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Assistant Secretary for Financial Institutions Michael S. Barr Written Testimony on Stabilizing the Housing Market before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity

Written Testimony

Stabilizing the Housing Market

Chairwoman Waters, Ranking Member Moore and members of the Committee, thank you for the opportunity to testify today about the Treasury Department's comprehensive initiatives to stabilize the US housing market and support homeowners.

Introduction

A strong housing market is crucial to a sustained economic recovery. It is a driver of stability in our financial markets and a fundamental source of wealth for individual families and communities. The recent crisis in the housing sector has devastated families and communities across the country and is at the center of our financial crisis and economic downturn.

Today, I want to outline the steps that Treasury and the Administration have taken to strengthen the housing sector, help millions of homeowners and lay the foundation for economic recovery and financial stability.

Weakness in the US housing market developed over many years. In advance of the downturn, inadequate regulation of lending and securitization practices, including lax underwriting standards, helped cause widespread over-leveraging in the residential mortgage sector that has contributed to millions of borrowers having mortgage payments they are unable to afford.

The rapid decline in home prices over the past two years has had devastating consequences for homeowners, communities and financial institutions throughout the country. Moreover, rising unemployment and other recessionary pressures have impaired the ability of many otherwise responsible families to stay current on their mortgage payments.

The result is that responsible homeowners across America are grappling with the possibility of foreclosure and displacement. Analysts project that more than 6 million families could face foreclosure over the next three years.

The Administration's Efforts to Stabilize the Housing Market

This Administration has acted quickly and aggressively to confront the economic challenges facing our economy and our housing market.

Within weeks of assuming office, President Obama worked with Congress to enact the largest economic recovery plan since World War II.

The Administration is addressing the housing crisis across multiple fronts. First, we boosted demand by implementing a new homebuyer’s tax credit in the Recovery Act. Within a month of taking office, on February 18, we announced the Making Home Affordable (MHA) Program, a critical element of Treasury's Financial Stability Plan. This program was broadly designed to stabilize the U.S. housing market and offer assistance to millions of homeowners by reducing mortgage payments and preventing avoidable foreclosures.

A key part of the broad housing plan is the Home Affordable Modification Plan – a comprehensive $75 billion program to lower monthly mortgage payments for at risk borrowers, providing modifications on a scale never previously attempted.

The Home Affordable Modification Program supports loan modifications that will provide sustainable, affordable mortgage payments for up to 3 to 4 million borrowers. HAMP offers "pay-for success" incentives to investors, lenders, servicers, and homeowners for successful mortgage modifications.

There are clear signs that the incentives offered under the Home Affordable Modification Program are having a substantial effect.

- Over forty-five servicers have signed up for the Home Affordable Modification Program, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the GSEs, more than 85% of loans in the country are now covered by the program.
- These participating servicers have extended offers on over 570,000 trial modifications.
- Over 360,000 trial modifications are already underway.

On March 4, just two weeks after the Feb. 18 announcement of MHA, the Administration, worked with the banking regulators, HUD, and the Federal Housing Finance Agency to publish detailed program guidelines for HAMP. These guidelines outlined a standard for the industry to follow in modifying mortgages to make them affordable and sustainable.

On April 28, the Administration announced additional details related to the Second Lien Program which will help to provide a more comprehensive affordability solution for borrowers by addressing their total mortgage debt. In addition, this announcement included provisions to strengthen the HOPE for Homeowners Program, administered by HUD, which provides additional relief for borrowers with mortgage balances greater than the current value of their homes. In August, we released the supplemental directive providing specific implementation guidelines for the Second Lien Program. Second lien servicers covering the majority of second liens in the country have committed to participate in the second lien program.

On May 14, we announced additional details related to the Foreclosure Alternatives Program, which will provide incentives for short sales and deeds-in lieu of foreclosure where borrowers are unable to complete the HAMP modification process. We also announced additional details on Home Price Decline Protection Incentives, designed to provide incentive payments for modifications to partially compensate lenders and investors for home price declines. As of September 1, Home Price Decline Incentive payments will become operational, and begin to be included in NPV calculations, allowing more borrowers in the geographic areas hardest hit by home price declines to obtain modifications.

The Administration's broad housing plan, the Making Home Affordable Plan, also includes broad support for the GSEs to support mortgage refinancing and affordability across the market.

On March 4, the Administration increased its funding commitment to Fannie Mae and Freddie Mac to support the strength and security of the mortgage market and to help maintain mortgage affordability generally. To this end, Treasury expanded its commitment to the GSEs under the Preferred Stock Purchase Agreements by $200 billion. The Treasury Department also continues to purchase Fannie Mae and Freddie Mac mortgage-backed securities to promote stability and liquidity in the marketplace.

In addition, the Administration increased refinancing flexibilities for the GSEs, providing more homeowners with an opportunity to refinance to lower monthly payments. As a part of this increased refinancing flexibility, the Administration launched the Home Affordable Refinance Program which expands access to refinancing for families whose homes have lost value.

Many homeowners who made what seemed like conservative financial decisions three, four or five years ago find themselves unable to benefit from the low interest rates available today because the value of their homes has sunk below that of their existing mortgages.

Originally, the Home Affordable Refinancing Program was designed to help homeowners whose existing mortgages were up to 105 percent of their current house value, but it has since been expanded to help those with mortgages up to 125 percent of current value.

Overall, the GSEs have refinanced more than 2.7 million loans since the announcement of the Administration's comprehensive housing plan.

HAMP Program Design

Key Principles

The Home Affordable Modification Program is built around three core concepts.

First, the program focuses on affordability. Building on the insights of Chairwoman Bair of the FDIC, it is designed to reduce mortgage payments to an affordable level based on a borrowers' gross monthly income. Every modification under the program must lower the borrower's monthly mortgage payment to 31% of the borrower's monthly gross income.

Second, HAMP's pay-for-success structure aligns the interests of servicers, investors and borrowers in ways that encourage loan modifications that will be both affordable for borrowers over the long term and cost-effective for taxpayers.

Third, the HAMP program establishes detailed guidelines for the industry to use in making loan modifications with the goal of encouraging the mortgage industry to adopt a sustainably affordable standard, both within and outside of the HAMP program.

In the past, a lack of agreed-upon guidelines has limited the number of loan modifications that are completed, even in instances where modifications would have been beneficial to all involved. HAMP should help increase the number of modifications industry-wide by providing standardized modification guidance to servicers and lenders.

That will be good for borrowers, good for lenders, good for mortgage lending standards and good for improved stability of our overall financial system.

Eligibility Criteria

The eligibility criteria for the modification program were developed specifically to help responsible American homeowners with the greatest need for assistance and to provide that assistance at the lowest cost to taxpayers.

Modifications are potentially available to all borrowers regardless of loan-to-value ratio, so borrowers can qualify no matter how much the price of their home has fallen.

The modification plan was designed to be inclusive, with a loan limit of $729,750 for single-unit properties, and higher limits for multi-unit properties. At this level, over 97 percent of the mortgages in the country have a principal balance that might be eligible.

Finally, because it is more effective to reach borrowers before they have missed a payment, the modification program includes additional incentives for the modification of loans where borrowers are current on their payments, but can demonstrate financial hardship or imminent risk of default.

Modification Process

Under HAMP's loan modification guidelines, mortgage servicers are prevented from "cherry-picking" which loans to modify in a manner that might deny assistance to borrowers at greatest risk of foreclosure. Participating servicers are required to service all loans in their portfolio according to HAMP guidelines, unless explicitly prohibited by pooling and servicing agreements, and further must make reasonable efforts to obtain waivers of any limits on participation.

Participating servicers are also required to evaluate every eligible loan using a standard net present value (NPV) test. The NPV test compares the net present value of cash flows with modification and without modification. If the test is positive, the servicer must modify the loan.

Under the program, servicers must reduce the borrower's first lien mortgage to a 31 percent debt-to-income (DTI) ratio, meaning that the monthly mortgage payment can be no greater than 31 percent of gross monthly income. To reach this payment, the servicer must use a specified sequence of steps:

1. Reduce the interest rate, subject to a rate floor of 2 percent.
2. If the 31 percent DTI has not been reached, extend the term or amortization period of the loan up to a maximum of 40 years.
3. If the 31 percent DTI still has not been reached, forbear principal until the 31 percent ratio is achieved.

Principal forgiveness may be applied at any stage. Additionally, each loan must be considered for a HOPE for Homeowners refinancing.

The borrowers' modified monthly payment of 31 percent DTI will remain in place for five years, provided the borrower remains current, and following the modification the interest rate will step up each year to a specified cap that will be fixed for the life of the loan. We believe HAMP creates new fixed-rate loans that homeowners can afford and can understand.

"Pay for Success" Incentive Structure

HAMP offers "pay for success" incentives to servicers, investors and borrowers for successful modifications. This aligns the incentives of market participants and ensures efficient expenditure of taxpayer dollars.

Servicers receive an up-front payment of $1,000 for each successful modification after completion of the trial period, and "pay for success" fees of up to $1,000 per year, provided the borrower remains current. Homeowners may earn up to $1,000 towards principal reduction each year for five years if they remain current and pay on time.

HAMP also matches reductions in monthly payments dollar-for-dollar with the lender/investor from 38 percent to 31 percent DTI. This requires the lender/investor to take the first loss in reducing the borrower payment down to a 38 percent DTI, holding lenders/investors accountable for unaffordable loans they may have extended.

To encourage the modification of current loans expected to default, HAMP provides additional incentive to servicers and lender/investors when current loans are modified.

Signs of Progress

Our progress in implementing these programs to date has been substantial, but we recognize that much more has to be done to help homeowners. Today, I want to highlight some key points of success:

We have signed contracts with over 45 servicers, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the GSEs, more than 85 percent of all mortgage loans in the country are now covered by the program.

Over 570,000 trial modifications have been offered under the program. Over 360,000 trial modifications are underway.

At this early date, HAMP has already been more successful than any previous similar program in modifying mortgages for at risk borrowers to sustainably affordable levels, and helping to avoid preventable foreclosures.

Nonetheless, we recognize that challenges remain in implementing and scaling up the program, and are committed to working to overcome those challenges and reach as many borrowers as possible. In particular, we are focused on addressing challenges in three key areas: capacity, transparency and borrower outreach.

Expanding Servicer Capacity

We are taking a number of steps and working with servicers to expand nationwide capacity to accommodate the number of eligible borrowers who can receive assistance through HAMP. I highlight some key measures below:

One, we are asking that all servicers move rapidly to expand servicing capacity and improve the execution quality of loan modifications. This will require that servicers add more staff than previously planned, expand call center capacities, provide a process for borrowers to escalate servicer performance and decisions, bolster training of representatives, enhance on-line offerings, and send additional mailings to potentially eligible borrowers

On July 9, as a part of the Administration's efforts to expedite implementation of HAMP, Secretaries Geithner and Donovan wrote to the CEOs of all of the servicers currently participating in the program. In this joint letter, they noted that "there appears to be substantial variation among servicers in performance and borrower experience, as well as inconsistent results in converting trial modification offers into actual trial modifications." They called on the servicers "to devote substantially more resources" to the program in order for it to fully succeed.

The joint letter to participating servicers also requested that the CEOs designate a senior liaison, authorized to make decisions on behalf of the CEO, to work directly with us on all aspects of MHA and attend a program implementation meeting with senior HUD and Treasury officials on July 28, 2009.

At the meeting on July 28, servicers committed to reaching a cumulative target of 500,000 trial modifications started by November 1, 2009. We are on track to meet that goal.

Two, we have made significant progress in reaching implementation objectives outlined during our July 28 meeting.

We are establishing denial codes that will require servicers to report the reason for modification denials, both to Treasury and to borrowers. This will enhance Treasury's ability to evaluate the program and consider options for further program enhancement. We expect denial codes to become operational on Oct. 1.

We are working with servicers and Fannie Mae to streamline application documents and develop web tools, which can serve as a centralized point for modification applications, and for borrowers to check the status of their applications.

Three, we are taking additional steps to expedite implementation, including greater disclosure of the NPV evaluation.

Transparency and Accountability

As Secretary Geithner has noted, we are committed to transparency and better communication in all of Treasury's programs. Accordingly, Treasury is focused on continued transparency and servicer accountability to maximize the effectiveness of HAMP. Specifically, we have taken three additional concrete steps in conjunction with the July 28 servicer liaison meeting to enhance transparency in the program:

On August 4, we began publicly reporting servicer-specific results on a monthly basis. The second public report was published this morning, September 9. These reports provide a transparent and public accounting of individual servicer performance by detailing the number of trial modification offers extended, the number of trial modifications underway, the number of official modifications offered and the long terms success of modifications.

Two, we are working to establish specific operational metrics to measure the performance of each servicer. These performance metrics are likely to include such measures as average borrower wait time in response to inquiries, the quality of information provided to applicants, procedures for document processing and review, and response time for completed applications. We plan to include these metrics in our monthly public report.

Finally, on July 28 we asked Freddie Mac, in its role as compliance agent, to develop a "second look" process pursuant to which Freddie Mac will audit a sample of MHA modification applications that have been declined.

This “second look” process began on August 3, and is designed to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification.

In addition, the “second look” program is examining servicer non-performing loan (NPL) portfolios to identify eligible borrowers that should have been solicited for a modification, but were not.

We have also expanded the efforts of the federal government to combat mortgage rescue fraud and put scammers on notice that we will not stand by while they prey on homeowners seeking help under our program.

Borrower Outreach

The third challenge we are tackling aggressively is borrower outreach. We recognize the importance of borrower outreach and education and are committing significant resources, in partnership with servicers, to reach as many borrowers as possible. Here, we have taken a number of steps:

We have launched a consumer focused website, www.MakingHomeAffordable.gov, with self-assessment tools for borrowers to evaluate potential eligibility in the MHA program. This website is in both English and Spanish and already has over 34 million page views.

We have worked with an interagency team to establish a call center for borrowers to reach HUD approved housing counselors, so that they are able to receive direct information and assistance in applying for the HAMP program.

Working closely with Fannie Mae, we have launched an effort to hold foreclosure prevention workshops and borrower outreach events in cities facing high foreclosure rates. These foreclosure prevention events include counselor training forums where representatives from Treasury, Fannie Mae, HUD and other agencies provide information and training to local housing counselors and non-profit groups, leveraging local resources to expand the reach of the HAMP program. We will have visited 10 hard hit markets by October 1, and will continue our outreach efforts throughout the fall and the year to come.

HAMP has made significant progress in reaching borrowers at risk of foreclosure. However, much more remains to be done and we will continue to work with other agencies, regulators and the private sector to reach as many families as possible.

Program Limitations

Finally, we recognize that any modification program seeking to avoid preventable foreclosures has limits, HAMP included. Even before the current crisis, when home prices were climbing, there were still many hundreds of thousands of foreclosures. Therefore, even if HAMP is a total success, we should still expect millions of foreclosures, as President Obama noted when he launched the program in February.

Some of these foreclosures will result from borrowers who, as investors, do not qualify for the program. Others will occur because borrowers do not respond to our outreach. Still others will be the product of borrowers who bought homes well beyond what they could afford and so would be unable to make the monthly payment even on a modified loan.

Nevertheless, for millions of homeowners, HAMP will provide a critical opportunity to stay in their homes. It will bring relief to the communities hardest hit by foreclosures. It will provide peace of mind to families who have barely managed to stay current on their mortgages or who only recently have fallen behind on payments. It will help stabilize home prices for all American homeowners and, in doing so, aid the recovery of the U.S. economy.

Conclusion

In less than six months, including the initial start-up phase, HAMP has accomplished a great deal and helped homeowners across the country. But we recognize the continued commitment needed to help American families during this crisis and will aggressively continue to build on our progress to date. For example, we are taking additional steps to expedite program implementation and increase take-up, including: implementing the Foreclosure Alternatives Program and strengthening the HOPE for Homeowners refinancing program. Each of these supplemental programs, along with the Second Lien Program and Home Price Decline Protection Incentives is designed to increase the effectiveness and take-up of the first lien modification plan.

Sustained recovery of our housing market is critical to lasting financial stability and promoting a broad economic recovery.

We look forward to working with you to help keep Americans in their homes, restore stability to the US housing market and growth to the U.S. economy.

Thank you. I look forward to your questions.

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