



**Testimony of Andrew Jakabovics
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Before the Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives**

**“The Obama Administration’s Response to the Housing Crisis”
October 6, 2011**

Chairwoman Biggert, Ranking Member Gutierrez, and other distinguished members of the subcommittee, thank you for the opportunity to testify before you this morning to discuss mechanisms and policy options to facilitate bringing the private sector back into the housing market in a supportive and sustainable way. I will also touch upon federal efforts to refinance mortgages and ways in which those programs could be expanded without additional taxpayer risk. I am Andrew Jakabovics, senior director of Policy Development and Research at Enterprise Community Partners (Enterprise), a national nonprofit organization that creates opportunities for low- and moderate-income people through fit, affordable housing and diverse, thriving communities. For nearly 30 years, Enterprise has provided financing and expertise to organizations around the country to build and preserve affordable housing and to revitalize and strengthen communities. Enterprise has invested more than \$11 billion to create more than 280,000 affordable homes and strengthen hundreds of American communities.

Enterprise brings public and private capital together to meet local needs. We work in communities that range from small rural towns to large cities, from urban neighborhoods to suburban job centers. We know that housing is more than just a physical building—it is the place where people build their lives, create networks and send their children to school. Secure housing is best provided in communities with a diverse mix of affordable and market-rate housing options; access to jobs and support; and strong commitments to the environment and civic participation. We work on holistic housing solutions so that people can live close to work or public transportation, in healthy and safe housing and in vibrant communities.

Prior to joining Enterprise, I had the privilege to serve as senior advisor to U.S. Department of Housing and Urban Development Assistant Secretary Raphael Bostic, where I worked closely with

senior officials at HUD and other Federal agencies on housing finance reform and mitigating the current housing crisis. I devoted attention to foreclosure prevention through improving opportunities for loan modifications for at-risk borrowers and to lessening foreclosure impacts on neighborhoods and communities, both of which are topics for today's hearing.

In addressing the housing crisis, solutions must address the needs of individual borrowers and their families. Solutions also must take into account that millions of people nationwide are in distress, causing aggregated effects playing out across the nation and over time. A comprehensive approach to stabilizing the broader housing market must include preventive efforts as well as remedial ones. The old adage, "an ounce of prevention is worth a pound of cure," certainly applies here; the cost of providing counseling or offering foreclosure mediation, both of which have proven successful in keeping borrowers in their homes compared to individuals navigating the complicated and often frustrating modification process without help, is far, far less than the cost of foreclosure borne by families, communities, municipalities, lenders, and investors.¹

Preventive Efforts to Avoid Foreclosure

In a low-interest rate environment, refinancing can be an effective mechanism for homeowners to reduce monthly housing costs, leaving them with more money in their pockets to meet other critical household budget needs or put money aside to build or replenish their rainy day funds or other savings. Moreover, with lower monthly costs, in the event that a wage earner suffers a cutback in hours, the likelihood of a future delinquency stemming from that income cut is reduced as well. Similarly, we know that when unemployed workers are ultimately rehired, they generally suffer a pay cut. When coupled with what we know about the causes of default—it most often requires the dual trigger of negative equity (reflective of willingness to pay) combined with a life event such as job loss, illness, death, or divorce (which impact ability to pay)—by reducing the monthly debt service on a mortgage, there is a greater chance that families will continue to be able to pay even under more challenging circumstances.

¹ Calhoun, Charles A., Mayer, Neil S., et al. (2010) "Preliminary Analysis of National Foreclosure Mitigation Counseling Program Effects, September 2010 Update." Washington, DC: Urban Institute.
Alon Cohen, "Talking It Up: How the Federal Government Can Implement Automatic Foreclosure Mediation to Help Homeowners, Lenders, Investors, and Taxpayers" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/01/talking_it_up.html

The federal Home Affordable Refinance Plan (HARP) was designed to lower the monthly costs of borrowers with mortgages bought by Fannie Mae or Freddie Mac (collectively, the Government Sponsored Enterprises, or GSEs) that remain creditworthy but no longer have sufficient collateral to qualify for a refinancing because of the steep declines in home prices across the country. The program allows borrowers with loan-to-value (LTV) ratios of between 80 and 125 to refinance into a new mortgage based on current interest rates.

But has HARP worked? Over 838,000 borrowers refinanced their mortgages under the program, as of June 30, 2011.² As house prices decline, the percentage of borrowers who find themselves unable to refinance increases, even as mortgage rates continue to hover at historically low levels. Expanding eligibility to borrowers above 125 LTV could offset some decrease in the eligibility pool, but some have noted that any mortgages refinanced at those very high LTVs could prove difficult to securitize.

Such loans, however, could remain on GSE balance sheets, and if offered regulatory forbearance by FHFA to require no additional capital to be retained above what was already reserved when the original note was securitized, the interest rate on the refinanced mortgage should be attractive to potential refinancers.

The greatest barrier to HARP's successful implementation, however, is likely the fees and charges associated with refinancing. Some costs such as recordation fees are inevitable, but most of the largest costs to borrower can not be justified. The risks to the counter party are simply incommensurate with the associated inflated fees. Specifically, loan-level price adjustments (LLPAs) and title insurance charged to borrowers who are refinancing can raise the cost of a new mortgage to the point where it simply isn't worth the hassle. In theory, LLPAs are a mechanism to create risk-based pricing, such that the cash flow to the GSEs more closely matches expected costs of loans to borrowers with certain financial characteristics or for properties with certain LTV ranges. While in the normal course of business, this can be viewed as a reasonable approach (with the caveat that excessively narrow criteria can proxy for possible discriminatory behavior), but in the case of HARP refinancing, not only is there no new credit risk to the GSEs, the likelihood of

² See <http://fhfa.gov/webfiles/22617/NCSpeech91911.pdf>

future defaults is actually reduced. Eliminating the LLPAs could significantly expand the number of borrowers participating in HARP.

We should also consider HARP in the broader context when evaluating its efficacy. If we consider it a single item in a much larger array, the picture brightens significantly. If the goal is to reduce monthly mortgage costs for as many borrowers as possible, thus strengthening families' balance sheets, this administration's efforts overall have put money back in the pockets of millions of homeowners. In 2010 alone, over \$1 trillion in mortgages were refinanced. That translates into over 4 million homeowners who saved money on their mortgages. If the average homeowner saved \$150 per month (the equivalent of dropping interest rates from 6% to 5% on a \$250,000 mortgage), those 4 million families would see an additional \$7.2 billion in their pockets every year, to spend as they see fit.

Stabilizing Housing Markets Means Putting People Back in Decent Homes

If refinancing is at one end of the mortgage process, REO disposition is at the other end. Stabilizing the housing market means more than being more effective in keeping people in their homes, it means dealing with the impact that foreclosures have on communities across the country. I am proud to currently be associated with Enterprise and previously with the Center for American Progress. Both organizations have demonstrated tremendous leadership on addressing the foreclosure crisis through the Neighborhood Stabilization Program and the REO-to-Rental proposals. I turn to those policies now.

We know the devastating impacts of foreclosure. It is obviously costly to families. But vacant and blighted properties also have terrible effects on neighbors of foreclosed properties and whole communities. A newly published study that looked at Massachusetts foreclosures over a 20-year period found that a nearby foreclosure reduces the value of a home by one percent.³ Foreclosures also have long lasting impacts on communities because lower valuations make their way into subsequent appraisals, with the effect on local prices observable up to five years after the initial

³ Campbell, John Y., Stefano Giglio, and Parag Pathak. 2011. "Forced Sales and House Prices." *American Economic Review*, 101(5): 2108–31.

foreclosure.⁴ Additional research has found a contagion effect, with price declines increasing with each additional foreclosure in the area. The impact of a foreclosed property increases the longer that property sits unsold.⁵

The Neighborhood Stabilization Program (NSP) was designed specifically to address that contagion. Through targeted interventions to acquire properties in hard-hit communities, NSP has created jobs when houses are restored to good quality and helped put families back into formerly distressed properties.

The most successful programs have been those that have brought private capital into their efforts to stabilize neighborhoods. In places like New York, Cleveland, and Sacramento, NSP funds have been leveraged more than 1:1 with private capital. These programs have focused on small areas within cities in order to maximize potential impact. However, the need to address foreclosed properties extends well beyond these places, so the need to bring responsible private capital back into the housing market will be critical for broader stability.

Capital is needed not only for acquisition, but also later when non-profits put homes up for sale. Nonprofits have been quite good at identifying potential homebuyers and providing would-be buyers with extensive pre-purchase counseling, but even with rigorous screening, it is very difficult to find banks willing to lend even to borrowers who meet FHA underwriting criteria. Without credit flowing back into communities, homes will continue to sit vacant and remain at elevated risk of vandalism, thus driving up the costs to NSP recipients and undermining the intent of the program.

Moreover, when NSP recipients cannot sell the homes, they cannot revolve the funds to acquire additional properties. This significantly limits the potential scope of NSP efforts to restore communities and eliminate blight.

The administration's recent proposal for Project Rebuild builds on the successes of NSP, with additional flexibility to address commercial properties and an explicit ability to use funds for establishing job training programs to ensure that local workers get the skills necessary to

⁴ Lin, Zhenguang, Rosenblatt, Eric and Yao, Vincent W. 2009. "Spillover Effects of Foreclosures on Neighborhood Property Values." *Journal of Real Estate Finance and Economics*, 38(4). Available at SSRN: <http://ssrn.com/abstract=1033437>

⁵ Harding, John P., Rosenblatt, Eric and Yao, Vincent W. 2008. "The Contagion Effect of Foreclosed Properties." *Journal of Urban Economics*, 66(3): 164-178. Available at SSRN: <http://ssrn.com/abstract=1160354>

rehabilitate and maintain those properties over time. Based on NSP's job creation and retention rates, it is estimated that Project Rebuild, if fully funded, would support 191,000 jobs while addressing 80,000 foreclosed, vacant, or abandoned properties nationwide.

Getting Smarter About REO

In addition to Project Rebuild, the recent request for information (RFI) jointly put forth by the Federal Housing Finance Agency, HUD, and the Department of Treasury for Enterprise/FHA asset disposition demonstrates an interest in finding better ways to dispose of properties those entities acquire in foreclosure. The current REO disposition process is designed to treat each property individually, assigning it to a broker for sale and then writing off the losses after closing. The process rarely takes into account how any individual property might impact other properties already being marketed by the same owner. Bulk sales to responsible, qualified buyers allows for a far more strategic disposition process than the current process allows.

Demand for rentals has increased as demand for ownership has declined. The RFI solicited input on potential mechanisms for converting many REO properties into long-term rental units. By removing REO properties from the for-sale inventory for several years, not only is there an opportunity to quickly increase the supply of rental homes, most of which will be affordable, but downward pressure on prices from excess inventory will also be alleviated. This too will allow for a faster housing market recovery.

To be successful, an REO rental program must address the initial sales process, buyer qualifications, post-purchase treatment of properties, and exit strategies for the buyer.

- Initial Sales Process
 - Properties should be sold in bulk at the metropolitan level or at the submarket level, so long as there is enough volume to keep the management costs reasonable.
 - REO rental won't work in all markets. In addition to having enough properties to create a reasonable portfolio size, local rental and ownership market conditions must show that rents would support higher valuations than current recoveries.
 - A range of financing options could be used, ranging from all cash deals to seller financing and joint ventures between FHA/GSEs and the buyers. One possible joint venture mechanism is for the sellers to provide the properties and the buyer bringing capital for the rehab. At full lease-up, the buyer would then buy out the

seller's stake in the joint venture with the availability of permanent financing, as in other commercial real estate development.

- Buyer Qualifications
 - All potential buyers would need to meet minimum capital requirements that demonstrate financial capacity to both acquire and rehabilitate each portfolio. This would include capacity to handle possible cost overruns during the rehab phase and sufficient reserves to cover possible slow lease-up periods.
 - In addition to financial capacity to acquire the portfolios, buyers would also need to demonstrate a track record of commitment to community and a history of responsible stewardship of assets. This could include a history of independent affordable housing development, past partnerships with nonprofits or other housing intermediaries, or evidence of past or present long-term investment in the market.
 - Local governments and community development partners with knowledge of best practices should be solicited to help develop criteria that would be used to approve potential buyers.
 - Buyers must also provide evidence of property- and tenant-management capacity. This capacity could be provided through a third party rather than directly by the capital partner, but third-party providers would also be obligated to show their experience managing properties at scale.

- Responsible rehabilitation and long-term stewardship of affordable rental units
 - Post-sale, it is critical that respondents take very seriously their responsibility to eliminate blight, rehabilitate properties, and maintain them. This is important for owners and tenants, but it is also important for neighborhoods.
 - Buyers must meet or exceed standards for housing quality for rehabilitation, building from the “adequate rehabilitation” standard that Congress established in the 1998 HUD Asset Control Area (ACA) program. To produce uniformly safe, decent, durable, and high-performing homes, the standards should meet those of the

NSP program, which would allow for consistency across programs with similar goals.

- Scattered-site property management is a difficult business and must be done properly for the sake of the tenants and the neighborhood. Rental properties must be maintained by property management companies with a proven record in scattered-site single-family asset management. If buyers themselves do not have this experience, they must partner with for-profit or nonprofit entities that do. Minimum criteria could include 2+ years experience managing 25 or more single-family scattered-site properties in markets that resemble the markets in which the property manager is proposing to work. Under this requirement, some locations could be excluded due to a lack of experienced property managers, not from lack of need.
- The property preservation field substantially has improved in performance and professionalism over the past several years and now has developed significant scattered site asset management capacity. Moreover, many of these national companies have also gained proficiency in tenant management, as they have needed to properly protect the rights of renters under the Protecting Tenants At Foreclosure Act.
- Properties in this program must remain available for rent for a minimum of five years after purchase. This will keep properties off the for-sale market, allowing it time to recover, and will also allow tenants the peace of mind to know they have stable housing options for the long term.
- Exit strategies for the buyers include strict limits on eligible disposition
 - Understandably, not all properties in a portfolio make good rental candidates. A certain share of the portfolio could be disposed of immediately after acquisition, but there should be limits on what percentage of properties can be used for non-rental purposes.
 - Eligible up-front disposition should allow for a percentage of properties to be demolished or donated for public use, but the rest of the properties should be rehabilitated and offered for rent. An unacceptable outcome would be for buyers to

do upscale rehabs in high-end communities and make those homes available for sale, while doing some rehab in moderate neighborhoods to rent and then letting the rest of the portfolio in already hard-hit areas rot.

- Going in, buyers must know what their options are for selling after the rental restriction is lifted. Some properties will likely remain rental even beyond the required holding period, but others will move back to owner occupancy.
- One idea that is gaining traction is the notion of lease-purchase—renting with an option to buy. Making rent payments for several years should rehabilitate most tenants' credit to the point of qualifying for FHA financing. The rules for this would need to be tightly written, but overall this provides a clear exit strategy for the portfolio buyer. In turn, this reduces uncertainty and raises potential purchase prices.

Better Outcomes through Better Coordination

Community stabilization efforts should be coordinated across Federal programs and with private actors. Programs need to work on the ground, so disposition strategies like REO to rental should complement existing efforts like NSP and future efforts like Project Rebuild. That could be accomplished in a number of ways, from encouraging portfolio buyers to transfer properties to local nonprofits working in NSP-targeted neighborhoods, to coordinated rehab efforts to quickly bring properties back online. Greater program flexibility to allow NSP recipients to more easily adapt to changing market conditions and areas of need would also allow for more efficient use of Federal funds and better performance of the FHA portfolio. Similarly, the competitive funding proposed under Project Rebuild could offer an incentive scoring system that awards points for coordination with bulk purchasers of REO.



In addition to smarter disposition processes for FHA and GSE properties, banks must do more for their own REO portfolios. They too need to be far more strategic about their REO disposition strategies, and if they fail to do their part to minimize the impact of foreclosures on communities, I would potentially recommend incorporating an assessment of REO practices into CRA evaluations.

Last, while much of this testimony has focused on minimizing the impact of foreclosures, I would be remiss if I did not mention that the best option for avoiding a costly foreclosure is to provide a distressed borrower with an affordable mortgage payment. With better coordination in mind, bulk note purchases by entities or consortia with the capacity and flexibility to restructure notes where possible (including through principal reduction) and the ability to transition properties with minimal disruption or vacancy (either through negotiating a deed-for-lease with the current owner or quickly repairing and renting) into affordable rental portfolios may yet hold the most promise for stabilizing the nation's housing markets.

**United States House of Representatives
Committee on Financial Services**

“TRUTH IN TESTIMONY” DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name: Andrew Jakabovics	2. Organization or organizations you are representing: Enterprise Community Partners
3. Business Address and telephone number: 	
4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets. Please see attached.	
7. Signature: 	

Please attach a copy of this form to your written testimony.

Enterprise Community Partners
 Andrew Jakabovics
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Item 6. Other Government Assistance Provided or Requested/Expected Sources and Use of Funds						
Department/State/Local Agency Name and Address	Contract #	Recipient	Type Of Assistance	Amount Requested/Provided	Expected Use of the Funds	
U.S. Department of Housing and Urban Development 451 Seventh Street, S.W. Washington, DC 20410-7000	B-07-CB-MD-0001	Enterprise Community Partners	Grant	\$13,070,000.00	Improve capacity of CDCs & CHDOs	
	B-08-CB-MD-0001	Enterprise Community Partners	Grant	\$13,440,120.00	Improve capacity of CDCs & CHDOs	
	B-09-CB-MD-0001	Enterprise Community Partners	Grant	\$14,836,263.00	Improve capacity of CDCs & CHDOs	
	B-10-CB-MD-0001	Enterprise Community Partners	Grant	\$25,289,043.00	Improve capacity of CDCs & CHDOs	
	T-09-NN-06-0002	Enterprise Community Partners	NSP Technical Assistance	\$7,145,559.00	Technical Assistance	