under this model, principal will be reduced to achieve a 31 percent first mortgage debt-to-income ratio, but not lower than 115 percent loan-to-value (LTV). Servicers will be required to run the new alternative NPV (that includes the new incentives) and standard NPV. If the alternative NPV yields a higher return than the standard NPV, the servicer will have an option to write down principal over a three-year period, as long as the homeowner remains current on payments. The lender will receive incentive payments for such write downs. The principal write downs are thus voluntary and subject to contractual restrictions.

While MBA is concerned this program may exacerbate delinquencies, we do not oppose such principal write downs at this time, as long as they remain voluntary. If they are made mandatory, such principal write downs would constitute takings by the federal government and would cause the same severe impacts as judicial cram downs, including the possible loss of mortgage insurance protections. We urge the Treasury Department to monitor the program to gauge whether it is causing strategic defaults and to make adjustments to avoid such deleterious consequences if necessary.

It is unclear at this time how many loans will be modified through principal reduction. There is not sufficient information about the alternative NPV calculation and its assumptions to determine how many will pass the test. Also, loans that are protected by mortgage insurance will require the insurer's approval and partial or full claim payment. Some pooling and servicing agreements (PSAs) may also prohibit principal write downs. Finally, each lien holder will have different tolerances on principal write downs due to their financial structure, loan purchase price, loan status, borrower financial situation, lien priority, and market conditions. The incentives for loan extinguishment are positive and may encourage lenders to use this option in certain cases.

One area of substantial concern, however, is the announcement that servicers must retroactively apply the new principal write down feature for all borrowers who have already received permanent modifications or who are in trial modification and current when the program is operational (later in 2010). This is a substantial burden on servicers that will not yield the results anticipated. The industry is disappointed with this broad requirement given existing concerns about servicer capacity. This provision exacerbates these concerns and should be more appropriately targeted when final guidance is given. Servicers need some finality in their evaluation of borrowers under HAMP. We suggest limiting such reviews to borrowers or loan products the servicers determine to be eligible for principal reduction.

<u>Supplemental Directive 10-02</u>

Supplemental Directive 10-02 was issued on March 24 and adds considerable new requirements to an already complex and heavily prescriptive process. The Supplemental Directive also creates performance timeframes for both servicers and borrowers, prohibits a new foreclosure referral when a borrower is cooperating with the servicer to obtain a modification, and requires a pause, or in some states a cancellation, of the foreclosure process while the borrower is in the trial period based on verified income. Borrowers in active bankruptcy must be considered for HAMP upon request.

We support the new timeframes in that they set out expectations on borrower cooperation and responses. While we have some technical and clarifying issues we would like to discuss with Treasury officials, we are most concerned with: (1) the solicitation and re-solicitation requirements and (2) the foreclosure pause.

- **Solicitation Requirements:** The solicitation requirement calls for four telephone calls and two letters, one of which must be sent by certified mail or overnight delivery. MBA appreciates that the Supplemental Directive also establishes what details must be provided in those communications. What is of concern is the requirement that servicers effectively re-solicit all eligible borrowers again under these requirements even if they were solicited before. This is a substantial burden on the servicing staff, will divert resources away from working with cooperative borrowers and will create confusion for borrowers. We believe re-solicitation is not necessary. Rather, efforts should be made to remove or avoid the creation of barriers to effective communications between servicers and borrowers, which we discuss later in our testimony.

- **Foreclosure Pause:** MBA is also concerned with the new requirement that servicers pause foreclosures if the borrower is in a trial modification. While we agree that a foreclosure sale should never occur while the borrower is being evaluated for HAMP or in a trial modification, we are concerned that this new requirement will actually require foreclosures to be cancelled. In some states, the cancellation of a foreclosure requires the complete recommencement of the action rather than a mere pause. Should the borrower fail to perform, the servicer must restart the entire process anew, causing significant delays and duplication of foreclosure costs. As stated above, the carrying costs of such delays need some reasonable support from the Treasury Department. We recommend Treasury also consider a low-cost loan program to help support the cost of advances of principal, interest, tax and insurance due to foreclosure cancellations.

<u>**FHA Enhancements**</u>

On March 26, HUD announced a new refinance program for underwater borrowers and the Treasury Department announced TARP incentive payments for executing FHA HAMP.

MBA supports the new incentives for FHA HAMP. In order to receive the incentives, the FHA servicer must sign a modified Servicer Participation Agreement. Irrespective of those incentives, servicers are required to consider FHA HAMP in the waterfall of loss mitigation and will continue to do so.

FHA also announced new refinance parameters for borrowers who owe more than their house is worth. The program enables refinances at 97.75 percent LTV (and 115 percent CLTV) for current borrowers even though they may have credit blemishes. The original lien holder must be willing to reduce the debt by 10 percent.

The benefit for lenders of this program is that performance of these refinance loans will not be subject to Credit Watch or Neighborhood Watch, which can affect the continued ability of a mortgage origination branch to originate loans if its delinquency rate exceeds FHA thresholds. Moreover, to date, these refinance loans are eligible to be placed in

Ginnie Mae securities with the most advantageous pricing. The combination of these two enhancements ensures more competitive interest rates and greater access to FHA credit for borrowers despite a poor credit score. The TARP incentives for price extinguishment of first and seconds liens are also positive provided that the receipt of such funds does not impose additional obligations. Conversely, the requirement for a 10 percent reduction in principal and a combined 31 percent first and second mortgage debt-to-income ratio will limit the number of borrowers eligible for the product. This refinance product is not available on FHA loans.

Second Lien Program

The administration released revised rules for the Second Lien Modification Program (2MP) also on March 26, 2010. When a borrower's first lien is modified under HAMP, participating second lien servicers must offer to modify the borrower's second lien according to specified protocol. The program is voluntary. Today, four of the largest banks, including Bank of America, Wells Fargo, Citigroup and JP Morgan Chase, have executed the 2MP agreement. The revised 2MP policies made several significant changes to the incentive compensation that we believe makes the program more attractive. Both the investors' Extinguishment Incentives and Payment Reduction Cost Sharing Incentives have been increased and the calculations simplified.

While MBA does not collect data on second lien servicing or holdings, according to the FDIC Quarterly Banking Profile, there were $661 billion outstanding in home equity lines in the fourth quarter of 2009, from 8,012 institutions reporting. Despite the large number of institutions reporting second lien activities, second liens and servicing are highly consolidated in the largest institutions. While it is unclear how many servicers will execute the 2MP contract, the fact that the four largest holders and servicers of second liens are participating will have a significant impact on the number of borrowers receiving help. According to the National Mortgage News Alternative Quarterly Data Report, 4th Quarter of 2009, the four residential second lien servicers who have signed the 2MP agreement hold or service approximately $427 billion in second liens. We estimate they represent approximately 60 percent of outstanding second mortgages.

Improvements to Facilitate HAMP

The subcommittee requests input on any process improvements that are needed within HAMP or within servicers' operations, to ensure that eligible borrowers receive trial modifications, and that eligible trial modifications are converted to permanent modifications.

- **Waiver Process:** The Treasury Department should establish a well-staffed help line to review and approve program exceptions. Borrowers' personal and financial circumstances are highly individual and do not fit neatly into program rules that are quite prescriptive. Servicers are understandably reluctant to approve exceptions that are reasonable, but outside the strict parameters of the program rules. If a waiver process is implemented, servicers must have the ability to rely on such waivers during MHA compliance audits. Rapid response and approval of waivers of HAMP guidelines would go a long way to help move borrowers from trial to permanent modifications. Such waivers are offered by Fannie Mae and Freddie Mac with regard to their own lending and servicing guidelines.

- **Interest Only Modifications:** The industry has requested for some time that the Treasury Department allow an interest only option for modifications. The interest only feature would be particularly helpful when addressing ARMs with low rates. The concept is similar to principal forbearance except that all principal payments would be deferred, but interest would accrue.

- **Fair Debt Collection Practices Act:**

  - **Eliminate Mini Miranda Warning for Mortgage Servicers:** MBA has been a long-time proponent of amending the Fair Debt Collection Practices Act (FDCPA) to exempt mortgage servicers from the so-called mini Miranda warning they must give delinquent borrowers prior to any discussion with them. The mini Miranda warning not only extends the telephone hold time, but chills the reception toward the offer of help. It is also unnecessary in a mortgage context because a borrower knows that he or she has monthly mortgage payments that are due. The mini Miranda requirements are in conflict with other parts of the FDCPA and create unnecessary liability for servicers trying to assist borrowers.

  - **Permit Informational Voice Mail Messages:** Servicers find themselves unable to properly and effectively communicate with borrowers due to the FDCPA. The act fails to allow servicers to leave voice mail messages with any meaningful information about the offer of help that would encourage borrowers to call back due to conflicting provisions of the law. When servicers do leave messages, court cases have been less than helpful and are contradictory as to what information can be left and whether stating the mini Mirada warning required by the FDCPA, also violates the act. Some servicers choose to refrain from leaving messages in response to these cases, a result that reduces effective communications regarding loss mitigation alternatives. Clearly this step would not be in the best interests of borrowers trying to remain in their homes. While there is little question that the provisions of the FDCPA provide critical protection to consumers relating to the debt collection practices of some collection agencies, application of the FDCPA to mortgage servicers and their counsel could have the unintended consequence of chilling meaningful communication with consumers regarding work out options.

Conclusion

HAMP is a critically important effort that is assisting hundreds of thousands of homeowners. Concurrently, servicers continue to assist hundreds of thousands of homeowners who do not qualify for HAMP with their own proprietary solutions. We hope to continue working with the administration on successful implementation of the new programs. Our members are dedicated to implementing HAMP and providing other loss mitigation solutions to financially distressed homeowners. Thank you for inviting me to testify before you today on behalf of the Mortgage Bankers Association.

Testimony of Alan M. White

Valparaiso University School of Law

Before the House Subcommittee on Housing and Community Opportunity

Recently Announced Revisions to the Home Affordable Mortgage Program (HAMP)

April 14, 2010

Chairwoman Waters, Ranking Member Capito and members of the Committee, thank you for this opportunity to testify concerning the vital questions of how we are responding and should respond to the foreclosure crisis. I have studied the subprime mortgage industry for the past ten years, and I am conducting ongoing research on mortgage defaults, foreclosures, workouts and modification agreements. I testified in September 2008 before the House Financial Services Committee about the inadequacy of voluntary action by mortgage servicers, and unfortunately the foreclosure crisis has grown dramatically worse since then. Month after month, up to and including March 2010, foreclosures and defaults remain at or near crisis peak levels. Voluntary mortgage modifications have failed to keep pace with foreclosures, much less turned the tide.

Amid the signs of gradual economic recovery, it is easy to lose sight of two critical facts. First, foreclosures and mortgage defaults remain at unprecedented levels not seen since the Great Depression.[1] Second, while the bubble in home prices has burst and they have declined by as much as 30%, the mortgage debt hanging over American homeowners has stubbornly refused to come down. Having doubled from $5 trillion to $10.5 trillion in seven years, home mortgage debt has eased by only about 3 percentage points in the past three years, and remains above $10 trillion.[2]

After twelve months, the Administration's Home Affordable program can only be judged a failure. In its current form, HAMP will not and cannot achieve the necessary degree of foreclosure prevention and mortgage debt reduction that are the essential prerequisites to an economic recovery. The goal of helping 3 to 4 million homeowners was ambitious but necessary to have an impact on the crisis. Through February there have been fewer than 200,000 permanent modifications, a number that cannot realistically be expected to mitigate the crisis.

In fact, the net impact of HAMP has been to sharply *reduce* permanent modifications from April 2009 through February 2010, by redirecting servicer efforts. This was partly a result of the unnecessarily prescriptive documentation requirements and the 3-month trial modification feature imposed by Treasury. Before HAMP was announced in March 2009 servicers were voluntarily and permanently modifying about

[1] Mortgage Bankers Association of America, National Delinquency Survey Fourth Quarter 2009 (reporting that 4.58% of all mortgages are in foreclosure and 10.44% are delinquent, compared with roughly 1% and 4%, respectively, in 2005).

[2] Federal Reserve Board of Governors, Statistical Release Z.1, table D.3 March 11, 2010.

120,000 mortgages each month. After HAMP went into effect, that number dropped to about 80,000 monthly.[3] It appears that as of March 2010 permanent modifications are just getting back to their pre-HAMP levels.[4] There is still no overall increase in modifications, or reduction in foreclosures, resulting from HAMP. New foreclosure starts were running at about 200,000 monthly at the end of 2009.

The recently announced changes to HAMP are not likely to increase the program's success significantly. The short-term payment relief for unemployed borrowers is commendable but limited to six months it is unlikely to help a sizeable number of the unemployed. Most servicers are already able to offer short-term forbearance plans of three to six months for unemployed borrowers without HAMP subsidies. Treasury and Congress should consider longer-term assistance for the unemployed, such as the 18-month assistance program offered by the Pennsylvania Housing Finance Agency (HEMAP). The new option to consider principal reduction, given that it is entirely voluntary, seems to me highly unlikely to affect servicer behavior.

Servicers continue to provide half to two-thirds of their permanent modifications outside the HAMP program. This is very troubling, given that servicers are giving up substantial subsidies and income from Treasury in order to avoid having to comply with HAMP rules and guidelines. The reasons for this are not clear, but suggest a need for Treasury to look closely at the proprietary modifications being done by servicers, including their payment performance, in order to improve the HAMP guidelines.

Separate from the question of preventing the tragedy of unnecessary foreclosure is the policy imperative of addressing the $10.2 trillion mortgage debt overhang. HAMP has not in any way helped with overall mortgage debt reduction, or what I call deleveraging the American homeowner. If anything, its "extend and pretend" approach is increasing household debt. Rather than urging servicers to consider principal reduction as an optional tool it should be made mandatory, and the HAMP subsidies should be targeted at principal reduction and interest write-offs. Not only is mortgage debt reduction essential for macroeconomic reasons, but also modifications with principal reduction have consistently been shown to re-default at significantly lower rates.[5] The Special Inspector General For The Troubled Asset Relief Program (SIGTARP) reports

---

[3] These numbers are from the HOPE NOW coalition data reports, available at https://www.hopenow.com/industry-data.php. See table 3.

[4] See Tables 1 and 3 appended to this testimony, summarizing modification totals from the Columbia collateral data file of securitized mortgages, as well as the HOPE NOW and OCC/OTS mortgage metrics data. HOPE NOW reports that total HAMP and non-HAMP modifications now exceed pre-HAMP levels, but that has not yet been confirmed in the OCC/OTS or Columbia data.

[5] OCC/OTS Mortgage Metrics report for 2009 Fourth Quarter, available at http://www.ots.treas.gov/?p=Mortgage%20Metrics%20Report; UNC Center for Community Capital, Tailoring Loan Modifications: When Is Principal Reducation Desirable?, August 23, 2009.

that the average mortgage debt for borrowers in HAMP trial modifications is between 115% and 140% of their home value.[6]

Mandatory principal reduction can only be achieved through a combination of bankruptcy reform, a comprehensive plan to buy the banks' delinquent and at-risk underwater second mortgages at fair value and incorporating mandatory principal reduction for underwater borrowers into the HAMP program. If this is not successful a mortgage purchase program similar to the HOLC may be needed. In March 2010 about 20% of foreclosure liquidations were second mortgages. The average loss severity was in excess of 100% of the original balance, i.e. the recovery was insufficient to pay even interest and fees, let alone any principal debt. About 30% of securitized subprime and alt-A second mortgages are delinquent.[7] These at-risk second mortgages, and more importantly the at-risk second mortgages on the balance sheets of banks, need to be resolved in a prompt but orderly fashion.

Taxpayer subsidies for necessary mortgage write-downs should be kept to a reasonable minimum. First lien foreclosures are resulting in losses in excess of 50%, and second liens foreclosure losses exceed 100%. In the case of second liens, taxpayers should not overcompensate banks and investors for mortgages of little or no economic value.

The new FHA write-down and refinance program will not work. Like the failed Hope for Homeowners program, it requires lenders or servicers to voluntarily reduce the principal on both first mortgages and second mortgages. Treasury will now offer to pay 10% to 21% of the second mortgage balance written down in the context of an FHA refinance. Under the previous second mortgage program (2MP, which apparently was never fully implemented) Treasury offered to pay either an incentive to servicers and investors that modified second mortgages to make payments affordable, or a subsidy of 6% to write down delinquent second mortgages and 10% to 20% to write down current second mortgages. Treasury now believes that second mortgage holders will be more likely to accept 10 to 20 cents on the dollar to cancel their loans in the context of a refinancing of the first mortgage than in connection with a first mortgage modification. But the effect on the second mortgage investor is the same – they are asked to write off 80% to 94% of the debt. No bank or investor has shown much willingness to accept that level of loss to date.

What further steps are needed to achieve real reductions in foreclosures and mortgage debt? First, Congress should enable bankruptcy courts to write down mortgage balances to home values for distressed homeowners. Chairman Frank warned the industry in 2008 that this would happen if the voluntary foreclosure mitigation programs failed. They have failed.

Second, the junior mortgage lien problem should be addressed promptly and systematically, with mandatory, not voluntary, purchases of at-risk underwater junior

[6] Special Inspector General for the Troubled Asset Relief Program, Factors Affecting Implementation of the Home Affordable Modification Program, March 25, 2010.

[7] These data are from the Columbia Collateral file.

liens at no more than 10% of outstanding balances. Estimates are that one-third to one-half of distressed first mortgages are associated with a second mortgage, amounting to perhaps one to two million borrowers. Thus if the average at-risk second mortgage amount is roughly $50,000, a 10% subsidy or purchase price would amount to $5,000 per mortgage, or $5 to $10 billion to eliminate $50 to $100 billion in distressed second lien debt. Appropriate Congressional legislation could authorize Treasury to compel lenders to sell their at-risk second mortgages to Treasury for a nominal amount in any case where the first or second mortgage is seriously delinquent and the first mortgage exceeds the home value. It should be noted that the majority of second mortgages, whether underwater or not, are not associated with a defaulted first mortgage and would not be affected.

Third, mortgage servicer performance must be addressed. In many cases, evidenced in consumer lawsuits and complaints, servicers are proceeding with foreclosures and sales while modification requests are pending, or even after they are approved.[8] Modification requests are languishing for as long as a year, servicers repeatedly ask borrowers to resubmit documentation that has been lost or become outdated, and housing counselors and mediators are unable to get timely information and responses from servicers. The HAMP call center reports receiving 39,625 borrower complaints about servicer compliance, including 5,170 calls reporting that the servicer lost the borrower's paperwork, 4,303 reports that the servicer incorrectly told the borrower they must stop making payments to qualify for a modification, and 1,457 complaints of servicers charging fees for HAMP applications or modifications.[9] I understand that Chairwoman Waters has personally experienced servicer failures while working on behalf of constituents.

Treasury should take action against servicers whose HAMP performance is inadequate. The monthly HAMP reports reveal that some servicers are much more successful than others at getting delinquent homeowners into temporary modifications and at converting temporary modifications to permanent ones. Congress should consider mortgage servicing legislation to provide better consumer protection and perhaps to allow consumers (or Treasury in cases where the taxpayer is the ultimate investor) to fire servicers. Another option would be compulsory transfer of servicing rights to servicers with high performance ratings.

You have also asked for my views on prevention of future foreclosure crises. Thus far the only legal restriction on a new wave of subprime and alt-A high-risk

[8] E.g. Complaint in Reyes v. IndyMac Mortgage Services, Inc. Civil Action 10-10389, Federal District Court District o Massachusetts (March 4, 2010); Sandra Forester, Owner Says their Boise Home was Sold Without Their Knowledge, Idaho Statesman April 7, 2010; Arthur Delaney, Chase Sued: Allegedly Told Homeowner to Stop Payments, then Foreclosed, Huffington Post, April 6, 2010.

[9] MHA Call Center Overview, February 2010, available at: http://www.financialstability.gov/docs/Borrower%20Contact%20Report%2003%2012%2010_FINALDRAFT3.pdf.

mortgages is the Federal Reserve's HOEPA regulation issued in 2008.[10] The Fed rule laudably bans no-doc mortgages, but only for mortgages priced at subprime rates, i.e. 3% above prime interest rates. It also restricts prepayment penalties for subprime mortgages, although some are still permitted. The risky mortgage features that have been clearly identified with the foreclosure crisis include undocumented income, 100% financing (i.e. no down payment mortgages), non-amortizing and negatively amortizing mortgages (i.e. monthly payments of interest only or less-than-interest-only), and prepayment penalties. These high-risk product features, alone or in combination, should be restricted, possibly in the way that investors are restricted from high-risk investment strategies, i.e. only very sophisticated individuals should have access to them. The Fed rule falls short in two fundamental ways: first it does not address the alt-A sector, i.e. mortgages with low interest rates but risky features, and second it does not address two of the four important risk features even for subprime mortgages, namely borrower equity and amortization. There is no significant subprime and alt-A mortgage lending in the market today, because of lender and investor skepticism about controlling the risk of these mortgage products. Over time, the investor fear and doubt will fade, and another cycle of reckless lending could develop, in the absence of sensible regulation. At this point the preferred approach in Congress seems to be to continue delegating these important decisions to administrative agencies, including perhaps a new consumer protection agency. Until clear limits on risky mortgage terms are put in place, Ponzi finance may yet return to the mortgage market.

In the long run, sustainable homeownership for low- and moderate-income families should be supported by a narrowly tailored federal intervention in the mortgage market. F.H.A. should be restored to the role it played before it was displaced by subprime mortgages, namely to provide access to low-income homebuyers who cannot otherwise qualify for financing. This requires finding an appropriate balance between reducing access barriers on the one hand, while avoiding zero down financing and unsustainable mortgage structures on the other hand. Fannie Mae, Freddie Mac and the Federal Home Loan Banks should provide capital for the low-priced end of the housing market, buying only safe and sustainable mortgage products, while private capital markets should finance he middle and upper end of the housing market. For all their flaws, at this juncture F.H.A., Fannie and Freddie are filling a vital role as a backstop to the collapsed private mortgage market.

Detailed summaries of the mortgage foreclosure and modification data I am following are available on my web page at:
http://www.valpo.edu/law/faculty/awhite/data/index.php

In addition I have written two papers summarizing the limitations of voluntary mortgage modifications in 2007 and 2008, which are available at:
http://ssrn.com/abstract=1325534 and http://ssrn.com/abstract=1259538.

I would be happy to answer any questions, and to respond to any specific queries from you or your staff regarding the available foreclosure and modification data.

---

[10] Federal Reserve Board, Truth in Lending Final Rule, 73 Federal Register 44521 (July 30 2008).

Table 1: Foreclosures and modifications, Columbia Collateral Files

Columbia Collateral File, 2000 to 2007 pools inclusive							
Report month	Total Loans	Bankruptcy	Foreclosure	REO	Foreclosures + BK + REO	FC +BK + REO as % of loans	Modifications
11/08	3,530,589	68,697	233,114	141,489	443,300	12.56%	21,221
12/08	3,462,975	67,878	235,965	139,913	443,756	12.81%	20,392
1/09	3,417,382	67,311	241,990	138,999	448,300	13.12%	23,224
2/09	3,385,216	68,388	248,723	140,853	457,964	13.53%	23,749
3/09	3,313,489	67,000	256,468	137,307	460,775	13.91%	20,894
4/09	3,295,897	67,611	271,769	126,931	466,311	14.15%	21,404
5/09	3,206,178	68,778	277,847	118,358	464,983	14.50%	19,041
6/09	3,173,292	70,324	281,560	111,662	463,546	14.61%	18,179
7/09	3,105,754	71,409	282,912	106,848	461,169	14.85%	14,149
8/09	3,029,722	72,663	282,148	101,777	456,588	15.07%	13,269
9/09	2,949,127	72,912	279,426	96,269	448,607	15.21%	12,132
10/09	2,893,727	71,163	279,353	91,619	442,135	15.28%	12,704
11/09	2,857,413	72,843	276,591	91,088	440,522	15.42%	12,908
12/09	2,795,333	71,617	275,560	87,685	434,862	15.56%	14,309
1/10	2,764,568	70,726	273,559	85,179	429,464	15.53%	15,642
2/10	2,718,236	69,846	268,569	87,204	425,619	15.66%	14,592
3/10	2,680,982	69,777	262,338	86,264	418,379	15.61%	21,821

N.B. The Columbia Collateral file is made available to investors each month, and provides performance data on securitized subprime and alt-A mortgages. It covers about 5% of the mortgage market and about 20% of mortgages in default or foreclosure. Only permanent modifications are reported, and no distinction is made between HAMP modifications and other modifications.

Table 2: Types of modifications, Columbia Collateral File

Columbia Collateral File, 2000 to 2007 pools inclusive						
	Mod P&I Positive Change *	Mod P&I Negative Change*	Mod P&I No Change*	%Mods w/ PmtReduced*	Number with write-offs	Percent with write-offs
11/08	8,528	9,802	2,891	46.2%	2,808	13.23%
12/08	7,627	9,850	2,915	48.3%	2,375	11.65%
1/09	8,789	11,365	3,070	48.9%	2,808	12.09%
2/09	7,275	11,162	3,674	50.5%	3,993	18.06%
3/09	5,984	10,628	2,816	54.7%	3,958	20.37%
4/09	5,827	11,760	2,363	58.9%	3,233	16.21%
5/09	5,138	10,575	2,296	58.7%	2,343	13.01%
6/09	4,819	9,949	2,289	58.3%	3,135	18.38%
7/09	3,197	8,523	1,498	64.5%	1,140	8.62%
8/09	3,003	7,848	1,478	63.7%	528	4.28%
9/09	2,597	7,350	1,273	65.5%	615	5.48%
10/09	2,571	7,535	1,583	64.5%	753	6.44%
11/09	2,499	7,955	1,305	67.7%	982	8.35%
12/09	2,257	9,555	919	75.1%	1,226	9.63%
1/10	2,385	10,850	1,020	76.1%	1,191	8.35%
2/10	1,978	11,677	937	80.0%	1,208	8.28%
3/10	2,462	16,183	1,245	81.4%	1,483	7.46%

Table 3 – Permanent mortgage modifications reported by HOPE NOW, OCC/OTS and Columbia Collateral file

	Modifications in Columbia file	HOPE Now Modifications	OCC/OTS Mortgage Metrics Modifications
11/08	21,221	98,000	40,000
12/08	20,392	122,000	41,000
1/09	23,224	117,000	63,000
2/09	23,749	127,000	63,000
3/09	20,894	127,000	63,000
4/09	21,404	118,000	47,000
5/09	19,041	99,000	47,000
6/09	18,179	94,000	47,000
7/09	14,149	80,000	44,000
8/09	13,269	86,000	44,000
9/09	12,132	75,000	44,000
10/09	12,704	73,000	41,000
11/09	12,908	82,000	41,000
12/09	14,309	139,000	41,000
1/10	15,642	149,000	-
2/10	14,592	148,000	-
3/10	21,821		