



**Testimony of
the Mortgage Bankers Association**

on

**“Emergency Housing Needs in the Aftermath of
Hurricane Katrina”**

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and

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Residential Loan Administration Steering Committee

**before the U.S. House of Representatives,
Committee on Financial Services
Subcommittee on Housing and Community Opportunity**

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Mr. Chairman and Ranking Member Waters, my name is J.K. Huey and I am Senior Vice President of Home Loan Servicing for IndyMac Bank. I also serve as Chairperson to the Mortgage Bankers Association's (MBA)¹ Residential Loan Administration Committee. I am here today to let the Committee know how the mortgage industry is responding to Hurricane Katrina and to share with you some ideas of how Congress may be able to help homeowners. In addition, I will share specific needs of the commercial real estate sector that will stimulate economic revitalization. Finally, I would like to discuss some of the challenges our industry faces in the months to come.

For the last two and a half weeks, I have watched with sadness as the waters rose and now as the waters recede. I am sure all of us in this room are watching the rescue, recovery, and clean-up operations with prayers for those who succumbed to nature's wrath, for those living without a home and for those who are charged with rescuing people and keeping them safe. While certainly nothing was perfect over the last two weeks, I have been amazed and proud to watch the brave Coast Guard personnel rescue people from their roofs and attics, and watched as strangers opened their homes, offered money and committed other acts of kindness for fellow Americans in need.

What we have witnessed over these last weeks has been an absolute tragedy, and we mourn the loss of life and homes. Few of us will ever forget the pictures we saw on television and in the newspapers. Our brave rescue workers are continuing their sad work of searching homes for signs of those who perished inside. We are all thinking of them.

Many member companies have operations in the affected areas. The first and most urgent endeavor of these companies was to locate employees and ensure their safety. While I do not have any specific information, it is my great hope that all employees and their families are safe and secure.

¹ **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,900 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.**

The mortgage industry's focus is also on its customers and how to provide the services they need. As with everyone in the country, we want, and in many instances can, provide immediate assistance to those who need it. For those who have mortgage loans with our member companies, we want to ease their burden as much as is possible.

But the mortgage industry will face its own challenges, especially those heavily invested in the affected communities. Those challenges include, among others, maintaining liquidity to provide temporary and long-term forbearance to borrowers, dealing with conflicts among insurance companies over coverage, managing properties that will be abandoned, gaining access to properties to perform inspections and emergency repairs and the resulting costs and losses associated with all of these challenges.

While no firm data are currently available, we estimate that as many as 360,000 mortgages were impacted by Hurricane Katrina. This number includes both loans secured by properties directly damaged by the Hurricane, as well as properties affected by secondary economic impacts, such as job losses from the Hurricane's aftermath.

The industry wants to see the Gulf Coast region prosper again, and we need to support the infusion of capital to these areas and encourage rebuilding of communities.

I. The Mortgage Industry's Response to Borrowers Affected by Hurricane Katrina

As this subcommittee knows, investing in a home is the single largest investment many Americans will ever make. As a result, we recognize that we must be available to our customers, even though some of our own operations have been severely impacted.

Mortgage companies understand the difficulties many borrowers are facing, not only with the loss or damage to their homes, but the emotional toll as well. The inability for many homeowners to return to their properties to assess the damage and begin repairs and rebuilding their lives compounds the stress many of these homeowners are under. The mortgage banking industry is committed to providing assistance to affected borrowers during this time of crisis.

The real estate finance system stepped into motion immediately upon learning of the damage caused by Hurricane Katrina. And by all accounts, our industry's response to borrowers' issues is positive. Mortgage companies are assisting affected borrowers, especially those with severely damaged properties, in the following ways:

- Providing extended grace periods to make their mortgage payments;
- Waiving late fees during this period;
- Waiving the reporting of derogatory information to credit bureaus;
- Waiving delinquency notices;
- Placing outbound calls and emails to customers to discuss their needs for extended forbearance and loss mitigation;
- Postponing foreclosure actions; and
- Requesting property preservation crews to go to affected areas to assess damage and provide emergency protective measures, if needed and appropriate.

Servicers are assisting borrowers in other ways including providing longer-term loss mitigation solutions, and second mortgages, renovation loans and refinance mortgages. But it is critical that borrowers contact their servicers so that all the options can be explored.

MBA understands that many borrowers are displaced from their homes and may not know how to reach the lender to seek out these benefits. In light of this fact, MBA has undertaken a series of public service announcements in major media markets where displaced residents are being housed, as well as in newspapers published in the Gulf Coast states. These advertisements provide lists of servicers' toll free numbers. In addition, MBA is posting servicers' toll free numbers on our website www.mortgagebankers.org and on our consumer-based site www.homeloanlearningcenter.org. We are asking the appropriate government and private sector organizations to further disseminate this information.

MBA has also committed a total of \$600,000 in donations to worthy organizations assisting individuals in the disaster areas. MBA has contributed \$100,000 to the American Red Cross and is committed to donate an additional \$500,000 to Habitat for Humanity International to underwrite the first year of a Program Management Office that will direct Habitat's "Home-In-A-Box" rebuilding initiative. This gift will enable Habitat for Humanity to employ additional experienced and talented individuals from the construction industry and to lay the groundwork for a recovery program focused on impacted families. Many of our member companies and their employees, including IndyMac Bank, are donating substantial amounts to the relief and rebuilding efforts.

It is important to note that mortgage companies are assessing and re-assessing the needs of our customers on an almost continual basis as we learn more about the problems they face and the scope and severity of their property damage. The mortgage industry, however, requires the flexibility to deal with the whole range of customer needs and to deal with our corporate responsibilities to protect the safety and soundness of our institutions and our shareholders. We must also abide by statutory and contractual requirements.

II. Federal Assistance to Address Immediate Housing Needs

The Subcommittee has asked MBA to provide recommendations for addressing both the short-term and long-term housing needs for individuals displaced by the hurricane. We would like to share the following suggestions on immediate housing needs:

a. Removal of Restrictions in Federally Assisted Housing Programs

Currently there are vacant apartments in areas where families were evacuated. Many of these apartments receive some sort of federal subsidy and are subject to federal regulations limiting who may occupy them. In order to provide a comprehensive and coordinated response, Congress should provide a temporary, emergency waiver of all program requirements for: Low-Income Housing Tax Credit (LIHTC) properties; properties funded with the proceeds from multifamily tax-exempt bonds; properties financed by the Federal Housing Administration (FHA); and properties that receive HUD subsidies, including Section 8 vouchers.

Among the many requirements that are limiting the supply of housing for hurricane victims are:

- Income and student status restrictions and verifications
- Tenant rent contributions
- Federal Emergency Management Agency (FEMA) certification
- Waiting list rules
- Initial inspection requirements
- Voucher payment standard ceiling
- Minimum lease terms
- Household size limits
- The required form of lease
- Portability of vouchers

While we appreciate the fact that the Departments of Treasury and HUD have responded in a measured way on programs within each Department's jurisdiction, Congress should act to provide clear authority and direction in this time of national emergency. A comprehensive waiver would allow apartment owners to respond immediately to the enormous need for shelter and avoid unnecessary and needless delays caused by all of the current program rules and regulations. A broad waiver would also allow state and local agencies to respond to this emergency without burdening them with needless paperwork.

b. Additional Federal Funding for Rental Assistance

Because many of the displaced families have lost their jobs, the need for rental assistance is much greater than can be accommodated with existing resources. Congress should provide funding for an initial 50,000 emergency Section 8 vouchers to be administered by the appropriate local housing agencies.

c. HOME Program

The HOME program provides formula grants to states and localities to fund housing activities. It is an affordable housing block grant program. States and localities, in partnership with local organizations, can build, purchase, or rehabilitate housing units available for rent or homeownership or can provide direct rental assistance. The program's great benefit is that it allows states and localities to use the funds for grants, direct loans, loan guarantees, credit enhancements, rental assistance or downpayment assistance. Each community decides for itself what priorities need to be funded.

In the Hurricane Katrina disaster area, HUD has allowed HOME grantees to reprogram previously awarded grants to redirect their funds to disaster recovery activities. HUD has also waived requirements to serve the housing needs of those displaced. HUD has shortened the time frame for amending a participating jurisdiction's consolidated plan, waived the source documentation for income verification, and waived property and rent standards for tenant-based rental assistance. Additionally, HUD has also waived some requirements for those participating jurisdictions that provide housing and shelter for evacuees. All of these waivers should be implemented immediately upon requests from overburdened participating jurisdictions.

MBA supports these waivers to current HOME program requirements to assist the families tragically impacted by the hurricane. MBA strongly supports increased emergency HOME funding to the hurricane disaster communities and those communities temporarily housing the evacuees and, therefore, taxing their resources. Current funding levels did not anticipate a disaster of this magnitude and a program with this flexibility should be used to its utmost. Waivers should remain in place for at least one year, preferably longer, and further waivers of matching requirements, income eligibility requirements, and maximum per unit subsidy restrictions under the HOME program should be included in any relief package for disaster victims and those communities accepting evacuees.

d. Use of Government Real Estate Owned

We are aware that HUD Secretary Jackson is assessing the inventory of HUD-owned homes to determine which ones are immediately available as temporary housing. It is our understanding that 50 percent of its current Real Estate Owned (REO) properties have been earmarked for evacuees, with more to come. The Department of Veterans Affairs (VA) has also announced that it is suspending REO sales and will pledge these properties to house displaced citizens. The

USDA Rural Housing Service (RHS) is undertaking similar action. We applaud Secretary Jackson, Secretary Nicholson and Secretary Johanns for their ingenuity and help. We know that in many cases REO properties are severely distressed and are not habitable because they are missing basic appliances and utilities or fail local safety codes. The FHA, VA, and RHS will need to be freed from restrictions in moving and applying existing internal funds for repairs to REO properties so they meet move-in and local code requirements. Additionally, these entities may likely need appropriations to meet property needs that aren't covered from any insurance proceeds or internal funds.

III. Longer-Term Housing Needs/Renovation Needs

In addition to addressing short-term housing needs, Congress should address the large challenge of renovating homes and apartments, as well as building replacement housing in the Hurricane-affected areas. We believe FEMA, FHA, RHS other government programs can be a catalyst for rebuilding neighborhoods, but current program requirements will be difficult to overcome. For example, obtaining an appraisal will be difficult, if not impossible, in many of these areas because there will be few if any comparable sales (for single family) or rent comparables (for multifamily). Loan limits may need to be waived in order for the Federal government to insure a wider variety of properties. Also, new and increased authority needs to be given to handle the magnitude of assistance we anticipate individuals will need. We offer the following recommendations:

a. Enhancements to FEMA-provided Assistance

Many disaster victims are turning to FEMA and the Small Business Administration (SBA) for assistance. These agencies offer a wide range of disaster relief programs that will be critical to stabilizing local economies in the affected cities and counties and ensuring affected Americans get back on their feet. Over the years, Congress has adjusted the authority FEMA has in providing financial assistance. In some cases it has added new authority and, in others, taken it away. We would encourage a revisiting of these programs. In particular, we suggest the following revisions:

i. Remove FEMA caps on Assistance for Repairs

Currently FEMA has authority to provide individual assistance up to \$26,200. There are various caps within that amount for home repair or replacement. We recommended removing those caps in order that the entire amount can be used for home repair or replacement if desired and appropriate.

ii. Temporary Mortgage and Rental Assistance

Prior to 2002, FEMA was permitted under the Stafford Act, 42 USC 5174(b), to provide temporary mortgage or rental assistance to disaster victims who, as a result of financial hardship caused by a major disaster, were unable to continue

paying their pre-disaster rent or mortgages. Unfortunately this form of housing assistance became unavailable for disasters declared on or after May 1, 2002. We believe the re-enactment of this provision would go a long way to assist persons affected by this storm. The authority, if reinstated, should not be subject to the individual cap referenced above.

b. FHA Enhancements

i. Section 223(e) Program:

Congress should consider amending FHA's the Section 223(e) program to apply to Hurricane-affected areas. Section 223(e) is a program that insures loans made to renovate older single- and multi-family housing stock. This change would require 1) an amendment to current statute as Section 223(e) is now limited to "property located in an older, declining urban area" and 2) an appropriation of credit subsidy as these loans are part of the Special Risk Insurance Fund and will probably be determined by HUD to require credit subsidy. An appropriation of credit subsidy in the amount of \$70 million over the next two years should be sufficient.

Section 223(e) could be amended by inserting the bold language as provided below.

Section 223(e). Notwithstanding any of the provisions of this Act except section 212, and without regard to limitations upon eligibility contained in any section of this title or title XI, the Secretary is authorized, upon application by the mortgagee, to insure under any section of this title or title XI a mortgage executed in connection with the repair, rehabilitation, construction, or purchase of property located in an older, declining urban area **or in an area designated for public assistance by FEMA as a result of Hurricane Katrina**, in which the conditions are such that one or more of the eligibility requirements applicable to the section or title under which insurance is sought could not be met, if the Secretary finds that (1) the area is reasonably viable, giving consideration to the need for providing adequate housing or group practice facilities for families of low and moderate income in such area, and (2) the property is an acceptable risk in view of such consideration. The insurance of a mortgage pursuant to this subsection shall be the obligation of the Special Risk Insurance Fund.

By utilizing this program, HUD would have authority to waive underwriting requirements, but must still assure that the property is an acceptable risk.

c.. Enhancements to Rural Housing Service

While we believe that RHS has the authority to amend necessary underwriting guidelines to account for situations that borrowers face due to Hurricane Katrina, we do believe they need to be granted broad authority, such as Section 223(e) gives FHA, to waive a number of program requirements.

Among the temporary program changes we suggest at this time are the following:

- MBA suggests relaxing the service area population limits for RHS programs to ensure they can aid a greater area within the disaster zones. Specifically, 42 U.S.C. 1490q allows the Secretary of Agriculture to waive the rural area definitions. We believe this authority should be utilized to allow RHS to operate in any area that had a pre-hurricane population of 50,000 or less.
- RHS should also be able to relax their income limits for families under their guarantee programs, as directed in Section 502(h)(2). MBA suggests that national median income should be used, in order that all affected areas are treated the same.
- MBA also suggests that Section 502 Guarantee income limits be raised from their current level of 115% of median income to 150% of median income.
- Furthermore, borrowers refinancing under the Section 502 program should have the ability to include repairs into the mortgage. Because the goal of rebuilding is to bring back communities, the income focus that is relevant under normal conditions may be constricting in the disaster areas.
- RHS should be given the authority to relax provisions of Section 502(h)(13)(A) and Section 502(h)(13)(B) to permit refinancing of non-RHS loans under its programs and refinancing to a higher rate, if necessary. MBA believes this would allow RHS to aid those families that currently do not have an RHS loan, but could find relief in refinancing to an RHS loan. Furthermore, it may behoove a mortgagor to refinance to a higher rate, if other characteristics of the RHS mortgage, such as term, provide a financial benefit to the borrower.

RHS, like FHA, would require appropriations to adequately serve the families in these areas. MBA believes, though, that the cost-effective insurance and guarantee programs of FHA and RHS will prompt private capital to return to the area, thus with less direct appropriations from Congress ultimately being required.

d. Increasing Low-income Housing Stock

Because many of the displaced families are low-income and will not be able to afford market rents, long-term building efforts should include new project-based Section 8 rental assistance and increases for low-income housing tax credits and tax-exempt bonds for the States affected by Hurricane Katrina.

IV. Commercial Property Reconstruction & Economic Stimulation: REMIC Legislation

With preliminary damage estimates from Hurricane Katrina currently speculated to reach as high as \$100 billion,² the rebuilding of the Gulf Coast areas affected by Hurricane Katrina will not occur overnight. The reconstruction and renovation of the commercial spaces in these areas will require a multi-disciplinary team of experts and public/private cooperation at all levels to revitalize these communities suffering from vast devastation. MBA strongly encourages investment in these communities and recommends that immediate measures be taken by Congress to spur community and economic development, in order that these areas may once again be vibrant places to live, work, shop and be entertained.

a. REMIC Legislation

In the House, a bill currently exists to improve the usefulness of REMICs (real estate mortgage investment conduits) by permitting certain technical loan modifications while maintaining qualified tax status. It is:

- HR 1010, introduced March 1, 2005 sponsored by Representatives Foley (R- FL) and Pomeroy (D- N.D.).

The proposed reform of the real estate mortgage investment conduit (REMIC) loan modification rules would affect real estate owners and tenants, the suppliers of real estate design, construction and renovation services, and the many businesses that provide services in conjunction with real estate sales. The proposed changes would allow REMICs to accommodate real estate owners in maximizing the value of their properties.

These changes are particularly relevant given the recent devastation caused by Hurricane Katrina. The changes would encourage owners to rebuild or renovate their properties, accelerate the flow of construction and renovation funds into the U.S. economy, increase real estate transaction volumes, and enhance the economic stimulus associated with the real estate sector. By maximizing the value of the real estate collateralizing REMIC securities, these changes also

² Estimate cited in JPMorgan "CMBS Research Special Topic: Commercial Property Insurance De-Mystified," September 7, 2005

maintain or enhance the security of REMIC bondholders under changing market conditions.

According to the Joint Committee on Taxation's *General Explanation of the Tax Reform Act of 1986*, it was believed that REMICs "should be flexible enough to accommodate most legitimate business concerns while preserving the desired certainty of income tax treatment." The changes recommended under the industry's proposal will not cause REMIC trusts to be engaged in an active business and will not alter the tax treatment of the REMIC vehicle, but will make REMIC rules more responsive to real estate business needs that are heightened in the declared disaster area of Hurricane Katrina.

Here are two of the most common ways in which the proposed changes would be applied by real estate owners in communities throughout the U.S. and particularly by those in the disaster area:

i. Preparing Space for Tenants

When commercial real estate owners lease space to a tenant, they frequently demolish the interior walls used by the previous tenant in order to reconfigure the premises for the incoming tenant. Owners also remove interior fixtures and carpeting, and install new walls, fixtures, paint and carpet for the new tenant. The improvements for a new tenant are known as "tenant improvements" and are negotiated as part of almost every commercial lease.

Under the REMIC rules, a tax opinion must be obtained before demolishing space in conjunction with building tenant improvements. If the space comprises more than 10% of the REMIC collateral, the change could be denied. This requirement makes it difficult for property owners to reconfigure their space in a timely manner and could cause them to lose leases with prospective tenants. Revision of the REMIC rules to permit owners to demolish space in order to construct new improvements would make the REMIC vehicle more useful to real estate owners and in the wake of Hurricane Katrina, provide for the most flexibility in rebuilding. Given the wide-spread water damage to properties affected by Hurricane Katrina, it is easily anticipated that many office buildings, hotels, and retail spaces will need to have greater than 10% of the collateral reconfigured.

ii. Sales of Outparcels or Pad Parcels

Often, commercial sites contain "excess" land which contributes little economic value to the improvements (outparcels) and would be more valuable to a third party. Retail sites often contain land that can be sold to a third party for a free-standing retail facility, often a smaller restaurant, bank or drive-through facility (pad parcels). Under the current REMIC structure, sales of outparcels or pad parcels require a tax opinion. If the value of the outparcel or pad parcel is

believed to materially alter the collateral, the sale could be prohibited under the REMIC structure, even though the cash realized from the sale would be used to pay down the REMIC loan or applied to property reserves as approved by the lender. Thus, the current REMIC rules prevent outparcel or pad parcel sales that would maximize the value of REMIC collateral and reduce risk to REMIC bondholders. The proposed change would allow beneficial sales to be made, at the lender's option, to accommodate development of potential small business sites as part of rebuilding efforts. For example, in a rebuilding effort a borrower may seek to acquire an additional parcel of land to support parking for an office building. The additional parking enhances the value of the building. Existing REMIC rules will not allow additional collateral to transaction even if it enhances the value of the property.

c. Brownfields Legislation

The situation in New Orleans will also have sweeping environmental implications. In all likelihood there will be many newly contaminated properties that fit the Environmental Protection Agencies (EPA) definition of brownfields properties. Special care and maintenance will be required on all environmentally contaminated properties to ensure the health and safety of the people living on and around these areas. Therefore, MBA supports the passage of the proposed legislation offered earlier this year, H.R. 877 (Representatives Weller, Becerra, and N. Johnson) that provides for expanded expensing of environmental remediation and clean up costs. The bill will also broaden the current definition of "hazardous substances" to include "toxic substances" (notably, petroleum) contamination. In addition, in October 2004, Congress passed H.R. 1308, which extended brownfields protections through 2005; this bill however, does not contain any funding provisions. MBA encourages providing funding for the enacted H.R. 1308 and providing permanent extension of the brownfields protections.

V. Mortgage Company Challenges

Mortgage companies have pledged their support to assist borrowers and the communities they serve during this crisis. However, many of the mortgage companies that have faithfully provided credit to and served these communities for decades will face their own challenges. MBA anticipates an increase in defaults and abandonment rates in disaster areas as borrowers choose not to rebuild, are financially unable to rebuild, or not permitted to do so for environmental or other reasons. While it is still too early to predict the exact magnitude of financial losses, some effort should be made to ensure mortgage companies have sufficient liquidity and control over loan losses.

MBA believes it is critical to begin discussing these business concerns and possible solutions before they become a reality or a crisis. Without solutions that address the entire fabric of these communities – including mortgage companies

and other financial services companies – we fear credit could dry up, causing local recession.

The most immediate need of mortgage companies is liquidity. As indicated earlier, mortgage companies are offering short- and long-term forbearance to borrowers. However, pursuant to mortgage-backed securities (MBS) agreements and contractual obligations, mortgage servicers are required to advance principal and interest payments to security holders during these periods of forbearance. In many cases, mortgage servicers must borrow the funds from banks and other financial institutions to make these advances. The debt service on these loans could place servicers under financial strain, especially companies with large concentrations of loans in affected areas. More assistance is needed to ensure liquidity to mortgage companies at no-cost. Freddie Mac, for instance, has indicated that servicers can suspend the advancement of interest for loans subject to its mandatory 90-day period of borrower forbearance. Principal must still be advanced. We applaud Freddie Mac for not imposing the entire burden on the servicing industry. We hope other holders, guarantors or owners of mortgage loans will follow with similar policies. Congress can assist in this area by enhancing Ginnie Mae's authority.

The industry's long-term needs will be for assistance or relief from losses due to catastrophic damage and high default and abandonment rates.

a. Increasing Liquidity: Allow Ginnie Mae to Advance Principal and Interest on Behalf of Issuers without Declaring an Issuer Default

Ginnie Mae's MBS program functions through servicers, referred to as "issuers." As stated above, issuers are required to advance principal and interest due on the mortgages even if the borrower fails to make the monthly payments. We estimate that approximately \$6.7 billion in Ginnie Mae guaranteed loans are in the disaster areas.

HUD's Office of General Counsel has indicated that it believes Ginnie Mae does not have authority to make advances of principal and interest on behalf of an issuer without a determination that the issuer is in technical default of its contractual obligations. Such a determination of default creates a sizeable business hardship for any financial institution.

A declaration of a default under the Ginnie Mae Guaranty/Contractual Agreement starts a "domino" default under the terms of other contracts issuers typically have for bank loans and warehouse lines. It also triggers defaults with other investors. In addition, external auditors will note the significance of these defaults and refrain from issuing unqualified opinions on the financial condition of the issuer. All of these repercussions are to the detriment of the issuer who is trying to assist homeowners in the affected areas. Without relief, we fear the financial strain on

many issuers will force them to limit forbearance time frames or face financial ruin.

MBA seeks a statutory clarification that Ginnie Mae can make advances of principal and interest for those issuers that are servicing mortgages in the disaster areas without a determination that an issuer is in default. The advances can be made on an interest-free basis. It is our understanding that Ginnie Mae would not object to this clarification of its authority. We have attached model language that would achieve the objective as Exhibit A.

b. Reducing Exposure to Loss: The Impact of VA No-bids

Unlike FHA, the Department of Veterans Affairs (VA) Loan Guaranty Program does not provide 100% insurance against losses due to default. Nor does the VA (and/or Ginnie Mae) make the servicer whole as do Fannie Mae and Freddie Mac (minus some costs that are not reimbursed). The VA is unique in passing risk of declining market prices to servicers because it provides only a limited guaranty. The guaranty varies, but generally covers 25% of the original loan balance. In the event of a liquidation sale (i.e., foreclosure), the VA uses a statutory formula to determine if it will pay only the guaranty or pay the servicer the outstanding debt (called “total indebtedness”) and take title to the property. When the latter occurs the VA sells the REO to recoup the amount paid to the servicer.

When the former occurs and the VA’s determines not to take title to the property, it will issue what is called a “no-bid” Advice Letter. A no-bid occurs, by statute, when the net value (fair market value minus a statutory VA “holding cost” factor) is less than the unguaranteed portion of the total indebtedness (unpaid principal balance, allowable interest and advances less any credits). When this occurs, VA will pay the amount of the guaranty, but will not take title to the property. The servicer thus takes any loss after the resale of the property. These losses can be substantial, and in the wake of Hurricane Katrina, could be catastrophic. There is an expectation that there will be substantial borrower defaults and abandoned properties that have servicers facing increased no-bids.

Most VA loans are in Ginnie Mae MBS and, thus, we reiterate that servicers do not get the benefit of the principal and interest payments. The principal and interest is passed through to security holders, who are protected 100% against principal loss by Ginnie Mae’s guaranty. The servicer takes the principal, interest and even out-of-pocket loss exposure to a large degree, despite the fact that they receive only a small administration fee per loan as income. Servicers are thus not equipped nor are they compensated to absorb *catastrophic* principal, interest and other losses. While it is true that servicers are aware of the risk exposure associated with the VA program, we believe this risk exposure is one factor for the shrinking demand for VA products. We are concerned that without some targeted reduction, servicers may abandon the program altogether as too risky or

will increase rates to price for the *catastrophic* risk. Standard no-bid risk (non-catastrophic) already accounts for ¼ to ½ percent higher interest rates on VA loans than FHA-insured loans.

In an effort to provide the VA with flexibility in this area and to assist mortgage companies in containing total losses, we ask that Congress consider providing the VA authority to waive the statutory requirement to declare no-bids. We ask that VA be permitted to take conveyance to a property and pay the total indebtedness and out-of-pocket expenses in cases of federally declared disasters areas without having to abide by the no-bid calculation. We also suggest allowing the VA to pay a claim even when conveyance does not occur due to unique circumstances, such as a declaration of hazardous waste contamination on the property. We anticipate that our recommendation would require some infusion of federal funds to support VA's activities in this area.

c, Relaxing Capital Standards

Currently bank regulatory capital standards establish the amount of minimum capital banks must maintain to support their portfolios. One-to-four family mortgages are granted a 50% risk weighting, provided the loans are current and conform to the agencies' credit enhancement or equity standards. This means that banks need hold only 4% capital against these assets. Once a loan becomes 90 or more days delinquent, however, the assets are assessed a 100% risk weighting, requiring 8% capital support. It is unclear at this time, whether the regulatory agencies will consider bank efforts to provide forbearance to borrowers for periods of 90 or more days to require this higher capital support. Of course, failure to meet minimum capital standards carries serious repercussions for these lenders and thus current capital requirements may restrict certain banks' (and thrifts') ability to offer more extensive forbearance periods. We would appreciate any Congressional assistance in seeking some relief from inequitable capital treatment of forbearance periods granted to victims of Hurricane Katrina.

VII. Summary

Mr. Chairman and Ranking Member Waters, MBA and the mortgage banking industry are committed to helping borrowers who have been affected by this great national tragedy. Our goal, however, is not *only* to provide for the immediate relief of the victims of the hurricane, but to restore the economic health of the affected communities as well. Part of that community includes the very mortgage companies that have provided mortgage credit and employ people from these communities. MBA's members and staff are available to you at any point going forward to address these and other issues during the coming months and years. We appreciate this opportunity to testify.

EXHIBIT A

PROPOSED AMENDMENT TO THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION CHARTER ACT

(Title III of the National Housing Act, 12 U.S.C. 1716 et seq.)

AUTHORIZATION OF GINNIE MAE TO ADVANCE PAYMENTS OF PRINCIPAL AND INTEREST ON BEHALF OF GINNIE MAE ISSUER/SERVICERS OF MORTGAGES IN GINNIE MAE GUARANTEED SECURITIES WHERE THE MORTGAGED PROPERTY IS LOCATED IN AREAS DESIGNATED AS PRESIDENTIALLY DECLARED KATRINA HURRICANE DISASTER AREAS

Section 306. (g) (1) of the Ginnie Mae Charter Act (12 U.S.C. 1721 (g) (1) is amended by adding the following sentences to follow and clarify the sentence that reads, "In the event the issuer is unable to make any payment of principal of or interest on any security guaranteed under this subsection, the Association shall make such payments as and when due in cash, and thereupon shall be subrogated fully to the rights satisfied by such payment." The additional sentences to be added as amendments to the Charter will read as follows:

"Without limiting the Association's authority to make such payments as described in the prior sentence, the Association expressly is authorized to make such payments of principal or interest on behalf of and upon the request of any issuer, without a finding of issuer default, 1) if the issuer has an obligation to make such payments due to the failure of a mortgagor to make such payments, and 2) if the associated mortgaged property is located in areas designated as Katrina Hurricane disaster areas. In the event that the Association makes such payments, it shall be subrogated fully to the rights satisfied by such payment. Katrina Hurricane related payments made by Ginnie Mae on behalf of an issuer may be made without payment by the issuer of interest to the Association for its advance of payments of principal or interest."

Explanation of Amendment

Ginnie Mae's mortgage-backed securities program functions through servicers, referred to by Ginnie Mae and in its Charter Act as "issuers." The issuers service the mortgage loans backing Ginnie Mae MBS and, pursuant to their obligations, the issuers advance payments of principal and interest due on the mortgages in the event that a borrower fails to make his or her mortgage payment.

Ginnie Mae MBS are backed by mortgages including approximately \$6.7 Billion in unpaid principal balance of mortgages in the disaster area. There is an expectation that there will be a substantial incidence of borrower defaults on these mortgages. Certain small- and medium-sized issuers servicing the mortgages will be unable to make the obligatory advances.

The Office of General Counsel of the U.S. Department of Housing and Urban Development has indicated that it believes Ginnie Mae does not have authority to make advances of principal and interest on behalf of an issuer without a determination that the issuer is in default. Such a determination of default would create a sizeable business hardship for any financial institution.

The Amendment clarifies that Ginnie Mae can make the advances for those issuers servicing mortgages in the disaster area. The advances can be made on an interest-free basis.

It is our understanding that Ginnie Mae would approve of this clarification of its authority.