Statement of

Patrick J. Lawler, Chief Economist

Federal Housing Finance Agency

Before the House Financial Services Committee

Subcommittee on Housing and Community Opportunity

”Examining the Making Home Affordable Plan”

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Chairman Waters and Ranking Member Capito, thank you for the opportunity to testify before this committee on the *Making Home Affordable* plan. This is an important topic and FHFA is happy to contribute to the dialogue. My name is Patrick Lawler, and I am FHFA's Chief Economist.

Today, the country faces an enormous challenge to stabilize the housing market. FHFA and the housing GSEs are actively working on foreclosure prevention to help homeowners in trouble through the *Making Home Affordable* plan. This is a major component of FHFA's efforts to ensure the housing GSEs fulfill their mission of providing liquidity, stability, and affordability to the housing market.

The *Making Home Affordable* plan is a critical component of President Obama's financial stability plan. The affordability plan reaches out to millions of American homeowners who are trying to keep their homes in these difficult economic times to help them refinance or modify their mortgages so that they will have more affordable mortgage payments. My testimony today will summarize the prominent role of Fannie Mae and Freddie Mac in this plan and progress made in implementing the plan.

Market Conditions

In late 2006 and 2007, rising delinquency and default rates on recently-originated subprime mortgages made investors aware of the extent of poor underwriting in subprime lending. In the second half of 2007, these factors led to a virtual collapse of the primary and secondary markets for subprime and nontraditional mortgages. These issues have extended to the primary markets and, combined with the economic downturn and reduced house prices, have created a serious problem with millions of American homeowners potentially facing foreclosure.

Over the past two years, serious delinquencies of 90-days or more have risen across the board. For subprime mortgages, serious delinquencies are 23 percent, and for subprime ARMs, 34 percent. Serious delinquencies are far lower at Fannie Mae and Freddie Mac at about 2 percent, which is even lower than the rate for all prime loans at 3.7 percent or the rate for all loans at 6.3 percent. Delinquencies in all categories are continuing to rise.

While Fannie Mae and Freddie Mac own or guarantee almost 31 million mortgages, about 56 percent of all single-family mortgages, the mortgages they own or guarantee only represent 20 percent of serious delinquencies. Private-label mortgage-backed securities represent 15 percent of the mortgages but 50 percent of the serious delinquencies. This is the problem we face in foreclosure prevention. If we are going to stabilize the housing market, we have to address that 50 percent, which comprises mostly subprime and alt-A loans. We believe Fannie Mae and Freddie Mac must be leaders in improving, promoting, and enforcing industry standards and best practices for all mortgages, and their roles in *Making Home Affordable* reflect that.

Overview and Expected Impact of the Homeowner Affordability and Stability Plan

FHFA was pleased to work on the development of the Administration's plan, announced in February and published in detail on March 4, 2009. It is a major step forward in reducing preventable foreclosures and stabilizing the housing market. It aggressively builds on the FDIC's and our streamlined mortgage modification programs. The key elements of the plan involve Fannie Mae and Freddie Mac.

1. *Making Home Affordable* refinance plan**.** Fannie Mae and Freddie Mac will provide access to low-cost refinancing for loans they own or guarantee. This will help homeowners reduce their monthly payments and avoid foreclosure. It is designed for borrowers who are current in their payments and seek to refinance at a lower rate or into a safer mortgage but who have experienced difficulties due to declining home values and limited availability of mortgage insurance.

2. *Making Home Affordable* modification plan**.** A $75 billion program will establish a national standard for loan modifications. Treasury will share a portion of the costs, which will provide financial incentives to borrowers, lenders and servicers. The Enterprises will monitor servicer compliance with the plan's rules, and for those loans owned or guaranteed by Fannie Mae or Freddie Mac, the Enterprise will bear the full costs of the modifications.

3. Treasury will support low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac. The Treasury Department doubled the size of its Preferred Stock Purchase Agreements to $200 billion each. This increase should remove any possible concerns that investors in debt and mortgage-backed securities have about the strong commitment of the U.S. Government to support Fannie Mae and Freddie Mac. In addition, the Treasury Department will continue to purchase Fannie and Freddie MBS, and increased each GSE's allowable mortgage portfolios by $50 billion to $900 billion, along with corresponding increases in allowable Enterprise debt outstanding.

Taken together, these three elements are extremely important steps toward achieving a recovery for housing markets and the entire economy.

Before going further, let me stress that a lot of work remains ongoing to operationalize these programs. So, my testimony today is a status report on those activities and there will be further details and information rolled out to servicers and to the public in the days and weeks ahead.

FHFA's Role in the Design of the *Making Home Affordable* Plan

During the last two months, FHFA has been working with Treasury and other agencies to help develop the details of the *Making Home Affordable* plan, first announced in February of this year. Drawing on the loan modification experience of Fannie Mae and Freddie Mac, and their Streamlined Modification Program (SMP), we have provided expertise and information to structure the new affordability plan to make it most effective.

Director Lockhart announced the Streamlined Modification Program in November. It was developed jointly with the U.S. Treasury, HUD, Fannie Mae, Freddie Mac, and HOPE NOW's members. More than 90,000 solicitation letters and modification agreements were sent to eligible borrowers. We have been carefully monitoring the success of the program, but it is clear that the program needs to be more aggressive to reach more troubled borrowers. The Making Home Affordable loan modification program is designed to meet that need. Fannie Mae and Freddie Mac have taken many additional steps to help avoid preventable foreclosures. They suspended foreclosures and evictions and developed programs to protect renters living in foreclosed properties. They are pulling loan files for a "second look" before foreclosures, and they are working with credit and housing counselors.

The new loan modification plan is based on our experience with SMP in a number of ways and builds on that success. For loan modifications, the SMP set a 38% debt to income ratio, which would lower the borrower's mortgage payment to no more than 38% of their income. We intended this to become a minimum standard across the industry, and for servicers to be able to go even lower. However, we have found that this is not always enough to provide an affordable payment to borrowers and help them avoid foreclosure. The *Making Home Affordable* modification plan lowers the debt to income ratio to 31%, with the government paying half the cost between 38% and 31%. We expect that with this lower ratio and payment, many more homeowners will be able to remain in their homes.

SMP was targeted toward borrowers who were most at risk – those who were 90 days behind in their mortgage. It is critically important to get to troubled borrowers as soon as possible, before they are significantly behind on their payments in order to keep more people in their homes. The *Making Home Affordable* modification plan goes even farther and includes homeowners who are facing reasonably foreseeable or imminent default, but are still current on their mortgage.

Implementation of the Making Home Affordable Plan

The *Making Home Affordable* plan is in the implementation stage. Both Fannie Mae and Freddie Mac will participate in the *Making Home Affordable* modification program both for the loans that they own or guarantee and as administrators on behalf of the Treasury Department for all other loan modifications under this program. Fannie Mae and Freddie Mac are the only participants in the *Making Home Affordable* refinance program, which includes new refinancing flexibilities for homeowners whose loans are owned by each of the Enterprises. The Enterprises have already issued guidance for their participation in these programs.

As an administrator of the modification program, Fannie Mae is working on guidance to seller/servicers that would address loans owned by Fannie Mae and Freddie Mac, and those owned by investors in private-label securities. Many of these securities have pooling agreements that require that servicers can modify loans only if they follow industry standards. Fannie Mae will be issuing new standards for servicers of private label securities, setting these new standards. This overcomes a major obstacle to loan modification. We expect these developments, along with the incentives offered to servicers to modify loans instead of foreclosing on homes, will motivate servicers, especially those related to private-label securities, to help American homeowners.

Each Enterprise has other key roles in the implementation of this program. Fannie Mae also has a paying agent role to provide the incentive payments to servicers who have modified loans. Incentives for modifications on loans that Fannie Mae and Freddie Mac already own will be paid out of their funds, while incentive payments on loans owned by other investors will be paid with TARP funds. In addition, Fannie Mae will be required to maintain data and report on how many loans are refinanced or modified, as well as relevant statistics about those loans.

Freddie Mac has an important audit and compliance role with the modification program. It will take a lead role in reviewing servicers' compliance with the program guidelines and ensuring that noncompliance is reported and handled, including required reporting, documentation and on-site visits to the servicers. Both Enterprises are hiring or transferring the necessary staff to conduct their respective roles in the program. And both Enterprises are developing appropriate systems, confidentiality standards and firewalls to ensure that this program has the highest integrity. FHFA is confident that both Fannie Mae and Freddie Mac have fully embraced their roles and are on track in developing the necessary infrastructure to ensure that the *Making Home Affordable* plan is a success.

The modification plan requires that servicers modifying loans use a Net Present Value model to determine if the borrower is eligible. FHFA has been working with experts from Fannie Mae, Freddie Mac, the FDIC and Treasury to put this model in place. The model includes acceptable discount rates, property valuation methodologies, house price appreciation assumptions, as well as foreclosure costs and timelines and borrower cure and redefault rate assumptions. This underwriting process will help reduce the possibility of redefault and mortgage fraud, which are concerns to everyone.

Monitoring and Oversight of the *Making Home Affordable* Plan

While I have described the plans that have been made and the progress in implementing them, what really count are the results. We have several ways of tracking the impact the plan is having on foreclosures and the economy through required reporting described above. In our role as the Enterprises' regulator, we are in a unique position to oversee the implementation of this plan and monitor its results.

Beyond continuing with our regular comprehensive examination work, FHFA will also be establishing a special team of trained examiners with expertise in key areas to pay careful attention to the implementation and results of the plan. This team will focus on the data used and created by the program, anti-fraud efforts, servicer registration, human resources, system development, and Freddie Mac's compliance function and internal controls over Fannie Mae's paying agent role.

As I mentioned earlier, Fannie Mae has a critical reporting role in this program and will be systematically collecting data, which FHFA will also review, about the loans made under this program, including re-default rates. We are hopeful that this information can be used to improve the program. For example, information on the performance of the loan made under this program could be used to improve the underwriting standards and the NPV model. Statistics on servicer participation could be used to address other challenges that the servicers of loans bundled in private-label securities are facing.

In addition, FHFA will publish information related to Treasury's and the Federal Reserve's purchase of senior preferred stock and mortgage-backed securities, and use of the GSE credit facility on regular basis starting this month. In September, FHFA began publishing *Foreclosure Prevention Reports*, which are transparent reviews of key performance data on foreclosure prevention efforts. These monthly and quarterly reports present data from more than 3,000 approved servicers on 30.7 million first-lien residential mortgages serviced on behalf of Fannie Mae and Freddie Mac, of which 84 percent are prime. FHFA will continue to release these reports and monitor the progress and results of the *Making Home Affordable* plan.

Next Steps for Homeowners

I've described the challenges we face in foreclosure prevention and the solutions we are implementing through the *Making Home Affordable* plan. Let me provide you with some next steps for American homeowners to take advantage of the plan.

I would encourage everyone to visit the website financialstability.gov or makinghomeaffordable.gov. At these websites, homeowners can learn more details about the plan and the options we have discussed. If they are current on their mortgage payments, they can learn if Fannie Mae or Freddie Mac owns their loan and the steps to apply for the refinance program. If they are behind on their mortgage, they can identify who to contact and what information they need to apply for the modification program. There is also a self-assessment tool for homeowners to determine if they are eligible. For those homeowners with questions or unsure of their situation, I would urge them to call 1-888-995-HOPE, the HOPE Now hotline to reach a free HUD-approved housing counselor to help them with the new program. Everybody who is struggling with their mortgage payment should look into how the *Making Home Affordable* plan can help them.

FHFA understands the nation's deep concern over the human tragedies of the foreclosure crisis. We believe that the *Making Home Affordable* Plan is the best way to help both the American homeowners and the economy in the long run. Thank you for the opportunity to offer this testimony. I will be happy to answer questions.