SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE FEDERAL HOUSING FINANCE AGENCY ON THE GSE CONSERVATORSHIPS

HEARING

BEFORE THE

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SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE FEDERAL HOUSING FINANCE AGENCY ON THE GSE CONSERVATORSHIPS

Tuesday, March 19, 2013

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Miller, Royce, Capito, Garrett, Neugebauer, McHenry, Campbell, Bachmann, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Hurt, Grimm, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Pittenger, Wagner, Barr, Cotton; Waters, Maloney, Velazquez, Watt, Sherman, Meeks, Capuano, Scott, Green, Cleaver, Ellison, Perlmutter, Himes, Peters, Carney, Foster, Kildee, Murphy, Delaney, Sinema, Beatty, and Heck.

Chairman HENSARLING. The committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

The Chair now recognizes himself for 2 minutes for an opening statement.

I would like to start off by quoting from our witness' testimony: "Few of us could have imagined in 2008 that we would be approaching the fifth anniversary of the placing of Fannie Mae and Freddie Mac in conservatorship and have made little meaningful progress to bring those government conservatorships to an end."

I could not agree more and that is why I am determined that today's hearing will be a truly historic one. I am determined that this hearing will be the last time that Director DeMarco—or, if you believe press reports, his successor—will testify before this committee before we finally and belatedly mark up a true Government-Sponsored Enterprises (GSE) reform legislation.

I define this as legislation to one, once and for all abolish Fannie Mae and Freddie Mac as Government-Sponsored Enterprises; and two, create a truly sustainable housing policy—sustainable for our economy, sustainable for those seeking the goal of homeownership, and sustainable for hard-working taxpayers who should never, ever be called upon again to bail out Wall Street.

Now, I know this is a heavy lift, especially in divided government, and that is why the leadership of this Administration is so critical. Regrettably, they have not released a reform plan; instead, over 2 years ago they issued a White Paper of options and simply let it gather dust. The interested public has long since deleted the PDF file from their hard drives.

After 4½ years, inaction is no longer an option, because the GSEs were at the epicenter of the financial crisis. They were part of a tragically misguided government policy to incentivize, browbeat, and mandate financial institutions to loan money to individuals to buy homes they could not afford to keep.

Consequently, millions saw the American dream turn into an American nightmare. Millions more were forced to contribute to what has proven to be the mother of all taxpayer bailouts. And shamefully, instead of being reformed, Washington continues to functionally grant them a monopoly.

So, part of today's hearing will focus upon what the Federal Housing Finance Agency (FHFA) is currently doing to reduce the size and influence of the GSEs and how to accelerate that process with the goal of repealing their government charters in the foreseeable future and help lead us towards a truly sustainable housing finance system.

I will now yield 4 minutes to Ranking Member Waters for her opening statement.

Ms. WATERS. Thank you, Mr. Chairman, for holding this hearing today on oversight of the Federal Housing Finance Agency.

We are at a pivotal moment in our housing recovery, having staunched the bleeding caused by the 2008 financial crisis after large declines in home prices in 2007 through 2011. Prices in many markets bottomed out in early 2012 and are now starting to rise.

Housing construction is likewise increasing and a record 1.1 million households were able to refinance under HARP in the last year. Freddie Mac posted $11 billion in income in 2012, and Fannie Mae expects to report significant net income when they file their annual report.

But headwinds remain in the market, with many homeowners still struggling to negotiate loan modification, refinance their mortgages, and understand the terms of the many mortgage settlements that have been negotiated. Principal reduction modifications also, unfortunately, remain rare, and the private sector continues to be largely unwilling to offer mortgage credit even to qualified borrowers due to investor skittishness over lingering problems in the private securitization market.

Acting Director DeMarco, who is here to testify before us today, finds himself at the center of this tremendously complex and important market as the conservator of Fannie Mae and Freddie Mac.

I appreciate that this is a tough job and that it is not easy serving in an acting capacity for nearly 4 years. But having said that, I am concerned that Mr. DeMarco has used his wide latitude in regulating Fannie Mae and Freddie Mac to make a number of controversial decisions during his tenure, including refusing to move forward with principal reduction modifications even when they would benefit the taxpayer, and raising fees in States with strong consumer protection laws.

While I have agreed with some of Mr. DeMarco's decisions, I am concerned about this lack of accountability, particularly since many of the choices being made will impact the future of the secondary mortgage market. I have been urging my colleagues to begin the work of reforming the GSEs because without action from this committee, Acting Director DeMarco will have to continue to take it upon himself to do the work of reshaping Fannie Mae and Freddie Mac outside of public scrutiny and without the input of the Congress of the United States.

This committee should begin the job of considering the many bipartisan reform proposals on the table so that we can give the market certainty; guarantee the continued availability of the stable mortgage products like the 30-year fixed-rate loan; and ensure that institutions of all sizes, including community banks and credit unions, are able to participate in the secondary mortgage market.

Moreover, I implore my colleagues in the Senate to support the next nominee selected by the President to head the FHFA.

Finally, as we consider the testimony today, let us remember that the issues we are discussing reach beyond specific policies regarding the GSEs. Our purpose is not only to put the GSEs on solid footing but to create the conditions that will help bring our economy back to full strength.

Mr. Chairman, I hope this is the priority of the committee going forward. Republicans are in charge. We have not seen a proposal come forward.

I would hope that this committee, under your leadership, would provide the leadership that is necessary to reform the GSEs. We know of your longstanding concern, and the criticism that you have launched constantly about the GSEs, so I am hopeful that you will be in charge of reform for us.

I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, for 1½ minutes.

Mr. GARRETT. Thank you, again, Mr. Chairman, for holding this important hearing.

And I would like just to start off, before my comments, by thanking Director DeMarco and also the entire team for all of their hard work during what have been very, very challenging times. Director DeMarco should be commended for his outstanding public service and his determination to stand up for the American taxpayer and for the American homeowner, as well. And he does so against tremendous pressure from those who would like to look at these Enterprises as their own piggybanks, if you will.

It is also encouraging to hear the recent announcement by the Director that he plans to continue this, and to continue the process of transitioning some of the credit exposure of Fannie and Freddie outside to the private sector. Everyone on this committee can agree, I think, that having over 90 percent of the housing market backed by the Federal Government is completely unsustainable.

I believe these changes will allow us to examine some new approaches and better ways to facilitate more private sector involvement in the mortgage market. And now, with $16 trillion in debt and annual $1 trillion deficits, we really cannot afford to continue keeping $11 trillion of mortgage credit on the back of the taxpayer.

I would also note that these steps taken by the Director are far more than any reforms that this Administration has undertaken.

It appears to me that they are more content to keep their head in the sand, if you will, and act as if no reforms are needed in our housing finance system.

So finally, thankfully, it does not appear that the Director feels this way. I thank him for his thoughtful work, and I look forward to working with him and also the members of this committee to pursue this process of reform.

Thank you.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 3 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, for calling the meeting.

And welcome, Mr. DeMarco.

It has been 4 years since the GSEs went into conservatorship and we all know how important housing is to our economy. Some economists estimate that housing and its related industries are a roaring 25 percent of our economy. Until we straighten out housing, our broader economy will not fully recover.

So this is a tremendously important issue to all of us. I applaud the bipartisan efforts on this committee with Mr. Campbell and Mr. Peters, and Mr. Miller and Mrs. McCarthy, and I hope we will have hearings to focus on their related ideas.

I look forward to hearing more today about your three-part strategic plan to build, maintain, and contract the GSEs. I believe your efforts for a single platform and standardized practices is a great step forward, a great development.

And I also believe that your efforts to maintain foreclosure prevention activities and credit availability and to refinance mortgages has been successful. I also want to applaud the work with the Home Affordable Refinance Program (HARP) to promote foreclosure prevention activities, which has had some successes: 1.1 million refinances have been done, which nearly equals the number of HARP refinances over the prior 3 years. That is a success.

And the focus of your office on underwater mortgages with those with greater than 105 loan-to-value ratios—these refinances represent 43 percent of the total HARP refinances in 2012 compared to 15 in 2011. So that is a movement in the right direction but we can still do more.

It is in the area of contracting that I have the most questions, including the effect that it will have on multi-family housing and single-family housing. The GSE multi-family housing portfolio picks up pieces of the housing sector that the private sector has not been interested in. They usually are not interested in providing affordable housing.

So I have questions about the effect that it will have on the policy goal of affordable housing, which I deeply support, and the 30-year mortgage.

I also have questions about what contracting will mean in terms of the guaranteed fees on States that have longer foreclosure times but better outcomes in terms of rates of foreclosures. These States are keeping people in their homes. Shouldn't we be looking at the result and rewarding States or localities that keep people in their homes as opposed to raising their fees?

I look forward to your testimony.

Thank you. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from California, Mr. Miller, for 1 minute.

Mr. MILLER. Thank you, Mr. Chairman.

Because of securitization technology, the secondary market of mortgage investors developed into a deep global market that generally worked well to the advantage of the average American. But the hybrid public-private model of Freddie and Fannie was fundamentally flawed. They acted as private companies with public policy charters, serving two masters.

What we replace them with must capture the important function they historically performed. We still need a viable secondary mortgage market with sound underwriting principles.

I introduced a bill last year to eliminate Freddie and Fannie, saying that we need to look to a secondary market for residential mortgages and focus on that. I proposed a system separate from the government, eliminating the conflict inherent in a model where the private sector benefitted from the government guarantee, meaning government risk, private sector rewards.

Make sure the secondary market was the privately financed capital we use was not government funds. Don't cap the maximum volume of purchases and sales, crowding out the private sector was not a part of the bill, it was the primary portion of it.

Historically, housing led to recovery in this country. It has to this time. We need an alternative to Freddie and Fannie and we need it rapidly.

Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from California, Mr. Sherman, for 1½ minutes.

Mr. SHERMAN. In the 1930s, we tried the idea of no Federal role in home finance. It did not work out.

Then we tried this GSE model, where organizations run by those rewarded for profits had a full, implicit Federal guarantee. They took risks to benefit their shareholders and the taxpayers were left holding the bag. So that is not something we should return to.

And I will agree with the chairman if that is as far as he goes.

But I do think we need a Federal agency, or more than one involved in the market, otherwise we will see the end of the 30-year mortgage with fixed rates available to average middle-class families. What percentage of the market this government agency or agencies should control or be involved in is a subject I look forward to discussing in this room.

We all want to help those homeowners who are in trouble or underwater, but we should recognize that many of the ways we help actually cost the Federal Government money, or should I say reduce the value of instruments held or, in effect, guaranteed by the Federal Government. I want to commend the GSEs for their help in allowing homeowners to refinance even if they are underwater since that usually doesn't cost the Federal Government any money.

What it does cost are those investors who are reaping 5 and 6 and 7 percent yields on government-guaranteed paper. So I commend you for that effort, and I look forward to hearing about more.

Chairman HENSARLING. The Chair now recognizes the gentleman from California, Mr. Royce, for 1 minute.

Mr. ROYCE. Thank you, Mr. Chairman.

I want to thank Director DeMarco again for being with us here today.

And I wanted to also share with the committee that I think the Director has taken some bold, courageous steps as both a regulator and a conservator of the GSEs, but I would have to say, the same cannot be said of the Administration.

Secretaries Geithner and Donovan promised long-term plans, and we have been given only options. We had a failure of the financial markets, we got a White Paper; we had a failure of the housing finance system, we got a White Paper. A White Paper with a choose-your-own-adventure response is not what Congress needs and it is not what our markets need.

We need to restore the appropriate role of the private sector in housing finance. We need serious leadership to move us away from a system overly reliant on taxpayers toward a free-functioning market which accurately prices risk.

Thank you. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Green, for 1 minute.

Mr. GREEN. Thank you, Mr. Chairman.

Welcome, Mr. DeMarco. There is a role for the private sector. There is also a role for the public sector.

I talk to the builders; they believe that there is a role for the public sector. I talk to the REALTORS®; they believe there is a role for the public sector. I talk to the bankers; they believe there is a role for the public sector. And my constituents who want 30-year loans understand that there is a role for the public sector.

The question is not really whether there is a role, but whether we will take the time to fashion and craft a meaningful piece of legislation without anybody's recommendation so that we may have the role codified into the law.

I do regret that we have not codified this into the law, but I don't blame the Administration. There are 435 Members of Congress. Any one of us can craft our own legislation.

I believe that those who have said that we should have done it in when we were in charge, ought to do it now that they are in charge.

I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, for 1 minute.

Mrs. CAPITO. Thank you.

And welcome, Director DeMarco, to our committee.

I want to thank the chairman for holding the hearing and also for his efforts to center the discussion on housing finance as we look forward to, hopefully, structural and significant reforms.

As has been said many times here, we have seen many changes to our regulatory structure here in the financial realm, but in some cases layered on too heavily for our institutions to be able to lend adequately. But one thing we have not done is to address the chief underlying cause of the crisis, and that is our housing finance system.

The objectives that led Fannie and Freddie to assume such considerable risk in size and the market ultimately led to a taxpayers' bailout, a rescue by the taxpayer.

So it is 4 years later and it is unacceptable that we have not reformed and made a business model available for housing finance. To date, we have left the taxpayers to pick up $187 billion in Treasury support.

The practice of privatizing gains and publicizing losses is unfair to the American people and meaningful reforms must reflect this.

Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, for 1½ minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman, for holding this important hearing today.

And I also want to thank Mr. DeMarco for his service and for being here this morning.

As we approach the 5-year anniversary of Freddie and Fannie we realize that the American taxpayers have injected almost $200 billion into these entities. And the history of Fannie and Freddie has proven that government involvement in housing finance not only creates moral hazard but it also creates political pressure for increasingly risky lending practices.

We learned that the government guarantees mortgage debt eliminates essential market discipline in the risk aversion for investors, and we learned that the government is incapable of establishing risk-based fees for guarantees and exposing taxpayers to billions of dollars.

Unfortunately, we evidently haven't learned this lesson yet, because here we are 5 years later and we have still not done anything meaningful about reforming Freddie and Fannie. In the meantime, 9 out of every 10 mortgages in this country have some Federal nexus, and the taxpayers are on the hook for that.

The White House said they wanted to do something about that, but to date they have not put forth any meaningful proposal. They put together a watered-down White Paper that says, "This is what we might do," but as we know, they never took any action on that.

It is really time for Congress and for the Administration to just step forward and get the taxpayers off the hook so that we can move forward with having a robust housing finance market in this country.

I look forward to your testimony, Mr. DeMarco. And thanks again for your service.

Chairman HENSARLING. The Chair now recognizes the gentlelady from Minnesota, Mrs. Bachmann, for 1 minute.

Mrs. BACHMANN. Mr. Chairman, thank you.

And I thank our witness, as well.

One thing we have learned about the GSE policies is that millions of Americans have been victims of these policies. They have lost, collectively, billions of dollars worth of assets.

The people who have suffered more than any are those at the bottom end of the economic scale, particularly the African-American community. They have suffered from these policies.

And when, as Mr. Neugebauer said, we see that over 90 percent of the mortgages have a nexus to government involvement this doesn't even pass the falling-off-the-chair-laughing test to think that somehow this is a public-private partnership. It is not. This is the Federal Government. It has been a failure.

When are we going to realize that government has been a very lousy steward of people's money? And also, we have, at the same time, disadvantaged a lot of people with a lot of well-meaning programs.

What we need to do is pay back the taxpayers who funded this bailout, get them out of guaranteeing the GSEs, and change our standards.

Thank you, and I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, for 1 minute.

Mrs. WAGNER. Thank you, Mr. Chairman.

As we continue this debate over housing finance reform, I am keeping three very basic thoughts in mind. The first is that the current situation, as has been brought up previously, with the taxpayers backing over 90 percent of the new mortgages, is both unacceptable and untenable. We have, of course, arrived here due to a history of flawed government policies that continue to pose a direct threat to homeowners and taxpayers.

The second thought is that the GSE model has to go, but in order for that to happen, Congress and the FHFA must work to establish market guidelines that provide transparency and legal certainty for private investors. This will encourage private capital finance to finance mortgages just as it finances virtually every other credit market in the United States.

Third, I believe that if we can establish those rules and guidelines, we will see private capital enter the mortgage market in a large way, moving us away from mistakes of the past and protecting families and taxpayers in the process.

With this in mind, I look forward to hearing the testimony of Mr. DeMarco.

Thanks.

Chairman HENSARLING. We now welcome Ed DeMarco as our sole witness today. In 2009, President Obama designated Mr. DeMarco to be the acting Director of the Federal Housing Finance Agency, which is the regulator of Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks.

Mr. DeMarco is a career civil servant, with over 20 years of housing policy experience, including stints at GAO, Treasury, and OFHEO. He holds both a B.A. and a Ph.D. in economics.

Without objection, Mr. DeMarco's full written statement will be made a part of the record. Members are advised that Mr. DeMarco will be excused as our witness at 12:30 today.

Mr. DeMarco, welcome to our committee again, and you are recognized for a summary of your testimony at this time.

STATEMENT OF EDWARD J. DEMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY (FHFA)

Mr. DEMARCO. Very good. Thank you, Mr. Chairman.

Chairman Hensarling, Ranking Member Waters, and members of the committee, I am pleased to be here to testify before you. As required, I submitted a detailed written statement to the committee, and I look forward to engaging with you today as there are many important topics to be discussed.

Fannie Mae and Freddie Mac, or the Enterprises, as I will refer to them, have been in government conservatorship for more than 4½ years. These lengthy conservatorships are unprecedented and they were never intended to be a—

[Disturbance in hearing room.]

Chairman HENSARLING. The committee will come to order. We will give you one warning and then you will be cleared from the room. Staff will get the Capitol Police.

The Rules of the House require all observers to maintain order and decorum. Clause 2(k)(4) of Rule 11 provides that the Chair will punish breaches of order and decorum by censure and exclusion from the hearing.

I hereby direct the Capitol Police to remove the gentleman causing the disturbance from the committee room.

All guests will be reminded that they are guests of the committee. They will observe decorum at all times or they will be escorted out of the room by the Capitol Police.

Mr. DeMarco, you are again recognized for a summary of your testimony.

Mr. DEMARCO. Thank you, Mr. Chairman.

And I do understand the pain that this housing crisis has caused for so many families around the country and the tremendous cost it has imposed upon the American taxpayer.

The first chapter of conservatorship focused on restoring stability and liquidity to housing finance during the financial crisis in the fall of 2008. We succeeded.

The second chapter focused on foreclosure prevention efforts, which were critical to help borrowers in distress and essential to meeting our conservatorship mandate to preserve and conserve the Enterprises' assets. Efforts to minimize losses on troubled mortgages have been good for borrowers, good for communities, and good for taxpayers—

[Disturbance in hearing room.]

Chairman HENSARLING. The Rules of the House require all observers to maintain order and decorum. Clause 2(k)(4) of Rule 11 provides that the Chair may punish breaches of order and decorum by censure and exclusion from the hearing.

VOICE IN AUDIENCE. And I thought Barney Frank had retired.

Chairman HENSARLING. The committee will come to order. The committee will come to order.

Mr. DeMarco, you are once again recognized for a summary of your testimony.

Mr. DEMARCO. The next line in my prepared remarks is: The task has not been easy. While we have not always succeeded, the results are better than frequently recognized.

In conservatorship, the Enterprises have completed more than 2.6 million foreclosure prevention transactions. Of these, nearly 2.2 million of these transactions resulted in the borrower staying in their home.

For borrowers able to pay their mortgage, the Enterprises have refinanced almost 15 million mortgages since conservatorship. More importantly, they have completed almost 2.2 million HARP refinances—

Chairman HENSARLING. The witness will suspend.

I would ask staff to ask the Capitol Police to come in again and escort these individuals outside of the hearing room.

Ladies and gentlemen, we are not going to allow you to disturb this hearing as part—

Ms. WATERS. Mr. Chairman?

Chairman HENSARLING. —of the people's—

Ms. WATERS. Mr. Chairman?

Chairman HENSARLING. —House, and so—

Ms. WATERS. Mr. Chairman?

Chairman HENSARLING. —you will be excluded—

Ms. WATERS. Mr. Chairman?

Chairman HENSARLING. —at this time.

Ms. WATERS. Mr. Chairman, can we just ask the people with the signs to put them down rather than putting them out?

Chairman HENSARLING. All guests have been warned. You will not interfere with the proceedings of the people's House. The Capitol Police is requested to escort all of these people out of the room.

And I would say to the ranking member, they have been warned not once but twice, and given every accommodation.

You will now be cleared from the room.

Again, Mr. DeMarco, you are recognized for your testimony. We hope you can get more than a couple of sentences out.

Mr. DEMARCO. More importantly, we have completed almost 2.2 million HARP refinances, which are targeted at borrowers with little or no equity in their homes. While not without its shortcomings, delays, and other problems, this collection of programs remains a noteworthy response to an unprecedented crisis, and the work to help borrowers continues.

Today, the tools and the processes are much better-established than they were a few years ago. A big reason for that is the dedicated work of employees at Fannie Mae and Freddie Mac and my own team of hard-working civil servants at FHFA.

While we continue to refine and improve these programs, last year we began moving on to another chapter of conservatorship. A year ago, I sent to this committee a strategic plan for the Enterprise conservatorships.

That plan had three broad strategic goals. First, build. Build a new infrastructure for the secondary mortgage market.

Second, contract. Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations.

And third, maintain. Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

These goals satisfy our statutory mandate as conservator, are consistent with the Administration's call for a gradual wind-down of the Enterprises, and preserve all policy options for Congress. Achieving these goals will produce a stronger foundation on which Congress and market participants can build to replace the pre-conservatorship GSE model.

Earlier this month, I announced specific steps I expect Fannie Mae and Freddie Mac to take this year in pursuit of these three goals. Briefly, we are building for the future by establishing a platform for future mortgage-backed securitization.

This platform, while owned by the Enterprises, will have its own CEO and board and will operate away from either company. Building this platform is an important element to assisting Congress with a transition from the old model to a new one.

We are contracting the Enterprises by setting targets to gradually shrink each of their three business lines this year.

And lastly, we are continuing efforts to maintain market stability and liquidity. Areas of focus this year include: reps and warrants; mortgage insurance; and force placed insurance.

In closing, the members of this committee have important choices to make—choices that will define the role of the government in the housing finance system for years to come. These choices will directly affect the business decisions of countless financial institutions and investors and help determine the framework for millions of households to borrow money for buying a home.

FHFA looks forward to working with this committee, other Members of Congress, and the Administration to make these policy determinations and end these conservatorships.

Thank you again for inviting me here today, and I look forward to discussing these important matters with the committee.

[The prepared statement of Acting Director DeMarco can be found on page 54 of the appendix.]

Chairman HENSARLING. Thank you, Mr. DeMarco, for your testimony.

The Chair now recognizes himself for 5 minutes.

Mr. DeMarco, on page four of your testimony you use the term “sustainable,” that you are focusing on a more secure, sustainable, and competitive model for the secondary mortgage market.

Jeffrey Lacker, the President of the Richmond Federal Reserve, has said, “We should phase out government guarantees for home mortgage debt. Otherwise, financial stability will be elusive and fiscal balance will be threatened by repeated boom-bust cycles in housing. Homeownership may be a laudable social goal, but if that is our objective we should subsidize housing equity, not housing debt.”

I, too, am focused on a sustainable housing finance system. Mr. Lacker is obviously of the belief that our current system can foment boom-bust cycles.

From your perch, and 20 years of experience in housing finance, do you see that as a risk? And how do you use the term “sustainable,” as you used it in your testimony?

Mr. DEMARCO. I certainly think that the housing market does go through cycles, and we have certainly experienced a wrenching nationwide cycle now. And, I think that there is plenty of argument out there that a contributing factor has been some government policies. But that is certainly not the only thing contributing to the problems we have had the last few years.

What I mean by sustainable is we are trying to build a market that truly can last for years and function with whatever role government has, that both government and private market participants can rely upon the soundness and stability of that model. So the infrastructure that we are trying to build is one that starts with basic building blocks—something as simple as data.

The first real step FHFA took as conservator to get moving on this future is something we announced back in 2010 with the Uniform Mortgage Data Program. We wanted to do something as simple as bring to the mortgage industry a standard set of data definitions for what gets reported on a mortgage application and comes to an investor, what the form and format and definitions for an appraisal look like so that we have consistency of data and that produces more quality.

It is a very basic building block. It sounds ho-hum. It is essential to building a sustainable model.

We are also looking at bringing standards to the marketplace.

Chairman HENSARLING. Mr. DeMarco, on page 15 of your testimony—any system of housing finance is going to have some cost, some benefits. On page 15, in talking about some of the Federal housing policies, including explicit credit support, you said such policies "further direct our nation's investment dollars towards housing. It would also drive up the price of housing, other things being equal."

So are you saying that credit guarantees, for what they do, perhaps, to lower interest rates—and I think the last data I saw from the Federal Reserve study of several years ago that the Fannie and Freddie model saves about seven basis points off of the interest to help the consumer but that the consumer may pay on the back end by paying more on their principal. Is that what you are saying in your testimony?

Mr. DEMARCO. Essentially. Right now, as has been pointed out in the opening remarks, over 90 percent of mortgage securitization is being backed by the taxpayer either through Ginnie Mae or through the Treasury support of Fannie and Freddie. If you subsidize this credit to everyone buying a house, you are essentially subsidizing no one. It is causing, just in sort of simple supply-and-demand terms, the price of the good to go up.

So if there is this broad, across-the-entire-market subsidy to housing credit, some portion or a good portion of that gets captured by the home seller and is leading to higher prices.

Chairman HENSARLING. I am running out of time here, so your answer may have to come in writing, but I am curious, what is it that we can do to incent private capital to come into the marketplace, as I observed, trillions of dollars of excess reserves of either banks or non-financial corporate balance sheets?

And I hope somewhere that we will pursue the questioning—I understand you have raised g-fees twice. I am curious, why not a third or fourth time?

But my own time has expired.

I now recognize the ranking member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

During the 112th and 113th Congresses, we have yet to have a hearing on various bipartisan GSE reform proposals introduced in the House of Representatives. We also did not have a hearing on Chairman Hensarling's proposal from the 112th Congress, which would have liquidated the GSEs and then hoped that the private markets would pick up the pieces.

Whichever approach you support, I think you agree that the Congress should be convening hearings on specific GSE reform proposals. From your perspective, Mr. DeMarco, as conservator, what are the costs of doing nothing?

Mr. DEMARCO. The costs of doing nothing are that we are continuing to risk the taxpayer support of Fannie Mae and Freddie Mac and we are making it harder for investors to return to this market and have confidence about what the rules of the road in mortgage lending are going to be going forward.

Ms. WATERS. In the absence of legislation, however, it seems—and I have had this discussion with you—that you have broadly interpreted your mandate to not only act as a conservator but to aggressively wind down the GSEs' market presence and entirely reform the secondary mortgage market. In your testimony, you propose winding down the investment portfolio at a faster rate than agreed to with the Treasury, reducing the GSEs' participation in the multi-family market even when it is unclear that private lenders would fill the affordable rental housing space, and increase the cost of single-family housing by offloading credit risk and raising guaranteed fees even higher.

Given that you are not Presidentially-appointed, permanent Director, where do you draw the line in terms of what you are able to do? Hypothetically, could you raise g-fees an unlimited amount? Could you wind down retained portfolios to zero? How are your decisions being informed by Congress and the Administration?

Mr. DEMARCO. Ranking Member Waters, I would welcome as much congressional direction and legislation on these matters as we could get. For my part, what motivates me and what constrains me is the statutes that Congress has enacted that provide the guardrails about what it is FHFA is supposed to do both as regulator and as conservator.

I am also informed by observing that within the Congress of the United States, while there have been a number of proposals for housing finance, none of them have involved restoring Fannie Mae and Freddie Mac to their pre-conservatorship corporate form. I am mindful that the Administration has repeatedly discussed its intent to wind down the Enterprises.

And I have tried to take a transparent process with Congress in explaining what it is we are doing and why, and with this strategic plan over a year ago, laid out for Congress my thoughts about where FHFA found itself as conservator, how it viewed its statutory responsibilities, and the gradual steps we plan to take under that strategic plan. So I have tried to be transparent about this and move in a thoughtful but gradual manner.

Ms. WATERS. The Treasury and the FHFA agreed to an increased portfolio reduction of 15 percent per year last summer. Why do you feel it is necessary to require the GSEs to exceed this target by selling less liquid assets? How will you ensure that such sales will not result in reduced return to the taxpayer?

Mr. DEMARCO. One of the requirements we placed on them is that these transactions be economically sensible. But I would point out that within the 15 percent reduction that is under the Treasury agreement, Fannie Mae and Freddie Mac can achieve that over the next couple of years by doing nothing, simply by absorbing the natural runoff of their retained portfolio.

I am trying to shrink their operations. I am trying to de-risk the companies so that we can get some of this risk off the back of the American taxpayer, and we are trying to take a gradual approach to doing that by encouraging sales of certain non-liquid assets on their portfolio.

This will also ease the job for Congress in terms of thinking about a transition away from Fannie and Freddie in conservatorship to a future model. The more we can simplify their operation and gradually shrink them, that makes the transition easier.

Ms. WATERS. In the multi-family space, you have set a target of 10 percent reduction in multi-family business new acquisitions in 2012. What will be the impact of this reduction on rental prices?

Mr. DEMARCO. I would not expect there to be any meaningful impact. Fannie Mae and Freddie Mac, in the early years of the conservatorship, their share in the multi-family mortgage market increased substantially. In 2012, it decreased; in 2013, what I want is to see that decrease continue. And we also have reason to believe that the overall size of the multi-family market is going to gradually decline.

So what I am trying to avoid is Fannie Mae and Freddie Mac operating with this government backing, taking on a greater share of the market than should be the case.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, the chairman of the Capital Markets and Government Sponsored Enterprises Subcommittee, for 5 minutes.

Mr. GARRETT. Thank you, again, Mr. Chairman.

And thank you, Director.

Let me just follow up. You said something interesting in response to the chairman's question about having such a—90 percent of the market and subsidizing the market to such an extent you said we are basically subsidizing everybody, right? That is interesting.

When you subsidize everybody, what is the effect on pricing in the market and what is the effect on the first-time homebuyer trying to get into that market?

Mr. DEMARCO. Basic economics would suggest that if you are subsidizing everybody on the demand side for housing, it is going to push up the price of housing, other things being equal. Now, there are a lot of other things going on in the marketplace, including the actions of the Federal Reserve, but that is just a basic economic observation.

Mr. GARRETT. But when you said it is, a light bulb just went off there because for those who say, "Let's just subsidize everyone," at the end of the day you are actually harming them, because it is going to be harder for that person to get into the market or stay in the market.

Let's talk a little bit about the risk, though, in the meantime, to the public, because the GSEs have credit risk, right?

Mr. DEMARCO. Yes, sir.

Mr. GARRETT. Okay, and so can you just talk a little bit about your work or your ideas about trying to sell off some of that credit risk? Because when the GSEs have credit risk, that means you and I as taxpayers have credit risk too, right?

Mr. DEMARCO. That is correct.

Mr. GARRETT. What are your plans there?

Mr. DEMARCO. Right now, with every single-family mortgage that Fannie Mae and Freddie Mac buy and then securitize, they are standing behind that mortgage 100 percent, which means the American taxpayer is standing behind it. What we would like to do is engage in transactions with private investors, with capital markets—to sell off some portion of this credit risk, meaning that if the mortgages that Fannie Mae and Freddie Mac are buying now, if they default that some portion of that loss—those early losses—would be absorbed by a private investor rather than the American taxpayer.

Mr. GARRETT. You mentioned somewhere that you have a target of around $30 billion in 2013, is that right?

Mr. DEMARCO. Yes, sir.

Mr. GARRETT. Is that the total amount of risk that we would be sending out to the private sector, or do you—

Mr. DEMARCO. No, sir. That is the unpaid principal balance of mortgages. So we want to see $30 billion worth of mortgages in which there is some amount of the credit loss associated with those mortgages has been sold off to the private market.

Mr. GARRETT. And what is that percentage-wise of all the credit risk that the GSEs have out there?

Mr. DEMARCO. Between them right now, in terms of the stock, they have about $5 trillion in mortgage guarantees. So it is a pretty tiny fraction.

Mr. GARRETT. This is less than a pilot program.

Mr. DEMARCO. It is a start.

Mr. GARRETT. It is a start. Great.

Another issue that we are dealing with is trying to deal with the sequester, right? And some ideas have come out supposedly to try to come up with other revenue to make up for lost revenue.

There was a bipartisan bill introduced last week to prevent the U.S. Treasury and the Administration from conducting an IPO with Fannie and Freddie, to basically sell part of them off—spin them off to the private sector and use that money as a new revenue stream. Have you heard about that? And what can you tell us about whether that would be a good idea or a bad idea?

Mr. DEMARCO. I am generally familiar with the bill. I am not sure who would want to purchase equity sold by these companies but I understood, really, the intent of the sponsors of that bill to say that we wanted to ensure that the Congress of the United States had a say in the disposition of Fannie Mae and Freddie Mac.

Mr. GARRETT. Okay. You know about the bill, but have you heard, is that something that the Administration is actually—

Mr. DEMARCO. No, sir. I am not aware that is being contemplated.

Mr. GARRETT. So, this would be one of the worst things that we could do, or the Administration could do, if they actually did that? If so, why would it be? Because you would be making money right, wouldn't it?

Mr. DEMARCO. Right now, they are starting to make money, yes, and I am pleased by that. That money, right now, every quarter is swept in a dividend payment back to the Treasury Department, and the way the senior agreement with the Treasury works is the actual liquidation preference of that senior preferred stock does not decline regardless of how much is paid in dividends. So there is still a liquidation preference retained by the Treasury Department that is substantial.

Mr. GARRETT. And isn't the bottom line also that if we did this, it would basically just put us back into the situation that we were pre-crisis days as far as this public-private partnership that just did not work?

Mr. DEMARCO. Yes, sir. If we tried to, in any fashion, recapitalize Fannie and Freddie as they are and put them back out there.

Mr. GARRETT. In my closing time, you are familiar with the preferred stock purchase agreements and the changes that the Administration made to it recently, I guess last year. Can you just talk about that, whether these changes hurt or helped your ability to fix or reform the system?

Mr. DEMARCO. I think that they helped in that they provided some assurance to investors in Fannie Mae and Freddie Mac securities that the dividend at Fannie Mae and Freddie Mac would not continue to borrow from the Treasury in order to pay the Treasury with regard to dividends. It also is ensuring that the taxpayer starts to see even more of a return on the support that has been provided and it does not allow for the companies to take their earnings and essentially recapitalize themselves.

Mr. GARRETT. I thank the gentleman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Why did Fannie and Freddie get into subprime lending, and what steps have you put in place to prevent any entity, whatever is there, from taking that action in the future?

Mr. DEMARCO. It is a complicated story with regard to the Enterprises' participation in subprime lending, but clearly it was driven by what was going on more broadly in the marketplace. There was a sense that Fannie Mae and Freddie Mac were losing market share to private participants; there was a sense of serving more borrowers at the margin of the mortgage market; and there was a sense that the strength of the U.S. housing market was such that home prices were going to continue to rise. So there were a lot of things going into their participation in that marketplace.

With regard to where we are today, we have undertaken a couple of pretty important steps. One of them is that the pricing of guarantee fees is much more risk-based today than it was. They were clearly underpricing risk in the marketplace.

The second is that underwriting standards have been improved. And the third is that through the discipline on lenders through things like enforcing reps and warrants, we are getting better discipline in the origination process with regard to ensuring that mortgages which are being produced today comply with the standards that Fannie and Freddie have.

Mrs. MALONEY. I am concerned about the multi-family housing, and I want to quote from your remarks that you gave at the National Press Club on March 7th: "We are setting a target of a 10 percent reduction in multi-family business volume from 2012 levels. We expect that this reduction will be achieved through some combination of increased pricing, more limited product offerings, and tighter overall underwriting standards."

Multi-family housing is a critically important base for affordable housing in our country—well over 15 million people rely on it: seniors; students; low-income; and moderate-income families—and I feel that preserving it is very important. So first I want to know, how did you decide on a 10 percent reduction as the appropriate volume? And have you done any studies to see if the private sector will pick up in this area and continue to help us with affordable multi-family housing?

Mr. DEMARCO. Of course. And certainly, Congresswoman, I share your feeling that the multi-family market is critical to housing our citizens and it is particularly an important source of housing for low- and moderate-income households.

With that said, we came to the 10 percent through looking at a variety of things, including the market size, the traditional role of Fannie and Freddie in this market space, expectations about the size of the market in the future, and recognizing that we did have a goal of gradually reducing the Enterprises' footprint in the marketplace.

Also paying attention to and being mindful of, unlike single-family where, as we talked earlier, over 90 percent of the secondary market activity is through the government, that is not the case in the multi-family market. The multi-family market retains a good bit of private capital participation and competition in that marketplace and I certainly have been hearing from the banking community that they want to participate in this market, they are active participants in it, and they are concerned about Fannie and Freddie operating with this kind of government backing having an unfair advantage in that market. So I am comfortable that there is private capital actively competing in this marketplace.

All that said, I want to assure you that we intend to monitor how this is carried out by the companies and how this market evolves, and to be mindful of that. And we have reminded the companies of their statutory mission to support affordable housing.

Mrs. MALONEY. Have you consulted with the Treasury Department and FHA about this target and are they part of this decision?

Mr. DEMARCO. Yes. I consulted with both of those departments in advance of announcing this decision.

Mrs. MALONEY. And I also want to question one of your speeches on March 7th on the differences between the single-family businesses and the multi-family businesses. Are you approaching them differently in your approach for the future?

Mr. DEMARCO. Yes, we are. And that is a good thing for me to explain, the reasoning here.

With single-family mortgages, Fannie and Freddie are retaining all of the risk when they buy the mortgage. In most of the multi-family mortgages they buy, they are already doing risk-sharing with private capital. I am trying to get the single-family to look a bit more like multi-family, where there is risk-sharing with private capital.

Mrs. MALONEY. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from California, Mr. Miller, the vice chairman of the committee, for 5 minutes.

Mr. MILLER. Thank you.

Mr. DeMarco, I have enjoyed some of your responses to the questions asked. In 2001, I started introducing language that defines subprime versus predatory. I think I got in three or four bills to the Senate which—I'm sad to say, they did nothing with them—really had specifics on underwriting standards.

But you have released your conservator scorecard in—I believe this was March 4th. And you had detailed specific priorities on three strategic goals. That sounds a lot like a bill I introduced with Mrs. McCarthy last year and I am glad you are moving that direction. But what effect do you think the new platform will have on getting the private sector money back to the secondary market?

Mr. DEMARCO. I think it has an opportunity to be an important contributing factor to bringing private capital back into the marketplace. When you think about investors in private label mortgage-backed securities and the losses that they have suffered and the problems that have become apparent as a result of the collapse of the housing system, I think that investors are going to be more comfortable bringing private capital back to the mortgage market if they can rely better on how securities are going to work, what the rights and protections of investors are, how mortgages are going to be serviced, and what kind of transparency there is with regard to the actual performance of the underlying mortgages.

These are all things we are trying to bring to this platform and we think it will make returning to this market more attractive for investors.

Mr. MILLER. The problem I have with the hybrid model without Freddie and Fannie is you have taxpayers being put at risk but the private sector is making all the profit. And you can see where Freddie and Fannie went wrong when they started taking market share to appease their stockholders, basically, and then made every mistake they could make at that point.

But what advantages or disadvantages do you see in spinning this platform off as a private entity?

Mr. DEMARCO. We are constructing it as a jointly owned entity of Fannie and Freddie. I really expect the Congress of the United States to make the final determination.

It is an asset of the conservatorship so it is going to be up to Congress to determine the disposition. Your options are essentially: you can make it a government-owned corporation; you can sell it to a private entity; or you can turn it into a market utility and have it operate really as just that, as a financial market utility.

Mr. MILLER. My concern is the approach we use on turning it into a private entity. Do you envision avoiding this flaw we have had in the past of a hybrid model that exists with Fannie and Freddie today?

Mr. DEMARCO. Without some sort of control or knowing what the governing mechanism is, it is certainly open to going in a direction other than the one I am designing for right now.

Mr. MILLER. What do you see as the benefits in spinning it off as a private entity, as you talked about—

Mr. DEMARCO. Let me say this: I think that the larger benefit, if I may, on this particular one is, I think, structuring it as a market utility—not as a for-profit entity but as something there to serve market participants. And one of the things that I would be concerned about is making sure that however this thing operates in the future, it operates so that small and mid-sized lenders have fair access to secondary market execution.

Mr. MILLER. The concern I have is, if you look at the FHFA today, there has been some debate on that, and I don't think the FHFA is necessarily crowding out the private sector as the private sector is not crowding in today. And much of that is due to legislation we have enacted on the private sector and the confusion we have created out there, which I think we have to eliminate.

But what are the main barriers you see today that prevent private capital from entering the mortgage market and secondary market finances as a loan?

Mr. DEMARCO. I think there are a number of things still inhibiting the full return. One of them is that Fannie Mae and Freddie Mac are still the dominant players in the marketplace and they are operating with taxpayer support, which puts them in a place that other private investors cannot get to.

The other is that the infrastructure for establishing standards and allowing for investors to feel comfortable returning is not there. And there is still plenty of regulatory uncertainty with regard to a range of things, from risk-based capital rules to regulations still to be implemented under Dodd-Frank.

Mr. MILLER. You have talked about the contraction of the GSEs and eliminated the concept of being the dominant presence in the marketplace, and they are reforms you are enacting today. But how do the barriers that we have created for you through legislation—the Dodd-Frank Act and such—impact your ability to do that?

Mr. DEMARCO. The biggest impediment, I suppose, for me, or the thing I could use most from Congress is legislative direction. Even if it is not the whole picture, at least to start to provide some sense of—

Mr. MILLER. Parameters within which you could work, basically?

Mr. DEMARCO. Parameters, yes, with respect to—take this platform, take how to gradually shrink Fannie and Freddie's presence in the marketplace. There are steps that we could take incrementally today.

Mr. MILLER. Thank you. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. DeMarco, the FHFA has proposed reducing the mortgage guarantee fees on a State-by-State basis. To determine the new fees, you will look at the length of judicial actions and cost of legal services, two factors that have high correlation to States with robust consumer protection laws.

As a result, New Yorkers will see the highest increase in g-fees under your proposal. Do you think it is fair for borrowers in New York to be saddled with higher fees just because the State requires accurate documentation and holds mortgage servicers accountable in the foreclosure process?

Mr. DEMARCO. Congresswoman, with respect to the State of New York or any other State, the residents of that State get the benefit of that protection, and if that benefit carries some cost, this is having the residents of that State also bear the cost that goes along with that benefit, as opposed to the residents of all the other States paying that cost.

But I would say with regard to the State g-fees—

Ms. VELAZQUEZ. Let me ask you this question: The underlying message that you are sending to States like New York is, "That is a wrong approach, to provide robust consumer protections," because—

Mr. DEMARCO. Absolutely not. That is not the intent of my message at all.

My message to the State of New York is that you are three standard deviations removed from the rest of the country with regard to how long it takes an investor to secure their security interest in a mortgage after the borrower defaults, and that imposes a great deal of added cost on Fannie and Freddie.

Ms. VELAZQUEZ. So borrowers will face higher fees?

Mr. DEMARCO. We have proposed that, and I have put it out for public comment. We are evaluating the—

Ms. VELAZQUEZ. And so we have—they will be—

Mr. DEMARCO. We are evaluating the comments—

Ms. VELAZQUEZ. —accountable for the financial crisis for which they were not to blame.

Mr. DeMarco, you continue to reject principal reductions that could help underwater homeowners despite analysis that shows billions of dollars in long-term savings. As you know, the rationale for not participating has been the fear of borrowers strategically defaulting to receive benefits.

So you cannot draft rules that will reduce the risk of fraud while also facilitating a faster housing market recovery and taxpayer savings.

Mr. DEMARCO. With regard to that issue, Congresswoman, the FHFA spent 6 hard months carefully studying and analyzing the principal reduction alternative under HAMP, which is what the Treasury Department asked us to do. We put out extensive analytics regarding the work we did and the conclusions we drew and the basis for that conclusion, and I think that we have documented the reasons why we declined participating in the principal reduction alternative for HAMP.

With that said, we continue on a path of energetic effort to provide foreclosure prevention alternatives to homeowners with Fannie and Freddie loans who get in trouble on their mortgage, and as I went through in my earlier remarks, I think we have demonstrated that through over 2 million homeowners in trouble on their mortgage being able to retain their homes—

Ms. VELAZQUEZ. Out of how many millions—11 million?

Mr. DEMARCO. It has to be with regard to the number of borrowers who are in trouble.

Ms. VELAZQUEZ. Mr. DeMarco, I heard your answer to the Congresswoman from New York about reducing the business volume to 10 percent, and so it doesn't make economic sense to me that you are going to reduce a 10 percent volume in one of the most profitable, stable portfolios that they have. Why is that?

Mr. DEMARCO. Right. Because it is not the actually—as conservator, we have set out to gradually shrink the Enterprises' footprint in the marketplace so that we can restore order to private capital, and I believe that the multi-family segment needs to be part of that just like the single-family segment does and the retained portfolio does.

Ms. VELAZQUEZ. We heard that the National Association of Home Builders estimates that up to 400,000 new multi-family housing units will need to be built each year for the next 10 years to keep up with demand, so it doesn't make sense—

Chairman HENSARLING. The time of the gentlelady has expired. Did you finish the question? He can answer in writing.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman HENSARLING. Okay.

In that case, the gentlelady from New York is recognized for a unanimous consent request.

Mrs. MALONEY. Thank you, Mr. Chairman. I ask unanimous consent to place in the record a letter signed by numerous Members of Congress in support of the gentlelady's position that guaranteed fees should be related to outcome—keeping people in their homes—and States should not be penalized for policies that—

Chairman HENSARLING. Without objection, it is so ordered.

Mrs. MALONEY. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, for 5 minutes.

Mrs. CAPITO. Thank you, Mr. Chairman.

I want to talk timing here. You have talked about reshaping and repositioning the GSEs. One of the great questions that I think we have before our committee, and you have asked for congressional guidance is, what is the timing aspect of this? Because I think we all realize if the timing window is too short, we could really harm the housing market, which I don't think anybody wants to do; if it is too long, are we ever going to get there?

So how do we find that sweet spot of the timing of winding down and letting the private market maybe take more of that space? And I would like to hear your thoughts on that question.

Mr. DEMARCO. I think that is a very fair concern, given the trauma our country's housing system has gone through. But now that we are 4½ years into the conservatorships, we clearly are seeing signs of recovery in housing across most of our markets in the United States.

So I do believe it is certainly time to begin that gradual stepping back, and we are trying to do that, to get it started, do it gradually.

But I also believe it is a multi-year venture to do that, and I think some of the things we are doing are multi-year ventures. It is going to take time for us to fully build out this platform and have it fully operational, and the steps that we have outlined with regard to contracting the Enterprises' footprint in the marketplace is meant to be gradual, done slowly over time, so that we don't disrupt the recovery of the marketplace and so that investors can gradually get comfortable and step back in.

Mrs. CAPITO. I know you are not going to react to specific timeframes but are you talking about a 5- to 10-year timeframe, or are you talking about a 10- to 25-year, or—

Mr. DEMARCO. I would like to see this within 5 years. I wouldn't even go 5 to 10 years. I think we should be moving ahead now.

Mrs. CAPITO. All right. Thank you.

The Consumer Financial Protection Bureau (CFPB) has put out a rule on the Qualified Mortgage (QM), and my understanding is that if your loan is securitized by Fannie or Freddie, you are automatically considered a qualified mortgage. In my view, I think this leads to more expansion of Fannie and Freddie participation because the lender is going to want a QM, the borrower is going to want a QM for a lot of different reasons. Do you have any thoughts on that issue?

Mr. DEMARCO. This is a pretty fresh rule, and we are actually analyzing it to understand the CFPB's—the way they define QM outside of the GSE realm and then looking at what the underwriting rules of Fannie and Freddie are, that go beyond QM, and we are actually reexamining this to get a sense of what this impact looks like. Because yes, to your point, in some sense it appears, at least, to run counter to the notion of, we are trying to contract the significance of Fannie and Freddie in the marketplace.

Mrs. CAPITO. Do you anticipate that Fannie and Freddie would—because they are going to write their own rule for a QM or have their own parameters. Is that correct?

Mr. DEMARCO. They have their own underwriting rules—

Mrs. CAPITO. Okay.

Mr. DEMARCO. —and so we are looking at that with—in light of what the CFPB has determined is appropriate to define QM in the non-GSE realm.

Mrs. CAPITO. Do you think there could be a scenario where you have a QM—you have a Qualified Mortgage in one scenario but in the Fannie and Freddie realm, it is not quite a QM? To me, that would lead to massive confusion.

Mr. DEMARCO. Let me put it this way, the way the CFPB has written this rule is that right now a mortgage that is not otherwise a Qualified Mortgage could be so if it passes through Fannie and Freddie's automated underwriting system.

Mrs. CAPITO. Okay.

The other question I is on the taxpayer protection issue. Could you—I only have about a minute left, and I know this is very complicated, but in my opening statement I talked about the $187 billion or whatever the exact figure is, and then we have talked about the $9.6 billion in net income over the last several quarters.

What does that $9.6 billion actually go to? Does it ever touch that $187 billion? Will it ever if it keeps generating profits? I guess what I am asking is if the taxpayers are ever going to get their money back?

Mr. DEMARCO. The amount that the taxpayers have put in with regard to covering the losses of Fannie and Freddie is not being reduced through these dividend payments.

The taxpayer is getting back a return on the capital that is put in; it is a dividend on the capital put in. But it is not a repayment of that capital. We are not lowering the amount that is owed to the Treasury Department under the senior preferred agreement.

Mrs. CAPITO. If the improvements continue, would that be a scenario where the principal would begin to get repaid, or do you—

Mr. DEMARCO. That is not how the agreement is structured.

Mrs. CAPITO. That is not the agreement. Okay. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from North Carolina, Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman. Mr. Chairman, in light of media speculation which started over the weekend, I decided to attend today's hearing as a member of this committee because of the critical importance of the subject being addressed. I am here solely to listen and not to engage. Therefore, I am going to yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back the balance of his time.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. DeMarco, I want to go back to something that you were saying a while ago and kind of get you to rephrase that because obviously there has been a lot of controversy about the principal writedown policy. In fact, there were some people here earlier who I think disagree with you, if you may have noticed, I don't know.

I think you spent an inordinate amount of time researching that issue. Is that correct?

Mr. DEMARCO. Yes, sir.

Mr. NEUGEBAUER. And the finding was—and it is your responsibility as the conservator—your responsibility is to conserve and do what is in the best interest of the taxpayers. Is that correct?

Mr. DEMARCO. Yes, sir.

Mr. NEUGEBAUER. And so did you conclude, then, that writing principal down for people who were already paying their mortgages was not in the best interest of the taxpayers?

Mr. DEMARCO. Yes, sir.

Mr. NEUGEBAUER. So I think it is kind of interesting, one of the things that has been said about the housing crisis is that Freddie and Fannie played a part in it, and there are a lot of people to blame, but one of the things that keeps kind of coming up is that Freddie and Fannie were being used by Congress and other political influence to make housing policy that wasn't necessarily sound. Would you concur with that finding?

Mr. DEMARCO. I would, sir, yes.

Mr. NEUGEBAUER. Yes. But isn't it kind of interesting that it is still going on?

Mr. DEMARCO. It has a certain irony after $188 billion of taxpayer money going into them.

Mr. NEUGEBAUER. Yes. We still have people who want to continue to use Freddie and Fannie for housing policy. Is that correct?

Mr. DEMARCO. It would appear that way, yes.

Mr. NEUGEBAUER. Yes. So I found it kind of interesting, I noticed that there were a couple of—I don't know how many people were involved, but some attorneys general are calling for your replacement because you didn't buy into the principal writedown program, so—and I guess—I think it is also interesting, some of those attorneys general also were part of the settlement. And what we do know is about half of the money that these States received for the settlement went to housing programs, but the other half of it didn't go to housing. Is that correct?

Mr. DEMARCO. From what I have read in press reports, yes, sir.

Mr. NEUGEBAUER. So I think one of the things that it points out is the reason that we need to begin to diminish the Freddie and Fannie role is that we—I think you heard me say in my opening testimony that we don't seem to have learned any of the lessons and that, in fact, there just continues to be pressure from within Congress and outside groups for Freddie and Fannie to keep doing what they have been doing. And basically what you testified is we are just putting more and more potential contingent liability on the American taxpayers. Is that a fair assessment?

Mr. DEMARCO. It is. And certainly, as was demonstrated here, this is an emotional issue. It is one that affects real families. And I take very seriously the harm that this financial crisis and this housing crisis has imposed on families across the country.

But we have tough decisions to make and we have to rebuild this system so that we don't put these families at risk like this again and we don't put the American taxpayer at risk like this again.

Mr. NEUGEBAUER. I want to go back to one other issue, and that is the portfolio. And you and I have had some discussions about that.

We are at record-low interest rates. In fact, I don't know how we can go any lower from here but the Chairman of the Federal Reserve seems to be on a mission to try to see if we can get these rates lower. And so, my opinion is that the value of your portfolio has to be at its maximum right now, because as those rates begin to trend back up, the value of your retained portfolio assets will go down. Is that typically how that happens?

Mr. DEMARCO. For certain portions of the portfolio, yes; for others, there may be more critical economic factors affecting the value of the assets.

Mr. NEUGEBAUER. What efforts do you currently have underway to kind of accelerate the reduction of the portfolio and what are some of the things you are doing in that respect?

Mr. DEMARCO. An important thing to understand about the retained portfolios of Fannie and Freddie is that they look—they are much different than they were the day they went into conservatorship. When they went into conservatorship, they were dominated by their own mortgage-backed securities, which traded in the marketplace, and home mortgage loans that they simply bought the mortgage and put it on their balance sheet.

Today, it is much different. It is much less liquid.

They have a lot of non-performing loans on their balance sheet. They have a lot of loans that have gone through loan modifications. Those modified loans are sitting on their balance sheet.

And as they have run off the more liquid stuff, including their own mortgage-backed securities, or sold that into the marketplace, they are left with less liquid assets, and that is what we are trying to gradually get off their balance sheet.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. There seems to be a universal belief that it is a bad idea to have the taxpayers take all the risk and private shareholders get the upside. We tend to view the two GSEs as government agencies, but as I understand it, technically they are 21 percent owned by their private shareholders. Furthermore, by keeping this 21 percent ownership, the net operating losses—the tax benefits—are still retained, in effect, by these entities.

We have a net of $137 billion of taxpayer money. It is on its way up to maybe $200 billion. Haven't the taxpayers done enough to deserve 100 percent ownership of these entities and to know that we are not going to lose revenue to the net operating loss carry-forwards? Why aren't we taking steps to acquire 100 percent ownership?

Mr. DEMARCO. We are looking forward to legislative action by the Congress of the United States to make those determinations.

Mr. SHERMAN. But until then, the taxpayers own 21 percent of something we are already paying $137 billion for, and until then, we are going to suffer the tax reductions of the largest pool of net operating losses I am aware of—losses in effect financed by our money. Perhaps there will be some action by Congress on that.

Mr. DEMARCO. I would welcome it.

Mr. SHERMAN. I would ask you to propose some, as a matter of fact. I would like to get your technical assistance in putting that together.

Over the last year or so, you have raised the guarantee fees in an attempt to level the playing field for private capital. Can you provide the committee with your findings regarding any increase in private capital participation in the secondary market as a result of your fees or in conjunction with your fees being increased?

Mr. DEMARCO. Given that along with Ginnie Mae, Fannie and Freddie are still representing over 90 percent of the securitization market and well over 80 percent of mortgage flow, one can't say that this has led to a dramatic reversal with regard to their share. But I can report, and I have said this publicly, that in our own conversations with market participants and observations of market practices, we do believe we are getting closer to a price at which we are going to see more mortgages not get sold to Fannie and Freddie because there is a more profitable execution elsewhere in the marketplace.

Mr. SHERMAN. So you think you are getting there but you are not—

Mr. DEMARCO. We are making progress, sir.

Mr. SHERMAN. You are not there yet.

I just want to comment that it was interesting to hear your opening remarks saying that the beneficiaries of the GSE activity are not so much the homebuyer as the homeowner, but I don't think that is necessarily a bad thing. Had we seen a further collapse in home prices, this country would be in much worse shape than we are now.

Mr. DEMARCO. And I wasn't putting a value judgment on it, Congressman. I was simply—

Mr. SHERMAN. Yes.

Mr. DEMARCO. —noting that if you are subsidizing everybody, there is a basic economic principle—

Mr. SHERMAN. I think we all understand that you provide lower interest rates and that supports housing prices.

Can you provide the committee with a timeline for the completion of this single securitization platform that you are constructing?

Mr. DEMARCO. I cannot. We said at the outset that it would be a multi-year effort. In response to an earlier question, I said that I would like to see this—I think this transition can be done within 5 years, but beyond that it is very hard to put a strict timeline on something when you are still in the design phase, trying to scope out what it is, and it is a pretty material undertaking, including a good bit of—

Mr. SHERMAN. You have talked about creating a "market utility or public utility." There are private sector enterprises and we could have some public utility that can package loans and sell them into the market. But only the Federal Government can provide a Federal guarantee.

Are you anticipating that this public utility is providing a Federal guarantee or just packaging and selling?

Mr. DEMARCO. I am anticipating that this utility will be structured in such a way that it can issue mortgage-backed securities that have a Federal guarantee on them and it can also issue mortgage-backed securities that do not have a Federal guarantee on them. They would not, presumably, be the entity providing that guarantee for the government. This is the operational platform under which the securities would be produced, sold into the marketplace, and because they would be done as a market utility, that consistency would make the market more liquid.

Mr. SHERMAN. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Mr. DeMarco, thank you for your service to our people and within our government.

I want to sort of take off from the previous line of questioning. You said that 90 percent of new mortgage originations are backed by the Federal Government. And a majority of the outstanding mortgages you preside over in what is the successor of Fannie and Freddie.

Now, I bring this up because the chairman started by asking—his final question was about how do you incentivize private capital back into this marketplace. Let me begin one step before that, which is, what are the current barriers to private capital coming into this secondary mortgage market?

Mr. DEMARCO. The dominant portion of the market being served by Fannie and Freddie operating with taxpayer support, uncertainty about what the government's role in the future is going to be, including the timing and ultimate disposition of Fannie and Freddie. There is uncertainty with regard to rulemakings that are still pending in the marketplace, including capital rules, and waiting to see a bit more how the market itself regains its footing. These are all contributing factors.

Mr. MCHENRY. So the first factor, which is the government backing, makes these mortgages cheaper, which means the private sector can't compete? Is that—

Mr. DEMARCO. That is basically it, yes.

Mr. MCHENRY. That is basically it. Okay.

So how can we incentivize private capital to come in?

Mr. DEMARCO. One way we can do it, and that we are doing it is we are—as we talked about earlier in this hearing—gradually increasing guarantee fees to move towards a pricing that was reflective of what private capital would expect to manage that risk for its own—with putting its own equity in place. That is an important component.

Mr. MCHENRY. Have you taken steps to actually put the two separate platforms of Fannie and Freddie together, and is that process ongoing?

Mr. DEMARCO. It is. And that is part of our conservator mandate. It is not just about building for the future, as important as that is.

Fannie and Freddie are operating a combined $5 trillion book of business. We have to continue to invest in the infrastructure for that business.

And, I have spent a lot of time thinking, what does it mean as conservator of two companies that the Administration says it wants to wind down? How do I invest taxpayer dollars in continuing to develop and strengthen the underlying infrastructure of their securitization business, using taxpayer money, if at the same time we are expecting ultimately to wind these things down? So the platform gives us a more efficient way of utilizing taxpayer dollars.

Mr. MCHENRY. What are the advantages and disadvantages of spinning off that entity as a private versus sort of a government-owned utility?

Mr. DEMARCO. I think that certainly if private market participants thought they had a greater stake in what this platform was doing, we would get their input into it, and it would help shape the design. I said when I put out the scorecard, we are intending to develop a formal mechanism to be receiving market input on this, but I think that the more they see that this is something that they can have access to and participate in, what it does to serve the market will attract them more to what we are doing.

Mr. MCHENRY. In previous hearings, I have been very frank with the position you have been put in as acting Director and the decisions you have had to make. Now I just ask very broadly and simply, what is your role here as conservator?

What does that mean? Does that mean you are here to protect the taxpayer? Does it mean you are here to see a vibrant housing marketplace and increasing values? Is it to make sure that investors are rewarded for investing in these entities? What is your purpose and role?

Mr. DEMARCO. Almost all of that, Congressman. In my prepared statement, I go through the statutory provision here, but fundamentally, we have a responsibility as conservator to conserve and preserve the assets. And what that means with the American taxpayer providing this capital, with all the risk exposure on the legacy book, that meant minimizing losses.

We also have a responsibility for ensuring stability and liquidity in the mortgage market and the statute also tells us we have to maximize our efforts to prevent foreclosures subject to a net present value test where we are protecting taxpayers.

Chairman HENSARLING. The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. DeMarco, let me pick up on a couple of things—couple of questions, I think, that were asked by Mr. Sherman first, and that is—let me first deal with the public utility that you proposed. I am wondering, what actions will you take to ensure that the large banks and investment firms and others who were bad actors, actually, that were shown to have contributed to the financial crises, to prohibit them from utilizing these public utilities that you proposed?

Mr. DEMARCO. Yes. I think that one of the really important things about restoring industry standards from data to the way mortgage securitization is done, by getting that to be a single industry standard rather than a set of proprietary standards operated by major, huge financial institutions—by doing that, Congressman, I think we make it easier for small and mid-sized institutions to continue to be active participants in this marketplace. Because then the industry and the vendors that serve this industry have to develop the technology just once and then that technology is available to all market participants.

That is why I think it is so important to get these standards done and to have standard contracts, standard disclosures, standard data reporting, because I think that is what is going to help a lot of the small and mid-sized participants to remain active in this marketplace.

Also, what we are looking for with this platform is it is very important to me that this operate in such a way that if you are a local bank in the State of New York or wherever, that you have access to the secondary mortgage market so that you can originate mortgages and sell them, and this platform needs to be designed in such a way that we ensure that kind of access for small and mid-sized institutions.

Mr. MEEKS. Do you think that will exclude the large ones, those that have really caused these crises, in my estimation, from also trying to take advantage of it?

Mr. DEMARCO. I am not looking to exclude large institutions from the marketplace. I am looking to make this marketplace as competitive and transparent as we can make it.

Mr. MEEKS. And let me ask, because on another issue—let me ask this question first—I want to make sure that I understand. We had a hearing here not too long ago, and the title of the hearing was, “Fannie Mae and Freddie Mac: How Government Housing Policy Failed Homeowners and Led to the Financial Crisis.” What do you think? Did Fannie and Freddie cause the financial crisis?

Mr. DEMARCO. It is hard to say that Fannie and Freddie have drawn over $100 billion to the American taxpayer and didn’t have anything to do with this crisis, so certainly the business decisions of these companies in the years leading up to conservatorship contributed to the housing crisis and the economic crisis we had here. There were a lot of factors at play and honestly, Congressman, I am not one to sign up for a single explanation for what caused this crisis.

There are so many parties that have a share in the blame here, from regulators, to Fannie and Freddie, to investors, to big financial institutions, to borrowers. There is fraud out there. There are a lot of contributing factors to what went wrong in this marketplace.

Mr. MEEKS. And let me also, because I know that you are suing some major banks for mortgage-backed securities that originated with triple-A ratings that Freddie and Fannie bought. Can you tell me why that lawsuit was brought?

Mr. DEMARCO. It is consistent with how FHFA has understood its conservatorship mandate to conserve and preserve the assets of the company. If there are losses being absorbed by Fannie Mae and Freddie Mac that by contractual or legal rights should be absorbed by some other party, or be the responsibility of another party, we are looking, with these companies in conservatorship, to exercise those rights and to get that compensation on the losses Fannie and Freddie have had.

So we see that with regard to the representation and warranty put-back claims that Fannie Mae and Freddie Mac have made. And with regard to private label securities, we felt confident that we had grounds to say that some of these securities sold to Fannie Mae and Freddie Mac were misrepresented in terms of what was there and that, after seeking other remedies, we resorted to the system that is in place to resolve these sorts of business disputes. We have resorted to the court system to set forth our claim and to seek appropriate compensation for these losses, and that is part of our responsibility to protect the American taxpayer.

Mr. MEEKS. I don’t think I am going to have much time left, so I will yield back.

Chairman HENSARLING. That is an accurate observation on the gentleman’s part.

The Chair now recognizes the gentleman from California, Mr. Campbell, for 5 minutes.

Mr. CAMPBELL. Thank you, Mr. Chairman.

And thank you, Director DeMarco.

I am going to follow up on some themes we have kind of touched on already, but dig a little deeper into them. You have mentioned that it will take several years to do GSE reform and to transition to a new and different system. What if we don’t get started? In other words, what are the costs or risks of inaction, of simply just leaving the GSEs as they are, well enough alone?

Mr. DEMARCO. There are several. First, certainly to the extent that the ongoing role of the GSEs crowds out market participants or makes it harder for them to compete, they are going to go deploy their capital someplace else. Then, if you want to draw them back in, you just make it that much harder.

Second, I have testified before this committee numerous times about the challenge of having two large companies like this in conservatorship. The two critical foundations of these companies are the people who work there and the basic infrastructures that support their operations. And we have been asking the employees of Fannie Mae and Freddie Mac for 4½ years to continue working at these companies under this kind of scrutiny and criticism and at reduced pay, and we have told them, "We don't know what is going to happen to you. The Administration keeps saying we are going to wind you down. All of these legislative proposals are that we are not going back to that business model. We can't tell you where we are going, but we want you to stay and keep working here." These individuals, they have careers for themselves and they have choices, and so I think that we certainly have risk with that kind of uncertainty.

And then another risk that I spoke of earlier is, we need to continue to invest in the infrastructure. Every day we buy a new 30-year mortgage, that is a 30-year commitment that the American taxpayers made, and I have to have a technology infrastructure and an operating infrastructure to be able to manage that risk over its entire lifespan, and that is quite a long tale already. I have to invest taxpayer dollars to keep that sound, so this is another reason why I think we should get going.

Mr. CAMPBELL. Looking at the g-fees, we mentioned there is a subsidy there; they are not equivalent to what—as you mentioned in your answer to Mr. McHenry's question, something that might bring private capital back would be a g-fee that would be equivalent to what the private sector deemed was the risk. If you look at the g-fees we have now—and I understand some of those have been diverted and are going to general government purposes that are unrelated to housing, or Fannie and Freddie, or FHFA, or anything—but if you look at the total amount of the g-fees, how close are we to what would be a market, for lack of a better term, rate or the kind of rate that would make private capital look and say, "Maybe I would take that risk for that price?"

Mr. DEMARCO. I have certainly heard from some market analysts who think that we are getting close. We have gone from—my testimony says that we have basically doubled the average g-fee pre-conservatorship from 25 to 50, and so I think that we are within striking distance of certainly getting there with regard to at least some portion of the credit risk.

One of the things that is important about the contract element of our strategic plan and what we want to do with these risk-sharing, since that is actually going to give us some actual market observation of what the market is pricing this risk at, and that would make me better-informed to be able to answer a question—

Mr. CAMPBELL. And it will do that how? How is that going to provide that information?

Mr. DEMARCO. What we are going to do is we are going to sell off some portion of the credit exposure on these mortgages and so the investor in the entity taking on that risk is going to want a return on it, and so through that price we will be able to start to discern how they are assessing the market price of this risk.

Mr. CAMPBELL. Okay. Other than the g-fees, what else would attract private capital? What else can we do to start to bring in, crowd in, however you want to call it, private capital back into taking some additional risk in this sector?

Mr. DEMARCO. One thing that hasn't come up here but certainly is on the minds of market participants has to do with the conforming loan limits. Conforming loan limits is something the Congress of the United States has legislated on a number of times since conservatorship, but the last act by Congress actually was to see a substantial reduction in the Fannie Mae-Freddie Mac conforming loan limit in high-cost areas. In early 2012, it went from basically $730,000 to $625,000, and the market is still operating. I think that there is room here for, again, as with everything else we are doing—g-fees and so forth—a gradual drawing in of conforming loan limits is another way to start attracting capital back.

Mr. CAMPBELL. Thank you.

I yield back.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

And thank you, Mr. DeMarco, for being here.

Mr. DeMarco, I don't know how I feel about your new approach but I want to congratulate you for having the courage to do it. Honestly, it has kind of surprised me that in the last Congress and this Congress, we have not yet had a single hearing on what we are going to do with the GSEs moving forward. There are several proposals on the table, and they are all worthy of debate, but thus far we have been—I know I personally have reached out to a lot of people trying to figure out what we should do and where we should go, but thus far, to my knowledge, we have had no formalized discussion.

My hope is that your proposal—good, bad, or indifferent—will prompt us into at least having an adult conversation about where we want to go. So I will watch it closely and maybe at a later time, we will have a more in-depth debate as to whether it is good or not. But as of today, I just want to congratulate you for having the courage to take some action.

Mr. DEMARCO. Thank you, sir.

Mr. CAPUANO. As far as the principal writedown, look, I fall on the other side of the issue than you do. We can sit here for the next 5 minutes and rehash it but that is not going to help.

I suspect that what you said earlier—I accept it, that you feel the pain of the people who are kind of caught in this vortex. And for me, the people that I have felt the most difficult for, at least lately, for a while now, are the people who are struggling to meet their mortgage regardless of principal writedown.

I have remortgaged my house 100 times and it is all about cash flow. It is nothing else other than, can I afford it? How much do I save? How much do I have to cost each month?

Cash flow is the most important thing that any homeowner is—at least the average homeowner, anyway. And the cash flow can be affected lots of different ways. Principal writedown is one way, and it is a good way by some standards, and that is fine.

The other way is to extend the term or reduce the rates. The problem with a lot of these people is that they cannot take current benefits of reduced, like I just did by rewriting my mortgage, because they are underwater, because they might have missed a couple of payments. Again, and I want to distinguish that group of people from people who haven't paid anything for the last 10 years; it is a different group.

But there are an awful lot of people who are struggling who, maybe if their mortgage was $200, $300, or $400 less per month, they could make it. Has there been any consideration to coming with a 40-year mortgage or a 50-year mortgage if you don't want to write down principal and allowing these people, temporarily as a one-time thing, to get into these lower rates so that they can get their homeownership back, their life back, their control of their life back, and so you can get off the hot seat for not doing enough for people with whom we are concerned? Have you given any consideration to other alternatives?

Mr. DEMARCO. Absolutely, Congressman, and I appreciate an opportunity to provide that information to you.

When we looked at the HAMP principal forgiveness, that was an approach within HAMP, but it still focused on getting the borrower to a monthly payment of 31 percent of the household's monthly income. The loan modifications we are doing at least get the borrower to 31 percent because HAMP is the first thing we are doing. Fannie and Freddie have done more HAMP refis than anybody.

So to your point, we are lowering the interest rate, we are extending the term to 40 years, we are forebearing on principal. We are taking the underwater portion of principal and setting it aside and charging a zero rate of interest on it. And all these things we are doing to do exactly what you just laid out, which is to enable the household's cash flow to be able to support the mortgage.

We have gone beyond HAMP. Fannie and Freddie have developed modification tools that will result in an even lower monthly payment than HAMP would for many of our borrowers. The Treasury Department liked it so much that they adopted it themselves over a year ago as what they call HAMP 2. It is now part of their program because they saw how it was working for us.

But it does the very things that you have said, Congressman, about trying to get the borrower's monthly payment down. If they want to stay in that house, we want to give them every opportunity to do that.

One other thing is, with respect to refinances, we have touched lightly on the HARP program during the hearing, and that is enabling underwater borrowers to be able to refinance their mortgage. But I can only do that for mortgages Fannie Mae and Freddie Mac already own. And we have seen great success with this program.

If I may, there was one thing in my written statement that hasn't come up at this hearing but I would like to make sure the Members are aware of it. We are very pleased with the success of the HARP program and we are getting prepared to undertake a marketing campaign to further reach out to let borrowers know, this is a legitimate program and this program really can help you, because as much success as we have had with it, we want to see more borrowers refinance to take advantage of it.

Mr. CAPUANO. Mr. DeMarco, I appreciate all that. I, for one, would love to see some more detailed statistics on that, because to be perfectly honest, when people come into my office foyer who can't access the program or they don't know about it, and if I can help that in any way, I like the idea of reaching out to people, but any detailed information about what you just said would be very helpful to—

Mr. DEMARCO. I will make sure our office gets that to you, Mr. Capuano.

Mr. CAPUANO. Thank you.

Mr. DEMARCO. I would really like to see this work.

Chairman HENSARLING. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Mr. DeMarco, thank you for your very capable service and your thoughtful presentation today.

You recently noted that the Administration's failure to provide a detailed plan on how to wind down the GSEs has made it harder to support the housing market and stabilize Fannie and Freddie. Given that the Administration has not provided leadership on winding down the GSEs, what steps have you taken as FHFA Director to prepare the GSEs for a post-conservatorship housing market? Is there more that can be done or does winding down the GSEs require some guidance from the Administration?

Mr. DEMARCO. Ultimately, bringing the conservatorships to an end, which is the ultimate wind-down, is going to require action by the Congress of the United States. In the meantime, we are taking steps to gradually contract the Enterprises' footprint in the marketplace: we are raising guarantee fees; we are now starting to sell single-family mortgage credit risk; we are shrinking the overall size of their multi-family book; and we are selling assets at an accelerated rate.

I will say about the Administration—I obviously have an important relationship with the Administration. The Treasury Department is the senior shareholder of Fannie and Freddie. I consult with them a lot on these things and I believe the Administration needs to speak to itself with regard to the specifics of what I have laid out, but I believe I have a good relationship with the Administration in talking through these issues and in indicating to them the direction that, as conservator and regulator, I believe it is useful to go, and I benefit from the feedback I get from them.

Mr. PITTENGER. So you feel that you have been adequately directed?

Mr. DEMARCO. I feel like I have a good working relationship and good consultation and I know where we agree and where we disagree. I would say what I need most to bring these conservatorships to an end is I need both the Congress and the Administration to agree on a legislative path that defines the role of the government in the mortgage market going forward so that we can know where we are actually building towards as we build for the future.

Mr. PITTENGER. Thank you.

I yield back my time.

Mr. DEMARCO. Thank you, Congressman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much.

And welcome, Mr. DeMarco.

Mr. DeMarco, with home sales and pricing—prices of homes increasing and mortgage spreads back at normal levels, why do Fannie and Freddie continue to assess an adverse market delivery charge that took in nearly $3 billion in 2012? Aren't these actually fees which are no longer needed and is effectively a tax on new homebuyers?

Mr. DEMARCO. I wouldn't say it is a tax on new homebuyers, Congressman, but I would say that we were—on the one hand, as I have made clear, we are on a path of continually raising the g-fees. You are talking about a component piece of the g-fees that was put in place when the mortgage markets were in distress.

I will say that as part of our valuation of the next steps for increasing g-fees, we are looking at the composition of g-fees, including adverse market fees and so forth. So I am assessing what you are talking about but I want to be clear that the overall path we are on is to continue to increase g-fees.

Mr. SCOTT. All right.

Let me ask you about loan level price adjustments, as well. Loan level price adjustments of as much as 3 percentage points make Fannie and Freddie execution uncompetitive relative to the FHA, and reducing these fees would make higher LTV loans with a private M.I. more competitive. Do you agree that these LLPAs are distracting the market and hampering the return of private capital?

Mr. DEMARCO. No. I think the more we raise the overall g-fees, the more we are going to encourage private capital back into this marketplace.

Mr. SCOTT. All right.

Now, with the Administration's intent on winding down Fannie and Freddie, is it your sincere and honest belief that the private market, in and of itself, will be able to absorb this void, especially considering, Mr. DeMarco, that 90 percent—this is a huge void—90 percent of all of the new mortgages were done by Freddie and Fannie? And it is just baffling to me that—I just am not satisfied that we have something that can take the place of that.

Mr. DEMARCO. Congressman, here is how I think about it: The short answer to your question, but I want to make sure I frame the question right, can the government step entirely out of this marketplace and can this single-family mortgage market be supported without any government involvement, and is that what I would like to see? That is not what I anticipate and it is not really what I am expecting or would like to see.

But I would frame it this way: The single-family mortgage market in the United States is a $10 trillion market, and I don't expect the outcome to be that all $10 trillion is done by private capital without government involvement nor am I expecting all $10 trillion to be done by the government without capital. That dial—if you think about a dial on that range—has moved well towards the government having most of the responsibility of this mortgage market, and that dial has moved in the last 5 years.

What I would envision is we have to start moving that dial away from government and away from taxpayers and back towards more private capital participation. But my gosh, between zero and $10 trillion there are a lot of places to put that—to reset that dial, and I think that we can make substantial progress away from taxpayers and still have a vibrant role for government.

And I have suggested elsewhere that in thinking about where that government role ought to be, it might be constructive for Congress to begin with the traditional, explicit government guarantee programs, such as the FHA program and the VA program, because those are existing programs to provide guarantees, and let's figure out where Congress intends them to serve the market and then one can think about, well, what is left and what does the government need to do to support the rest?

Mr. SCOTT. But doesn't it make sense that we ought to figure out exactly what government's role should be? If you agree that government has the role here and it does, how do we figure out how to make that work? How do we guarantee that the 30-year fixed mortgage will stay in place and available as an option to that without the government role?

Chairman HENSARLING. The time of the gentleman has expired. The witness can answer in writing.

The Chair now recognizes the gentleman from Ohio, Mr. Stivers, for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

Thank you, Mr. DeMarco, for being here today. I want to first recognize and congratulate you for the 2012 strategic plan, the three-point plan that you have undertaken, and I think we all agree that is the direction we need to go: first, to build a new infrastructure for secondary markets; second, to eventually contract the GSEs' dominance; and finally, to maintain the foreclosure prevention activities and credit availability that the American public require.

And I want to ask around those three things some questions. First, on building the new infrastructure—and I know Mr. Capuano asked a little bit about this—do you know what—this is sort of a two-part question—timing you have for developing a single security, because right now there are changes on a monthly basis that some of the servicers are having to deal with, and is that single platform that you are envisioning—are you trying to use that as a foundation or a building block for the reformed housing finance system going forward?

Mr. DEMARCO. The answer to your second question is yes, I do think that this could serve as a building block for Congress to utilize in envisioning a future secondary mortgage market.

The answer to the first question about how long, we announced 13 months ago that it was our intention to work with Fannie and Freddie to develop this platform so we made that clear to the Congress and the public. In October of last year, we issued a White Paper in which we described for the market the potential scope of this platform and how it would actually operate and we solicited public input on this.

We have been considering that input in going about the next phase of the design of the platform. We expect to continue to reach out to market participants in a formal way to be able to continue to get market input.

But overall, end to end, this is a multi-year project.

Mr. STIVERS. Great. Thank you. And I want to thank you for that work, and I think we can potentially use that as a basis for our system moving forward.

I will ask you a rhetorical question that I don't think you are going to answer but I am going to ask anyway: Once that is complete, do we really need two GSEs? I am not going to ask you to answer that, but that is a rhetorical question.

I would like to ask you some questions with regard to the system moving forward and how it pertains to regional banks and community banks. Do you believe it is important to maintain a competitive market in mortgage origination, secondary, and servicing markets—

Mr. DEMARCO. Absolutely.

Mr. STIVERS. Do you think that—do you believe that these markets are more or less competitive than they were 5 years ago today?

Mr. DEMARCO. Interestingly, in some ways, they are perhaps getting a bit more competitive. Some of the largest institutions have actually stepped back a little bit.

Mr. STIVERS. And do you believe that concentration in those markets—additional concentration of market share in those markets—would be a good thing or a bad thing going forward?

Mr. DEMARCO. I am not a big fan of concentration in our financial system, and that is why the more we can do to keep this competitive and to keep an active role for small and mid-sized players, the better.

Mr. STIVERS. I agree with you, and I think that is what has led to some of the too-big-to-fail, and so I guess I would ask, what steps do you take or what analysis do you perform in making changes to the GSEs and market rules to ensure that those changes won't disproportionately affect regional banks or community banks and otherwise lead to more consolidation or concentration market share?

Mr. DEMARCO. I think it is critically important that we develop standards that define how the mortgage market works.

Just as one very quick thing—if you used to sell a mortgage to Fannie Mae or Freddie Mac and you are a local bank and you sell one loan to Fannie Mae you had to provide a whole bunch of proprietary coding regarding the characteristics of that mortgage. If you were to take that mortgage and say, "No, wait, I want to sell it to Freddie," you would have to provide all that information in an entirely different system with different data definitions, and so forth.

That was particularly costly for our small and mid-sized institutions. It also degraded the quality of the data that each company was getting. That is why I think that data standards are important and will really help smaller institutions compete.

Mr. STIVERS. Thank you.

And I would just like to thank you for what you are doing. I hope we can all work together on this committee and with the Senate and with the Administration, because I think every day we wait to reform the GSEs is another day that the taxpayers are on the hook for more potential losses.

I want to thank you for the way you have run your conservatorship, and I look forward to working with you in the future.

With that, I yield back.

Mr. DEMARCO. Thank you, Congressman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the ranking member, as well.

Mr. DeMarco, some things bear repeating. You have indicated to Mr. Scott—and I may be paraphrasing—that you believe there is a role for the public sector in home mortgage financing. Is this correct?

Mr. DEMARCO. I do, Congressman.

Mr. GREEN. That then means, sir, that you are now in agreement with the builders that I talk to, the bankers that I talk to, the REALTORS® that I talk to. I think that this is a fair assessment when I say that most of the people who are involved in this process that I talk to see a public as well as a private role in mortgage financing. Is this a fair statement?

Mr. DEMARCO. It is. And to be clear and elaborate on it, I think that—

Mr. GREEN. Let me do this, because my time is limited, and I will try to give you some time to elaborate, but I do want to add this, that because you and I agree that there is a role for the public sector, it also means that you and I disagree with people who say that there is only a role for the private sector. You and I have to assume that this is a fair statement, true?

Mr. DeMarco, listen, you and I are going to have to agree or disagree, and right now you and I seem to be in agreement.

Mr. DEMARCO. We are, Congressman.

Mr. GREEN. All right. That is what I am talking about, Mr. DeMarco—our agreement.

Mr. DeMarco, that makes news for me because prior to this hearing, I was not absolutely sure where you were, and I appreciate your being absolutely certain as to where you are.

Now, moving along quickly, Mr. DeMarco, you indicated that you support the HARP program. Is that correct?

Mr. DEMARCO. Yes, sir.

Mr. GREEN. That is a refi program.

Mr. DEMARCO. Yes, sir, it is.

Mr. GREEN. And, Mr. DeMarco, if you support it tell me, how are you working to make sure that persons who are under the purview of the GSEs can benefit from your support?

Mr. DEMARCO. We have continually looked at the performance of this program and made changes to make this more accessible to borrowers around the country. And I think that the numbers in 2012 speak for themselves, but importantly, we are not done. As I said a little bit earlier, we are intending to undertake a marketing campaign in the near future to make citizens more aware of this program and the potential benefits—

Mr. GREEN. Permit me to ask this: Is there something that prevents you from creating an automated process by which you can send notices to persons who are financed through the GSEs—you hold their mortgages—sending them a notice indicating to them that they may be eligible for this program?

Mr. DEMARCO. That is being done, Congressman. It is done by their mortgage servicer.

Mr. GREEN. By the mortgage servicer?

Mr. DEMARCO. Yes, sir.

Mr. GREEN. Would it in any way be too much—be done to an extent that we would conclude that we had done more than we should for you to do this with the portfolio that you have?

Mr. DEMARCO. I think we are doing quite a lot here with it and I am not sure what you are driving at but I—

Mr. GREEN. I will tell you what I am driving at with 1 minute and 35 seconds left. We have a lot of people, Mr. DeMarco, who can pay a lower mortgage payment and keep their homes.

Mr. DEMARCO. Yes, sir.

Mr. GREEN. Many of them may lose their homes. I think that we can do more to make them aware of the refi program that you have talked about, and I think that coming from you and your august position, this would mean something to them. So I am going to ask that you consider doing something by way of a notice.

Mr. DEMARCO. Okay. I have already committed that we are going to undertake a public marketing campaign and we are going to—

Mr. GREEN. Does public marketing mean notice? Public marketing—

Mr. DEMARCO. That means we want to—

Mr. GREEN. —is a nebulous term.

Mr. DEMARCO. We want to improve general public awareness and we also want to reach out directly in those communities where—

Mr. GREEN. So I am going to have to take, Mr. DeMarco, from your testimony that you are not saying you will send a notice?

Mr. DEMARCO. I am sorry, Congressman, I already said that we are—we have been sending notices directly to borrowers about this.

Mr. GREEN. You have?

Mr. DEMARCO. Yes, sir.

Mr. GREEN. Then I misunderstood you, and I owe you an apology for the misunderstanding.

Mr. DEMARCO. That is fine. I am sorry for the confusion.

Mr. GREEN. Mr. DeMarco, I like you—

Mr. DEMARCO. Thank you.

Mr. GREEN. —and I want to make sure we understand each other.

Now let me move quickly to the National Affordable Housing Trust Fund. Do you believe that such a fund should exist, Mr. DeMarco, that we should have a fund to help us maintain our affordable housing stock?

Mr. DEMARCO. Congressman, that really is outside the bailiwick of my responsibility as regulator and conservator. That is a policy decision for the Congress. I really am not—I didn't come here prepared to have an opinion about the trust fund.

Mr. GREEN. I will accept your answer, Mr. DeMarco. Thank you.

Mr. DEMARCO. Thank you, sir.

Mr. GARRETT [presiding]. The gentleman's time has expired, and we appreciate the comity between the two gentlemen and all the areas in which they found common ground.

And with that, we turn now to the gentleman from Virginia, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman.

And thank you, Mr. DeMarco, for your candor and for your leadership.

After many long years, the GSEs are beginning to turn a profit, and I guess I would like to hear from you, what are the advantages and disadvantages of their return to profitability for you, as conservator? And what should we—has it led to any changes in tactics to accomplish this reform on your part, and what are things that perhaps we would be wise to be looking out for with this positive turn of events but also recognizing that we really do need fundamental reform and the taxpayers have ponied up north of $180 billion?

Mr. DEMARCO. It is hard to see any negative to Fannie Mae and Freddie Mac starting to show a profit since that is what we have been working towards all along. So I think that is certainly good news.

One of the key drivers here is house prices. That has a huge impact on the profitability of Fannie Mae and Freddie Mac, so it is an indication that the country's housing markets really are starting to stabilize and show some sign of recovery—also a very positive thing.

And the fact that they are making money now gives us more flexibility to undertake these important steps of selling off some portion of the credit risk. It gives us the opportunity and the resources to do things like invest in building this platform. And because we have worked through a good bit of the legacy we can start to free up resources to these future-looking goals that we have.

Mr. HURT. Are there any disadvantages that you can think of?

Mr. DEMARCO. I can't think of any disadvantages to them earning money.

Mr. HURT. Okay.

In your speech that you gave on March 4th at the National Association of Business Economics, you stated that one of the effects of the housing crisis has been a shift in consumer demand patterns away from home purchases towards renting, and I was wondering if you would comment on your view as to whether or not this shift is a rational phenomenon of consumers and investors adjusting to new market realities versus a normalization of demand as the distortions of an over-subsidized government mortgage market are reduced?

Mr. DEMARCO. I would expect it has elements of both, Congressman.

Mr. HURT. It has what?

Mr. DEMARCO. It has elements of both. Households have reassessed at the margin how they want to manage their balance sheets, what the risks are of being a homeowner, and so that has certainly come into play, the weakness of the economy, and even for those who are still employed, if they have a lack of certainty, if they fear that their job could be at risk or their hours could be at risk, that is going to make them less likely to want to buy a home at this time.

So these are all contributing factors and I think there is perhaps a natural readjustment. We had reached a homeownership rate above what we had ever seen before, and if that is above some concept of a natural rate then one might expect to see a modest decline in it.

Mr. HURT. Thank you. I yield back the balance of my time.

Mr. DEMARCO. Thank you.

Mr. GARRETT. The gentleman yields back.

Mr. Cleaver is now recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

And thank you, Ms. Waters.

Mr. DeMarco, do you see anything wrong with the mortgage-backed securities actually guaranteeing a return, which is essentially what happens now? Unlike anything else you—if you go to Ginnie Mae, it is 100 percent guaranteed.

Mr. DEMARCO. Right.

Mr. CLEAVER. Do you see anything wrong with someone doing an MBS and saying, I know I am going to get my money because it is guaranteed by the Federal Government?

Go ahead?

Mr. DEMARCO. I do, Congressman. I think that the basic risk of the taxpayer guaranteeing most or all of the mortgages in this country is that you are relying on civil servants. As loyal as we are and as hardworking as we are, you are relying on government agents to interpret and study and follow mortgage credit risk and to be able to, from time to time, make adjustments in pricing due to that rather than relying on market participants who actually have their own money to lose having to make that continually informed judgment about what mortgage credit risk actually looks like.

So while I think—as I said in my conversation with Mr. Green—there is clearly a role for government, there is also clearly a role for the private sector, for people who have their own money at risk to be able to assess this risk and help price it in the marketplace. That is not a job for government alone.

Mr. CLEAVER. But reform is probably needed, but you would agree, I think, that any reform would be massive and messy. And the charter allows for the GSEs to do the mortgage-backed securities and so to undo it creates a problem, and for me, it has always seemed a bit unsavory.

But at the same time, I don't think we can do—I agree with you and Mr. Green that we absolutely must have the secondary mortgage market. So I don't know how we fashion this.

Mr. DEMARCO. If I may, I may have an explanation about what we are doing that might help both of us here—help all of us, really. Let me try to explain in a slightly different way what we are doing with this contract strategically.

What I want to do with mortgages that are being sold to Fannie and Freddie now—rather than Fannie and Freddie and hence the American taxpayer being the only source of guarantee, I want to take some portion and say to market participants, “Here, we will do a trade, right? I am going to sell you this risk, right, and you are going to get a return for being willing to bear this risk.”

So now I get the benefit of your private equity backing this and I get the benefit of your perception of what this risk actually looks like rather than just relying on my agency to do that. And so what we get is a market price, market signals about this risk, and we are now in a shared risk environment.

What we are doing in 2013 is I have instructed Fannie and Freddie to undertake multiple types of transactions—there are different ways of selling off pieces of this credit risk—so that we can see what kind of execution we get in the marketplace, how the marketplace is pricing it so that we get a better sense of, then, all right, if this starts to look like there is good demand for this we can then start to proceed gradually to see, okay, how much more can we sell, how much more will they buy, and how are they continuing to address this risk? And I think that is the way we keep this from being big and messy but we make it orderly and gradual; we do it in a resolute way to bring private capital back to the market.

Mr. CLEAVER. Have you written anything on that?

Mr. DEMARCO. Pardon?

Mr. CLEAVER. Have you written anything on that?

Mr. DEMARCO. We have a couple of documents. I would be happy to share them with you, Congressman, and I would be happy to come up and go over them in more depth than our 5 minutes here allows.

Mr. CLEAVER. Yes. I would appreciate that very much.

I yield back the balance of my time.

Mr. GARRETT. The gentleman yields back.

Mr. Hultgren of Illinois for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you so much for being here today, Mr. DeMarco. I appreciate your time and information.

Mr. DeMarco, as has been noted, currently over 90 percent of new mortgage originations are supported by the Federal Government through either the GSEs or FHA, while the GSEs either own or guarantee about 61 percent of all new residential mortgage loans made in the United States. If the development of a sustainable housing finance system based on private capital is to be successful, what issues should policymakers consider regarding the appropriate role of the FHA and the GSEs moving forward, and how can we prevent leakage from the wind-down of GSEs from driving business to FHA and expanding taxpayer liability?

Mr. DEMARCO. With regard to FHA, while obviously this is not a program that I am responsible for I would, in response to your question, offer a few observations. First, Congress could give FHA greater clarity with what Congress expects FHA's targeted market to be. Is this to serve first-time homebuyers? Is it based on certain communities? Is this really meant to help people get into their starter home, their first home, and then after that, you are expected to go to the conventional market or not?

But giving FHA—right now the only real sort of parameter or limit is the loan limit that FHA operates under, so that is one way Congress could express some guidance to the role of FHA. There are things that could be done with FHA to give it greater flexibility in terms of pricing risk and being able to resource itself as an agency to carry out a mandate.

In other places, we set up these sorts of guarantee functions as independent, government-owned corporations, and give them more flexibility in terms of how they manage their business, what resources, greater flexibility in the human capital, the people they hire to do the job, and greater flexibility with regard to pricing. These are all things that Congress could consider in the context of FHA's role in the marketplace going forward.

Mr. HULTGREN. Switching gears just a little bit, I wonder if you could talk a little bit about how you think increasing g-fees will affect the FHA. Will increasing g-fees push business to FHA? Will there be more explicit government guarantees there? How do you see this all playing out?

Mr. DEMARCO. FHA and FHFA certainly keep an eye on what the other's g-fees are. We have both been gradually increasing g-fees in the marketplace.

Another critical component here that shouldn't be lost is it is not just Fannie and Freddie's g-fees that matter in this matrix, but it is also the mortgage insurance premium that private mortgage insurance companies are assessing for this risk. That is also an important price element when one is looking at the decision of a borrower to go FHA or go conventional.

But we are well-aware that increasing our g-fees, with everything else being constant, could tend at the margin to move this risk over to FHA. But the point is, whether it is Fannie and Freddie buying the mortgage or FHA buying the mortgage, we all should be operating with appropriate risk-based pricing mechanisms so that we undertake this business in a way in which we are adequately pricing for the risk that we are undertaking.

Mr. HULTGREN. Thank you.

I know time is limited, and to get to as many people as we can, I will yield back the balance of my time. Thank you, Mr. Chairman.

Mr. GARRETT. The gentleman yields back.

Mr. Ellison is recognized for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman and Ranking Member Waters. I appreciate you calling this hearing.

Mr. DeMarco, I just want to acknowledge that you did acknowledge the pain that millions of families have gone through. I think it is important for you to note that, because as we are having this very civil conversation, the reality that people are going through—not just individual families but whole neighborhoods.

Mr. DEMARCO. Yes, sir. Absolutely.

Mr. ELLISON. Let me ask you this: Now, Fannie and Freddie are making some profit. A few years ago, we passed a bill establishing the National Housing Trust Fund and the law said that the proceeds would fund the National Housing Trust Fund, which would help low-income families. Now, in my own district of Minneapolis, we have an occupancy rate of like 98 percent and we could really use the help that a National Housing Trust Fund for low-income rental housing could provide.

When do you see the GSEs complying with the law that would fund the trust fund, or do you?

Mr. DEMARCO. I would say we have been complying with the law from the beginning because the law clearly indicated that FHFA could make determinations based upon the financial condition of the companies not to contribute money to the funds, and that has been our ongoing determination.

Mr. ELLISON. Do you see that changing? What is the future of funding the National Housing Trust Fund, given the profitability?

Mr. DEMARCO. First of all, I want to make sure this profitability is sustainable, Congressman, and I am still mindful of the monies that erode to the Treasury Department and that frankly these funds, if they don't go to the trust fund, are going back to the taxpayer, and I have not thought about this recently so I would want to give your question a little bit more careful consideration.

Mr. ELLISON. I appreciate that. And proceeds can go in different directions—some to pay back the taxpayer, some to fund the Housing Trust Fund. I appreciate you thinking about that.

I have talked to people about these difficulties, as everybody on this committee has and you have, and one of the things that I would like to get your feedback on is the situation in which somebody perhaps can't pay their mortgage, they will maybe lose their home in foreclosure, and then maybe it will be sold back at market rate, which then, at least to my understanding, the previous occupant is not allowed to bid on. Are you familiar with this situation?

Mr. DEMARCO. I am. That would be—

Mr. ELLISON. Could you speak to this?

Mr. DEMARCO. That would be considered an unsafe and unsound practice to engage in that sort of activity, because then you are not actually doing things at arm's length.

Mr. ELLISON. What if you were to just treat the person as an arms-length person, just look at their new financial situation, look at their ability to pay now? Because as has been said by many, many people fall into foreclosure because of the market, because of a medical problem.

Will you at least look at these cases on a case-by-case basis? Because it seems like there is a blanket denial.

Mr. DEMARCO. I think I would like to do better than that, Congressman. I think that where we have gotten to is this: A family gets in trouble on their mortgage, we now have processes and requirements in place for the servicer to be reaching out to that family from day one and there is a whole menu of options to help that family that are tailored to what the potential circumstances might be that have caused them to get into trouble.

Is it a temporary issue regarding a medical condition where the person is out of work for a few months? Is it unemployment? Is it a permanent reduction in income for that household?

For each of those types of situations, we have tailored responses, but what we have done much better on now is when this happens today, the servicers know what to do and they are supposed to be in contact with that borrower right away. I don't want that borrower getting 90 or 120 days behind on their mortgage before they have actually been working with the servicer and have been offered the kind of assistance that you are talking about.

Because fundamentally, Congressman, the way we are going to most help people is to get them right away. When they first get into trouble, we want to be reaching out to them. And frankly, we want them reaching out to us.

This menu of opportunities here, including significant reduction in their mortgage payment, are now well-established. We have these systems in place now and I really want to be able to help people now.

Mr. ELLISON. We are getting to the yellow light, Mr. DeMarco, so I am going to try to get my question in. I might have to take the answer in writing.

Okay, so you have indicated that the FHFA's first goal is to build a new infrastructure for the—

Mr. GARRETT. I am going to ask the gentleman to submit his question in writing. We have an agreement with the witness and also the ranking member that all Members who are in the room right now will get their questions in, and then Mr. DeMarco will be excused a little past the time that he has agreed upon.

Mr. DEMARCO. Very good. Thank you, Mr. Chairman.

Mr. GARRETT. So we will go now to Mr. Mulvaney.

And I will be strict on the time for each person.

Mr. MULVANEY. Thank you, Mr. Chairman.

Mr. DeMarco, thank you for being here today. I want to talk a little bit about your strategic plan, which you have laid out in your testimony as having three basic pieces: the concept of building this new infrastructure; contracting part of the business; and maintaining other parts of the business.

And I want to focus on this concept of contracting, because when I look at the details on contracting part of the business I see some discussion—I want to talk specifically now about single-family. I see some discussion about raising fees, some discussion about entering into these risk-sharing transactions, but it is not until I move to the multi-family part that I see specific targets in terms of percentage reductions, and I think you said a 10 percent goal this year for shrinking the multi-family portion of your business.

Have you set similar targets for shrinking or contracting the single-family portion of the business?

Mr. DEMARCO. No. We have not approached it that way and there is an explanation for that, Congressman.

In the multi-family, segment Fannie Mae and Freddie Mac today risk-share on virtually all the multi-family mortgages that they purchase. That is, there are already established processes and business practices whereby if Fannie Mae buys a multi-family mortgage, they are not taking all that credit risk; they are sharing it with the originator.

That is not the way it works in single-family. We have another step we have to take first in single-family, and that is establishing what these processes are to start sharing the risk.

So my goal is in 2013, let's get those transactions tested in the marketplace and let's get the process to do it in place, and then in subsequent years we can look towards more like an approach we are taking with multi-family to say, we want to see an increase in share of this sold off.

Mr. MULVANEY. Fair enough.

And let's, to the extent we can, look down the road a little bit as to the future when possibly you are able to start talking about specific percentage targets for shrinking the single-family portion of the business. How small of a market share can you have and still provide the liquidity that you think is necessary for the market? We go back to the early 2000s and you all were 80 percent of the market; in the mid-2000s, you were 45 percent of the market; now you are effectively 100 percent of the market.

How small a role can you play and still fulfill that particular function?

Mr. DEMARCO. The particular function of—

Mr. MULVANEY. Providing liquidity—

Mr. DEMARCO. —providing liquidity? That certainly can be a good bit less than 90 percent. But the point is that you are not going to turn the switch overnight, and I think that the way to sort of get to wherever that answer is is to do it incrementally, and that is the path we are on.

Mr. MULVANEY. But I think it is fair to say historically at least, that the market can function with you supplying guarantees on less than half of—

Mr. DEMARCO. Absolutely, Congressman, yes. Fannie Mae and Freddie Mac traditionally, I believe, had less than half the market.

Mr. MULVANEY. And that sort of transitions to my larger question, which is, we talk about contracting the market, which obviously folks in here may agree or disagree with, but even when you talk about the strategic plan—all different pieces of it, including contracting—you are still talking about operating within the existing system, the existing regime, which is this implicit taxpayer guarantee. And I would ask you—and again, it may be rhetorical, Mr. DeMarco—isn't that system broken? If your goal in doing this is to protect the taxpayer, isn't it true you are just not going to be able to protect the taxpayer until you get rid of the guarantee?

The only way you are going to get rid of the potential conflicts that Mr. Ellison so eloquently laid out, which is—look, you have three masters right now. You have the taxpayers that you owe money to and you are also trying to protect them from future risk; there are circumstances under which you are asked to contribute to a Housing Trust Fund; but you have private shareholders.

Isn't that whose system—isn't the GSE system fundamentally flawed, and regardless of anything you do to contract it, build it, sustain it, we are still going to have these issues in the long run?

Mr. DEMARCO. It is broken, Congressman, and I look forward to working with the Congress to come up with a better one.

Mr. MULVANEY. Is it possible to fix it with leaving the implicit taxpayer guarantee in place? Don't you have to either go to a system where you all become an agency or you become a private entity? Either one or the other, you can't be both?

Mr. DEMARCO. You certainly need to clarify where the government's role is and its exposure and where private capital's is. The GSE model that you are talking about being broken, that was the problem. It was a complete melding of private capital and public support in a way that just harmed the American—

Mr. MULVANEY. I think it is fair to say—and I appreciate the steps you are taking to protect the taxpayer, because clearly that is the goal of your strategic plan, but I would put it to you—not to you, put it to the larger group that we are always going to have this risk. Regardless of how successful Mr. DeMarco is in contracting, building, maintaining, whatever, until we get the taxpayer out of the business of the guarantee, the taxpayer is always going to be on the hook eventually.

I thank you for the work that you are doing, but I encourage everybody else to consider the possibility that it is the system that is broken, not the operation of the system.

Thank you.

Mr. GARRETT. The gentleman yields back.

Mr. Perlmutter is recognized for 5 minutes.

Mr. PERLMUTTER. Thanks, Mr. Chairman.

And, Mr. DeMarco, it is good to see you.

Mr. Pollard, it is good to see you as well.

Just a couple of things. Mr. Mulvaney first brought up multifamily housing. In the last 4 or 5 years, as we have gone through this, I have not heard any complaints about Fannie Mae or Freddie Mac's role in the multi-housing market as a participant in various loans and obligations. Have you received any complaints on the multi-family piece of this?

Mr. DEMARCO. I hear lots of complaints, Congressman, so I am sure I have heard complaints about multi-family.

Mr. PERLMUTTER. But that hasn't been the area of—where there has been substantial requirement by the taxpayers to underwrite some of these loans?

Mr. DEMARCO. That is correct. We have managed to keep this business profitable.

Mr. PERLMUTTER. Okay.

Second question, speaking of profitability, one of the gentlemen—I think Mr. Hurt—brought it up that Freddie Mac has made some money recently. Is that true?

Mr. DEMARCO. Yes, sir.

Mr. PERLMUTTER. How much? In the last month or 2 months?

Mr. DEMARCO. About $8 billion.

Mr. PERLMUTTER. Okay. Has Fannie Mae made any money recently?

Mr. DEMARCO. They have. They have not filed their year-end financials but they have indicated in a filing to the SEC that they will report positive income in 2012.

Mr. PERLMUTTER. I just want to congratulate you on that, because it hadn't been going that way for a long time. And what I thought was a really good description of the zero to $10 trillion sort of continuum, over the last few years the Federal role has grown because there was no private involvement in the market because they got clobbered. They got clobbered more than Fannie Mae and Freddie Mac.

So the private sector—and I appreciate the theory, and I agree with a lot of the theoretical statements you have made, but the private sector didn't price it very well when they were pricing it either back in 2005, 2006, 2007, and 2008. Wouldn't you agree?

Mr. DEMARCO. Yes. Neither GSEs nor the private sector did a very good job pricing mortgage credit risk—

Mr. PERLMUTTER. Then, the private sector more or less withdrew completely from the market, in which case there was a vacuum—

Mr. DEMARCO. That is correct.

Mr. PERLMUTTER. —for Fannie Mae and Freddie Mac and for the role that you have been playing as FHFA.

Mr. DEMARCO. That is correct, Congressman.

Mr. PERLMUTTER. I agree with you. In terms of the continuum or the dial, as you described it, we probably are too far in terms of the Federal involvement, but without it, there would have been no market.

Mr. DEMARCO. That is correct.

Mr. PERLMUTTER. So let's talk about standards. You were talking about sort of technological platforms and standards. One of the reasons that we all got into trouble—both the private and the public sector—is that the underwriting standards seemed to go out the window for several years. Wouldn't you agree?

Mr. DEMARCO. Yes, sir.

Mr. PERLMUTTER. So underwriting standards you all have put back into place have led to the profitability of two of your organizations now?

Mr. DEMARCO. Yes, sir.

Mr. PERLMUTTER. One of the standards that I have been worried about is sort of this technological standard, and Senator Wyden has written a letter to the Department of Justice concerning lender processing services, LPS. Were you involved in any of the litigation—was Fannie Mae, Freddie Mac, or you as the conservator involved in any of the settlements with LPS?

Mr. DEMARCO. Let me verify, but I think I am pretty sure I know the answer. I don't believe we were involved in that particular litigation.

Mr. PERLMUTTER. What I would like you to do—and I would ask your counsel, as well—is to take a look at the role of LPS in all of this. There was one platform—a technological platform—that was very good when things were going smoothly but it was very hurried in terms of lawyers processing foreclosures, and those kinds of things. And I just ask for you all to take a look at that.

And I would be remiss if I didn't bring up REMX for you to say that is an area where I think if you exercised those calls, there would be additional profitability to both Fannie Mae and Freddie Mac.

And with that, I will yield back.

Mr. DEMARCO. I appreciate that, Congressman.

Mr. GARRETT. The gentleman yields back.

Mr. Huizenga is recognized for 5 minutes.

Mr. HUIZENGA. I appreciate that your time is growing short—2½ hours under the lights and in front of the camera, and I appreciate that.

I do have something. We just heard about LPS. I want to talk a little bit about lender-placed insurance (LPI). I don't think that is something that has come up, kind of a technical, in-the-weeds thing, but I know that there had been a push by Fannie Mae looking at trying to basically come up with one lender, one underwriter, one agent group. I believe you had put the brakes on that operation or on the movement towards that.

Do you see any value in selecting these preferred vendors versus having a free market system do that?

Mr. DEMARCO. Congressman, I have concerns about the way the lender-placed insurance market has worked. I think a lot of people do.

What I am seeking, and we actually made it part of the scorecard for 2013, is I am seeking to work with other regulators and with other market participants to come up with a market standard for how to improve the transparency and the competition in this marketplace so that both borrowers and investors are better protected. So what I am looking for is not a Fannie Mae-centric approach or conclusion here. I certainly want to help Fannie Mae. As conservator, I want to see them in a better position with regard to LPI.

But I think we can do better than that. I think we can do something to create a better standard for the market so whether the borrower's mortgage is owned by Fannie Mae, Freddie Mac, or some other market participant, if we can bring something better to the way this market works, that is what I am aiming—

Mr. HUIZENGA. Okay, so I think I am hearing you say that FHFA will—you are going to attempt to preserve a rule for these servicers and these NVAs, and underwriters, that you will try to put in some reasonable rules and guidelines that will be issued but it will—

Mr. DEMARCO. We want to continue to have insurance coverage when you have a situation where either a borrower is unable to obtain homeowner's insurance in their particular location or the borrower defaulted on their mortgage so we don't have insurance coverage because they are not been paying. We want to make sure that the asset is protected but—

Mr. HUIZENGA. Which I think we all see. My background is in real estate and developing, and I am very familiar with those things, and obviously we have to protect the asset for those who have invested heavily in it, and you just can't have it hanging out there.

I have a couple of minutes and a couple of really quick things. It does seem to me that we were talking a little bit about—my friend from Colorado was talking about how there was no marketplace for these mortgages and we needed to have Fannie and Freddie step in. I am not sure that they needed to quite step in as dramatically as they have; however, it does strike me that we got in that situation because of fraud. It wasn't because nobody was making a bad business decision based on calculations that they—having all the information.

It seems to me they made bad business decisions because there was a significant piece of the equation missing as they would go in and make those calculations. Isn't that fair?

Mr. DEMARCO. I would certainly add fraud to the list of contributing factors of the housing finance crisis, but I think plenty of bad business decisions were made even outside of the fraud operating—

Mr. HUIZENGA. It seems to me that when we—not verifying people's income and then suddenly, through a whole myriad of systems, declaring that triple-A probably is not the best system to do that.

On a more philosophical question, do we really need 30-year mortgages? We have a neighbor to the north where 30-year mortgages have not been part of their history. They may amortize over that but then there is 1-year—sometimes even 6-month—1-year, 5-year now; they are now just really getting into long-term mortgages.

And I am curious if you can unpack that a little bit in the next 45 seconds?

Mr. DEMARCO. As an economist, the notion of need is—I don't think we interpret that quite the same way as everybody else, so it is a little hard for me to respond to a question about, do we need.

I will make an observation about 30-year mortgage, however. In some sense, it arose as an affordable product because mortgages used to be—even which fixed-rate mortgages became more commonplace, they were 15 years, and they were 20 years, then it would be 25 years, and we kept pushing out the maturity spectrum to make financing more affordable. And not that there is anything wrong with that, it is that with a 30-year mortgage, you do not really start paying down principal over those first several years.

And one thing I would say about 30-year mortgages, it is not necessarily the best mortgage product for a homebuyer, especially a first-time homebuyer. If you look at statistics and see that the first-time homebuyers in this country tend to own their first home for 4 years or for 5 years, it may not be the best for their circumstance if they buy that house with that kind of timeline is what they expect, there may be a different mortgage product in which they can build equity at a faster rate than a 30-year fixed-rate mortgage.

Mr. HUIZENGA. I appreciate that. And then somebody, obviously, at 60 years of age, maybe financing or refinancing it for 30 years is—you are outside your potential earning power stroke there.

So thank you. I appreciate that, Mr. Chairman.

Mr. GARRETT. I recognize Mr. Kildee for the remaining 5 minutes.

Mr. KILDEE. First of all, thank you very much, Mr. DeMarco, for hanging in there.

And thank you to the chairman and ranking member for rewarding patience and allowing me a few minutes of your time.

For a few years before I arrived here in Congress, which was just a couple of months ago, I was the president of a nonprofit organization dedicated to dealing with vacant and abandoned property.

I came to that work because for 13 years prior to that, I was a county treasurer in Genesee County. I was living my lifelong dream of being the tax collector in Flint, Michigan. I think you understand what I was dealing with to a certain extent.

Mr. DEMARCO. Yes.

Mr. KILDEE. But one of the concerns that I developed and became much more aware of, especially as I travelled the country and helped set up land banks—about 100 land banks around the country that I have participated in arranging, including the one in my hometown, is the approach that most systems seem to take when it comes to real estate, and I am speaking specifically about REO management and disposition.

Systems tend to treat these assets as a commodity at a marketplace and often measure the value of a transaction in purely transactional terms and don't ever consider, let alone attempt to internalize, the sometimes very negative externalities of those disposition decisions. So I have a couple of questions that deal with that particular area.

One—and if you could try to be as quick as possible—what is the status of the Enterprises' REO now as opposed to, say, a year ago?

Mr. DEMARCO. We certainly are reducing the REO inventory, and one of the things that is contributing to these reported profits in 2012 is that the return we are getting on these sales is higher than had been anticipated.

Mr. KILDEE. About a year ago—according to this, it was in February of 2012—there was a pilot program announced that would take Fannie Mae-owned properties and offer bulk purchases to investors. I would just ask you to comment on that, but particularly comment—as I understood it, the intent was to get property out of your inventory or out of the inventories of the Enterprises and support what was an increasing demand for quality rental housing in many of those communities. That was at least one of the potential outcomes.

How has FHFA or anyone else ensured that the disposition standards that were the basis for those transactions have been adhered to by the purchasers?

Mr. DEMARCO. Actually, with the pilot program you referenced, there were a number of restrictions on the disposition of the properties post-transaction, and so we have a regime in place to monitor that, but it was something that in some sense limited the ability of the acquirer in terms of how they would dispose of the properties.

Most of the properties that were part of these pilot transactions were properties that were already rented, so Fannie was the landlord, if you will, for these properties. So they already had renters in them and we wanted to see that rental—the property would be preserved as a rental property for a period of time, and so there were covenants and this restricted disposition in that way to ensure most of the properties remained rentals for a number of years.

Mr. KILDEE. Is there any data or experience that shows how successful that has been in terms of the downstream condition of the properties? Is it working or have there been situations where purchasers have not adhered to those standards, and has there been action taken—

Mr. DEMARCO. It is a little early yet, since we closed on the transactions in late summer, but I am not aware of any problems that have been identified to date.

Mr. KILDEE. Was there any specific preference granted to community-based entities, local land banks, or nonprofit intermediaries that might take the approach that the transactional value or even the revenue stream generated by those properties were not the only considerations, that the external effect of the condition of the property was also a consideration?

Mr. DEMARCO. Yes, sir. In fact, that was part of it. I would probably want to have my staff come talk to you about what the technical details were, but we did have provisions in there that included partnering with local nonprofits and housing groups which had familiarity with these markets.

Mr. KILDEE. And then finally, specific to REOs held by the Enterprises, to what extent has it been the case that local relevant State law or local ordinances have been adhered to regarding management and the condition of those particular properties?

Mr. DEMARCO. We adhere to State law. Where State law conflicts with Federal law or the operations of the conservatorship—we have a couple of instances of that being a problem, but those have been rare.

Mr. KILDEE. Thank you very much.

Mr. GARRETT. Thank you.

I believe the ranking member has something to enter into the record?

Ms. WATERS. Thank you, Mr. Chairman. I have here a document from ESOP, that is Empowering and Strengthening Ohio's People. I ask unanimous consent to enter it into the record.

Mr. GARRETT. Without objection, it is so ordered.

I would like to say thank you to the Director for, as I said at the outset, your work in this area. Also, thank you for your testimony today. Thank you for spending a little extra time so we could get through all of the Members who did have the patience to stay and ask questions.

And I do also appreciate the comment you made early on to a couple of the Members that you would follow up on an individual basis to answer some of those additional questions, so I thank you for that.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 12:44 p.m., the hearing was adjourned.]

A P P E N D I X

March 19, 2013

Statement of

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the U.S. House Committee on Financial Services
On Sustainable Housing Finance:
An Update from the Federal Housing Finance Agency on the GSE Conservatorships

March 19, 2013

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Sustainable Housing Finance: An Update from the Federal Housing Finance Agency on the GSE Conservatorships
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Chairman Hensarling, Ranking Member Waters and members of the Committee, I am pleased to be invited here today to discuss the Federal Housing Finance Agency's (FHFA) oversight of our regulated entities, Fannie Mae and Freddie Mac, (together the Enterprises) and the Federal Home Loan Banks (FHLBanks).

Although I will touch on the financial condition and performance of Fannie Mae, Freddie Mac and the Federal Home Loan Banks as requested, the main focus of my testimony will be on key topics related to FHFA's role as the Enterprises' conservator and regulator. I will begin with the goals of FHFA as Conservator. Then I will review FHFA's approach to preparing for increased private market participation in housing finance and describe the significant activities that FHFA has undertaken during the past year to further our conservatorship goals. Finally, I will close with some thoughts on the role of government in housing finance.

It is unprecedented that two enormous financial institutions such as these have been in conservatorship for more than four and one half years. Throughout this time, FHFA has explained its approach to the conservatorships in light of the statutory responsibilities Congress gave the agency as Conservator. I have reported to Congress numerous times regarding FHFA's actions in light of these responsibilities, recognizing that the prolonged time in conservatorship has required us to adapt to changing circumstances, while remaining consistent with the fundamental responsibilities given us. I am pleased to provide you with this report on what we have accomplished and where we are headed.

Goals of Conservatorship

As it has been some time since I appeared before this committee at a general oversight hearing, it may be useful for me to begin with a brief overview of what it means for Fannie Mae and Freddie Mac to be in conservatorship and what statutory responsibilities FHFA operates under as conservator.

The Housing and Economic Recovery Act of 2008 (HERA), which created FHFA, specified two conservator powers, stating that the Agency should "take such action as may be:

(i) necessary to put the regulated entity in a sound and solvent condition; and
(ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."

Furthermore, HERA provides: "DISCRETIONARY APPOINTMENT. – The Agency may, at the discretion of the Director, be appointed conservator or receiver for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity."

The determination to place the Enterprises in conservatorships was made as the financial crisis of the autumn of 2008 was taking shape. At that time, the private mortgage securitization market had already vanished, house prices were declining rapidly, and the Enterprises' eroding financial condition and inability to access capital markets threatened a collapse of the country's housing finance system. FHFA, with financial support from and substantial consultation with the U.S. Department of the Treasury, placed the Enterprises into conservatorships on September 6, 2008.

Conservatorship, along with taxpayer support from Treasury provided through the Senior Preferred Stock Purchase Agreements (PSPAs), permitted FHFA to take greater management control of Fannie Mae and Freddie Mac and give investors in the Enterprises' debt and mortgage-backed securities confidence that the Enterprises would have the financial capacity to honor their financial obligations. At the time, Treasury Secretary Henry Paulson referred to conservatorship as a "time-out" to allow markets to continue to function while policymakers considered and acted on a permanent resolution.

From the outset, FHFA stated that the goals of the conservatorships were to help restore confidence in the companies, enhance their capacity to fulfill their mission, and mitigate the systemic risk that contributed directly to instability in financial markets. Today, FHFA is balancing three responsibilities: preserve and conserve assets, ensure market stability and liquidity, and prepare the Enterprises for an uncertain future.

The initial phase of the conservatorships was focused on stabilizing the Enterprises' operations to ensure the continued functioning of the mortgage market. As operations were stabilized, I would characterize the second phase of the conservatorships as focusing on developing tools for the Enterprises to reduce losses on their legacy credit exposures. This effort was also consistent with FHFA's statutory responsibility under the Emergency Economic Stabilization Act to provide assistance to homeowners and minimize foreclosures. FHFA also clarified that the Enterprises would be limited to continuing their existing core business activities. This type of limitation on new business activities is consistent with the standard regulatory approach for addressing companies that are financially troubled. And it is even more pertinent for the Enterprises given their uncertain future and reliance on taxpayer funds.

In short, while there still is legacy credit exposure to work through, the second phase of the conservatorships put in place the loss mitigation infrastructure to help borrowers and protect taxpayers. At the same time, the companies' new books of business are much stronger than their old ones.

But that still leaves us with a mortgage market that is reliant on federal government support, with very little private capital standing in front of the federal government's risk exposure. There seems to be broad consensus that Fannie Mae and Freddie Mac will not return to their previous corporate forms. The Administration has made clear that its preferred course of action is to wind down the Enterprises. Of the various legislative proposals that have been introduced in

Congress, none of them envision the Enterprises exiting conservatorship in their current corporate form. In addition, the recent changes to the PSPAs, replacing the 10 percent dividend with a net income sweep, reinforces that the Enterprises will not be building capital as a potential step to regaining their former corporate status. The amount of funding, essentially the Enterprises' capital base, available under the PSPAs also will become fixed when the Enterprises report year-end 2012 financial results.

FHFA's 2012 Strategic Plan for the Operation of the Enterprise Conservatorships

In early 2012, recognizing that the conservatorships were over three years along and not likely to end soon, FHFA developed and formally communicated to Congress a strategic plan for the companies to pursue while in conservatorship, pending legislative action. That Strategic Plan had three goals:

1. **Build.** Build a new infrastructure for the secondary mortgage market.

2. **Contract.** Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations.

3. **Maintain.** Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

These goals satisfy our statutory mandate as conservator, are consistent with the Administration's call for a gradual wind down of the Enterprises, and preserve all options for Congress while establishing a stronger foundation on which Congress and market participants can build to replace the pre-conservatorship government sponsored enterprise (GSE) model.

With a focus on transitioning to a more secure, sustainable and competitive model for the secondary mortgage market, FHFA established the 2012 Conservatorship Scorecard to provide a roadmap for the Enterprises to implement the Strategic Plan. The Scorecard had four focus areas all tied to the Strategic Plan and great progress was made in all areas.

Building upon the 2012 Scorecard, earlier this month FHFA published the Conservator's Scorecard for 2013, again setting forth annual performance targets to build, contract, and maintain. I would like to walk through each of these with you now while also highlighting some of the successes of 2012.

Build

The first strategic goal is to build a new infrastructure for the secondary mortgage market. The basic premise behind this goal is that the Enterprises' outmoded proprietary infrastructures need to be updated and maintained, and any such update should provide enhanced value to the mortgage market with a common and more efficient model. The Enterprises' infrastructures are not the most effective when it comes to adapting to market changes, issuing securities that attract private capital, aggregating data, or lowering barriers to market entry. In short, there must be some updating and continued maintenance of the Enterprises' securitization infrastructure. This requires the investment of capital, capital that would come from taxpayers through the PSPA. We concluded that to the extent possible, we should invest taxpayer dollars to this end once, not twice.

We also have undertaken this effort with the goal that it will have benefits beyond the Enterprise business model. Therefore, this new infrastructure must be operable across many platforms, so that it can be used by any issuer, servicer, agent, or other party that decides to participate.

To move this effort forward and gather input from the industry, FHFA issued a white paper in October 2012 on the build goal, which includes the development of a common securitization platform and a model contractual framework. One of the most important issues we raised in the white paper was the scope of the securitization platform. One approach we outlined is that the focus of the platform could be on functions that are routinely repeated across the secondary mortgage market, such as issuing securities, providing disclosures, paying investors, and disseminating data. These are all functions where standardization could have clear benefits to market participants.

Earlier this month, I announced as part of the 2013 Scorecard that a new business entity will be established between Fannie Mae and Freddie Mac. We believe that setting up a new structure, separate from the two companies, is important for building a new secondary mortgage market infrastructure. This does not mean we are consolidating the companies. Our objective, as we stated last year, is for the platform to be able to function like a market utility, as opposed to rebuilding the proprietary infrastructures of Fannie Mae and Freddie Mac. To make this clear, I expect that the new venture will be headed by a CEO and Chairman of the Board that are independent from Fannie Mae and Freddie Mac. It will be physically located separate from Fannie Mae and Freddie Mac and will be overseen by FHFA. Importantly, we plan on instituting a formal structure to allow for input from industry participants.

What I have just described is the governance and ownership structure for the near-term phase of the platform. It will be initially owned and funded by Fannie Mae and Freddie Mac, and its functions are designed to operate as a replacement for some of their legacy infrastructure. However, the overarching goal is to create something of value that could either be sold or used by policy makers as a foundational element of the mortgage market of the future.

We are designing this to be flexible so that the long-term ownership structure can be adjusted to meet the goals and direction that policymakers may set forth for housing finance reform.

In the October White Paper we also put forth some broad ideas on creating a model contractual framework. Similar to the securitization infrastructure effort, the focus of this effort is to identify areas where greater standardization in the contractual framework would be valuable to the mortgage market of the future.

FHFA's alignment efforts, under which FHFA, Fannie Mae, and Freddie Mac work collectively to modify, enhance, and improve Enterprise programs and practices, will continue in 2013.

Much can be learned from these efforts, but given that the ultimate outcome of housing finance reform remains uncertain, this is an optimal time to further consider how best to address contractual shortcomings identified during the past few years. A great deal of work has already been done in this area by market participants, including the American Securitization Forum's Project Restart and additional input will be exceptionally valuable. As the Enterprises move forward with risk sharing transactions such as those I will describe shortly, the development of transactional documents will provide a real time test of a new standardized contractual framework for transactions where the private sector is absorbing credit risk.

Another aspect of the build goal is the Uniform Mortgage Data Program or UMDP. This effort may get overlooked at times, but a solid foundation of data standards is vitally important regardless of the future direction of housing finance reform. I am very encouraged by this effort as the Enterprises have worked through an industry process set up through MISMO – the Mortgage Industry Standards Maintenance Organization – to move this process forward. Considerable work has already been accomplished through the development of a Uniform Loan Delivery Dataset and a Uniform Appraisal Dataset. Work is beginning on the Uniform Mortgage Servicing Dataset. This latter effort will take time, but working through the process with a broad-based coalition of industry participants in MISMO should serve as a model for future efforts as we seek to rebuild the foundation of the mortgage market. In the end the benefits are immense. Developing standard terms, definitions, and industry standard data reporting protocols will decrease costs for originators, servicers and appraisers and reduce repurchase risk.

Contract

The second strategic goal is to gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations. The basic premise behind this goal is that with an uncertain future and a general desire for private capital to re-enter the market, the Enterprises' market presence should be reduced gradually over time.

In 2012, guarantee fees were increased twice, which now brings the average guarantee fee on new mortgages to around 50 basis points, approximately double what guarantee fees were prior to conservatorship. A key motivation behind increasing Enterprise guarantee fees is to bring their credit risk pricing closer to what would be required by private sector providers. However, the increase in guarantee fees is part of the contract framework; it is not designed primarily to increase the Enterprises' revenue. The idea is that at some point the increases in guarantee fees will encourage private capital back into the market. We are not there yet, but in conversations with market participants, I think we are getting closer. We also set some goals in 2012 of executing on risk sharing transactions. While we did not execute any transactions, a considerable amount of preparatory work was done to lay the groundwork for 2013.

To move the contract goal forward, we set forth three priorities in the 2013 Scorecard.

First, in the single-family credit guarantee business we have set a target of $30 billion of unpaid principal balance in credit risk sharing transactions in 2013 for both Fannie Mae and Freddie Mac. We have specified that each Enterprise must conduct multiple types of risk sharing transactions to meet this target. For example, we expect to see transactions involving: expanded mortgage insurance; credit-linked securities; senior/subordinated securities; and perhaps other structures. The goal for 2013 is to move forward with these transactions and to evaluate the pricing and the potential for further execution in scale. What we learn in 2013 will set the stage for the targets for 2014, and I fully expect to move from a dollar target to a percentage of business target at some point in the future.

While it is not a Scorecard item, we also expect to continue increasing guarantee fees in 2013, and the execution of the single-family risk sharing transactions I just described should provide valuable information as to how market participants are pricing mortgage credit risk.

Second, the multifamily business presents a different set of issues. Unlike the single-family credit guarantee business, the Enterprises have a smaller market share and there are other providers of credit in the multifamily market. The Enterprises' market share of new multifamily originations did increase during the financial downturn, but in 2012 it returned to a more normal position.

Another difference from the single-family business is that each Enterprise's multifamily business has weathered the housing crisis and generated positive cash flow. In contrast to their common approach to their single-family businesses, Fannie Mae and Freddie Mac do not take the same approach to their multifamily businesses. Each approach also already embeds some type of risk sharing. For a significant portion of its business, Fannie Mae shares multifamily credit risk with loan originators through its delegated underwriting program. For a significant and increasing portion of its business, Freddie Mac shares multifamily credit risk with investors by issuing classes of securities backed by multifamily mortgages where the investor bears the credit risk.

Given that the multifamily market's reliance on the Enterprises has moved to a more normal range, to move forward with the contract goal we are setting a target of a 10 percent reduction in multifamily business new acquisitions from 2012 levels. We expect that this reduction will be achieved through some combination of increased pricing, more limited product offerings, and tighter overall underwriting standards.

Finally, the retained portfolios of the Enterprises have been declining since 2009. The initial PSPAs required a 10 percent annual reduction, and the most recent changes to the PSPAs increased the annual reduction to 15 percent. The composition of the Enterprises' retained portfolios has also changed significantly since the establishment of the conservatorships. Prior to conservatorship, the retained portfolios were dominated by their own mortgage-backed securities and performing whole loans. As those securities have been paid down, and as the need to work through delinquent loans increased, the retained portfolios changed from being relatively liquid to being less liquid.

To address this issue and further "de-risk" the Enterprises' retained portfolios in 2013, we are setting a target of selling five percent of the less liquid portion of their retained portfolios, in other words their retained portfolios excluding agency securities. Given that natural run-off in the retained portfolios would have likely satisfied the PSPA reduction targets in the next few years, and that the Enterprises are not actively purchasing new assets for their retained portfolios, this added requirement to sell from the less liquid portions of their retained portfolios should lead to an even faster reduction than is required under the PSPAs.

Maintain

Finally, in 2013 we seek to make further progress on the third strategic goal, maintaining foreclosure prevention activities, and promoting market stability and liquidity. Foreclosure prevention efforts were extensive in 2012 as FHFA and the Enterprises continued to simplify, streamline, and improve existing programs. As of November 31, 2012, the Enterprises put in place more than 200,000 new loan modifications.

In fact, the Enterprises have undertaken more than 2.6 million foreclosure prevention actions from the establishment of the conservatorships through November 2012. They put in place 1.3 million loan modifications. Along with other foreclosure prevention actions, such as repayment plans, the Enterprises have enabled nearly 2.2 million families having trouble paying their mortgages to remain in their homes. In this same time frame, they have also assisted more than 430,000 other families to gracefully exit their home without going through foreclosure, through short sales and deeds-in-lieu of foreclosure.

In 2012, the Enterprises implemented changes to the Home Affordable Refinance Program (HARP) that we announced late in 2011. Those changes included: expanding the program to greater than 125 loan-to-value ratio; clarifying representation and warranty exposure; and incenting shorter-term refinance opportunities through reduced pricing. The results have been impressive:

- The volume of total HARP refinances in 2012, nearly 1.1 million, nearly equaled the number of HARP refinances over the prior three years.

- HARP refinances with greater than 105 loan-to-value ratios made up 43 percent of total HARP refinances in 2012, compared to 15 percent in 2011.

- HARP refinances into a shorter-term mortgage made up 18 percent of total HARP refinances in 2012 for underwater borrowers, compared to 10 percent in 2011.

We look forward to building on those successes in 2013. We soon will be implementing a nationwide public relations campaign to educate consumers about the HARP program and the eligibility requirements.

Another "maintain" priority was initiated in September 2012 when FHFA and the Enterprises announced the start of fundamental changes to the representation and warranty framework, which is moving the process to more upfront monitoring. The goal of these changes is to improve the credit risk management practices of the Enterprises, and provide more certainty to originators as they make decisions on extending credit. The priorities for 2013 include:

- Enhancing the post-delivery quality control practices and transparency associated with the new rep and warranty framework.

- Working to complete rep and warranty demands for pre-conservatorship loan activity.

Let me close this review of the conservatorship strategic plan by highlighting a couple of other 2013 priorities. One will be the near-term efforts regarding mortgage insurance to update master policies and formulate eligibility standards. While this effort can be looked at as maintaining credit availability, it also seeks to strengthen and clarify standards to increase the reliability of this form of credit enhancement. This will be a needed step for mortgage insurance to remain a viable risk transfer mechanism in the future.

Another policy project of note is the development of an aligned set of standards for force placed, or lender-placed, insurance. The various concerns with force placed insurance are well-known, including the costs, limitations on coverage, and consumer protections. From our perspective, we could have addressed some of these concerns with a narrowly focused approach that would contain costs for Fannie Mae and Freddie Mac, such as Enterprise self-insurance or a direct procurement of insurance coverage by and for the Enterprises. However, I believe that these Enterprise-centric options would do little to address the needs of a future mortgage market without the Enterprises. Therefore, we plan to pursue a broader approach, bringing together Federal and state regulators to participate in the dialogue with us and with a wide range of stakeholders. We would like to establish a set of standards that could be adopted by a broader set of mortgage market participants, similar to what was done with the Servicing Alignment Initiative. This broadened approach will also enable greater regulatory coordination in an effort to consider the various issues associated with force placed insurance.

Financial Condition and Performance

Before turning to options for the future, I should first address current market conditions and the financial condition and performance of the Enterprises and of the FHLBanks, which are also important components of the U.S. housing finance system.

Housing Market Conditions

- We are seeing signs of recovery in the housing market across a number of dimensions and, while the marketplace is by no means "normalized," conditions are promising in many ways.
- According to the latest data from the National Association of Realtors, the inventory of homes available for sale was only 1.7 million units in January. Given that the annualized rate of home sales during that month was nearly 5 million properties, this represented only about 4.2 months' worth of supply. Just a year earlier, the relative supply was a still-modest 6.2 months. And at its peak—in July 2010—the supply was 12.1 months' worth available for sale.
- According to the FHFA index, national home prices grew 5.5 percent between the fourth quarters of 2011 and 2012.

- Census data from December 2011 estimated the seasonally adjusted annualized rate of housing starts to be about 700,000 units. By September 2012, that rate had grown to roughly 840,000 units and, in January, the rate was estimated at 890,000 units. This compares to a low of about 480,000 units in April 2009, and is 61 percent of the long-run average.

- The latest CoreLogic information, which includes data for October, indicates that shadow inventory dropped roughly 12.3 percent between October 2011 and October 2012. This decline represented a reduction in the shadow inventory pool of about 300,000 units.

Freddie Mac

- Net income for the fourth quarter of 2012 totaled $4.5 billion, and represented the fifth consecutive quarter of positive earnings. Annual net income of $11.0 billion represented a record level of earnings for Freddie Mac and compares to a net loss of $5.3 billion in 2011.

- In 2012 Freddie Mac required $19 million of funding from Treasury bringing the cumulative Treasury draw to $71.3 billion. Through December 31, 2012, Freddie Mac has paid $23.8 billion in cash dividends to Treasury on the company's senior preferred stock. Under the PSPAs, the payment of dividends cannot be used to offset prior Treasury draws. This provision has remained unchanged since the PSPAs were established. So while $23.8 billion has been paid to Treasury in dividends, Treasury still maintains a liquidation preference of $71.3 billion on its senior preferred stock.

- The credit quality of new single-family acquisitions remained high in the fourth quarter of 2012, with a weighted average FICO score of 756. The average loan-to-value (LTV) ratio for new business was 75 percent. This higher LTV ratio is due to the expansion of HARP eligibility to borrowers whose mortgages have LTV ratios about 125 percent and to relief provided to lenders for borrowers with LTV ratios above 105 percent. These high LTV refinances represented 43 percent of HARP loans in 2012.

Fannie Mae

- Net income for the third quarter of 2012 totaled $1.8 billion, and represented the third consecutive quarter of positive earnings. For the first nine months of 2012, Fannie Mae reported earnings of $9.7 billion compared to a net loss of $14.4 billion for the first nine months of 2011.

- Fannie Mae did not require funding from Treasury in the first nine months of 2012. Fannie Mae's cumulative Treasury draw remains at $116.1 billion. Through September 30, 2012, Fannie Mae has paid $28.5 billion in cash dividends to Treasury on the company's senior preferred stock. Under the PSPAs, the payment of dividends cannot be used to offset prior Treasury draws. This provision has remained unchanged since the PSPAs were established. So while $28.5 billion has been paid to Treasury in dividends, Treasury still maintains a liquidation preference of $116.1 billion on its senior preferred stock.

- The credit quality of new single-family acquisitions was strong in the third quarter of 2012, with a weighted average FICO score of 761. The average LTV for new business was 77 percent. Again, this higher ratio is due to the expansion of HARP to borrowers with high LTV mortgages.

Federal Home Loan Banks

- The Federal Home Loan Banks have emerged from the financial crisis in generally good condition, profitable and with a strong capital position. The System reported net income of $2.6 billion in 2012, the highest annual earnings since 2007.

- Retained earnings have grown significantly in recent years and totaled $10.4 billion, or 1.37 percent of assets, as of year-end 2012. Retained earnings are at their highest level ever, and will continue to grow as a result of provisions included in each FHLBank's capital plan. The System regulatory capital ratio of 6.8 percent exceeds the regulatory requirement of 4.0 percent. The market value of the Federal Home Loan Banks is 124 percent of the par value of capital stock, the highest ratio in at least 11 years.

- The aggregate balance sheet of the Federal Home Loan Banks has shrunk considerably in recent years, led primarily by declining advance volumes due to market liquidity and sluggish economic growth. Advances totaled $426 billion as of year-end 2012, down 58 percent from a peak of $1.01 trillion in the third quarter of 2008.

Role of the Government in Housing Finance

In thinking about the role of the government in housing finance, I would start by reiterating the objectives that I shared in previous testimony. Our main purpose in addressing housing finance reform should be to promote the efficient provision of credit to finance mortgages for single-family and multifamily housing. I believe that an efficient market system for providing mortgage credit to people that want to buy a house should have certain core characteristics: allowing innovation, providing consumer choice, providing consumer protection, and facilitating transparency.

At the most fundamental level, the key question in housing finance reform is what, and how large, should be the role of the federal government?

Let me first approach this issue from a somewhat technical standpoint as an economist. A typical way that an economist would think about the government's role in the marketplace is in the context of a potential market failure. A market failure may lead the private market to produce less of, or more of, a particular good than would be economically optimal. Broadly speaking in housing finance there are at least two potential market failures that are often considered; each may lead to an under-provision of mortgage credit.

A potential market failure could arise in housing finance if market participants have undue or unnecessary concerns about the ongoing stability and liquidity of mortgage credit in a purely private market across various economic environments. If this view prevails in the housing market, less credit will be provided than would be the case in the absence of this type of uncertainty. The government response to this type of potential market failure could take a number of approaches, ranging from establishing standards and greater transparency for the market; providing liquidity or credit support under certain market conditions; to providing a government guarantee to largely eliminate uncertainty.

Another potential market failure is what is often thought of as the positive externality associated with homeownership. In this view, the benefits of homeownership extend beyond the individual household to the broader aspects of society, hence if left solely to the market the number of homeowners will be less than optimal. A common government approach to increase market demand is to provide some type of subsidy or other assistance to encourage or facilitate such consumption. Many aspects of government policy beyond the housing finance market are used to promote such an outcome in housing. Prominent among these is the mortgage interest tax deduction. Direct subsidies to lower the cost of mortgage credit or easing the eligibility terms for a mortgage are methods of delivering subsidies through the housing finance market.

With that technical background, in considering government policy as it relates to the housing finance market, it is useful to start with some basic market facts. As of the fourth quarter of 2012, there was about $9.9 trillion in single family mortgage debt outstanding. About 13 percent was guaranteed through direct government programs, roughly 52 percent was guaranteed by Fannie Mae and Freddie Mac, and the remainder not guaranteed by the Federal government. On a flow basis, *Inside Mortgage Finance* reports that in the third quarter of 2012 new single family mortgage originations totaled approximately $510 billion. Of that total roughly 18 percent was guaranteed through direct government programs, 66 percent through Fannie Mae and Freddie Mac, and 16 percent not guaranteed by the Federal government. Measured by securities issuance, the proportion supported by the government is over 90 percent. However measured, it should be clear that today's housing finance market is dominated by government support.

While the choice obviously rests with lawmakers, the substantial and longstanding role of FHA and VA suggests there will continue to be some meaningful government role in the future housing finance market. As a nation we are committed to providing opportunities for homeownership, and there may be other social goals where it is decided that government support is warranted. The relevant question appears to be more in the line of how do we move from the housing finance market of today, where almost all new single-family mortgage originations have some type of government support, to a future market far more reliant on the private provision of mortgage credit. And in particular, of the $5 trillion portion of the mortgage market currently served by the Enterprises, what share, if any, should have government credit support in the future?

At a conceptual level, I think the place to start answering this question is to think about the role of the traditional government mortgage guarantee programs, like FHA. FHA and other traditional government credit programs are typically what are used to address credit market failures or to achieve public policy goals. If policymakers begin by defining the role FHA and other government mortgage credit programs should play in the future in terms of which borrowers would have access to these programs, then it should be easier to consider the government's role, if any, in the remainder of the mortgage market.

This is not dissimilar to the approach taken in other credit markets. Take business lending as an example. The government provides support to address potential market failures or achieve other public policy goals through the Small Business Administration and direct government credit programs. The rest of the small business loan market is generally left to the private sector, and credit for larger businesses is generally provided without direct government credit support. Other consumer credit markets, like auto loans, have little if any direct government credit involvement.

I think there is broad recognition that the single-family mortgage market has at least one important difference from other consumer credit markets – the size of the overall market – and the need to draw on broader sources of capital to fund this level of activity. The single-family mortgage market also has come to rely on the Enterprises as the mechanism to attract capital to this market.

Fannie Mae and Freddie Mac are often said to bring essential benefit to the mortgage market by ensuring the ongoing liquidity of the market. With their statutory public mission and statutory (low) capital requirements, the Enterprises were long able to guarantee mortgage credit risk at a volume and price other market participants could not. They were also seen as having a public mission to promote the availability of mortgage credit, especially to support affordable housing.

Still, there seems to be relatively broad agreement that this government sponsored enterprise model of the past, where private sector companies were provided certain benefits and charged with achieving certain public policy goals, did not work. That model relied on investors providing funding for housing at preferential rates based on a perception of government support, which ultimately turned out to be correct and has resulted in Enterprises' drawing $187.5 billion in funds from Treasury as of December 31, 2012.

Considering how to replace the government sponsored enterprise model, in particular developing an efficient secondary market that can access capital markets to serve the single family market that is not covered by traditional government credit programs is central to congressional consideration of ending the conservatorships.

The options here for the Committee's consideration range from a market-oriented approach that would ensure broad minimum standards were in place to establishing a Federal backstop to provide liquidity when needed, to developing a government guarantee structure to ensure stability in the flow of mortgage credit and limit market uncertainty. These options are not novel – they are essentially the three options that the Administration set forth in its white paper more than two years ago

Standard-Setting

A standard-setting approach would replace some of the standard-setting that the Enterprises undertake today with a regulatory regime or a market utility that sets those standards. This model would not rely on a government guarantee to attract funding to the mortgage market, but rather would look to standardization and rules for enforcing contracts to provide a degree of certainty to investors. The focus in such an approach could be on setting standards around key features that investors need to know to be willing to price credit risk in the mortgage market. These include standards associated with underwriting, pooling and servicing, and disclosures.

Clearly a standard-setting framework is much different than a framework that has a government guarantee. Investors would be required to price the credit risk of mortgages. They also would be responsible for enforcing their rights under the standard contracts developed under this framework. Those requirements are consistent with the way that a private market functions. Arguably, this is part of the market oversight and investor protection regime that is already established in various securities laws overseen by the Securities and Exchange Commission. Part of the question here is given the size of the single family mortgage, and the unique characteristics of today's agency securities market, in particular the To-Be-Announced market, would additional standard-setting measures enhance liquidity and provide further structure to the market? An important question to consider is are there other areas in terms of monitoring or compliance that could potentially broaden the investor base while still achieving the primary function of having private markets price credit risk?

To establish a liquid non-government guaranteed market there would seem to be a need to have greater homogeneity in borrower characteristics. I would think such a market would broadly cover the bulk of the business that the Enterprises undertake today, but such a market might not be available to all borrowers currently served by the Enterprises. With greater transparency in requirements, it would give borrowers a clear sense of the qualification requirements. Traditional government guarantee programs would still exist to meet various policy goals. And finally, for borrower characteristics that do not fit neatly into the secondary market, we need to find a way to get insured depository institutions back into the business of funding mortgages. Understanding individual borrowers and special circumstances is at the heart of the financial intermediation function of insured depository institutions and an issue that deserves further exploration. I would also note that the Federal Home Loan Banks give depository institutions access to credit across the maturity spectrum to assist in funding such mortgages on depository institution balance sheets.

Federal Backstop

In a standard-setting approach without a government guarantee, it would be important to consider how such a market would operate in a time of stress. Having clear standards and greater transparency would certainly improve market operations, but there still could be cyclical swings that could broadly be of concern to the government. Two potential concerns are:

- Preserving the availability of credit in times of stress is an important function. Is there a role for the government, perhaps through the Federal Housing Administration to take on this role if necessary? Or alternatively, with a more standardized market and infrastructure, would it be possible for an existing guarantor, like Ginnie Mae, to play such a temporary guarantee function?

- Preserving liquidity in the market and the financial system in this framework would be an important function. Is there a need for a backstop source of funding when financial markets become temporarily illiquid? For example, could the Treasury Department, the Federal Reserve or the Federal Home Loan Banks play a role in a market that had this type of standardized structure?

Government Guarantee

Finally, the third option, somewhat similar to what is in place today, is a housing finance system with some type of government guarantee. Clearly if the securities offered in a reformed housing finance market have a government guarantee, those securities will be priced favorably and have a high degree of liquidity to reflect that guarantee. However, pricing for those securities would not provide the benefit of market pricing for credit risk of the underlying mortgages. In these structures, much like the banking system and deposit insurance, private sector capital through equity investment would stand in a first loss position, with a government guarantee that was funded through an insurance premium being available to cover other losses. This type of structure requires a significant amount of regulatory safety and soundness oversight to protect against the moral hazard associated with providing a government guarantee.

While such an outcome has certain merit and some attractive features, the potential costs and risks associated with such a framework should be fully explored. To put it simply, replacing the Enterprises' implicit guarantee with an explicit one does not resolve all the shortcomings and inherent conflicts in that model, and it may produce its own problems. In past testimony I have offered three observations in that regard for your consideration.

First, the presumption behind the need for an explicit federal guarantee is that the market either cannot evaluate and price the tail risk of mortgage default, at least at any price that most would consider reasonable, or cannot manage that amount of mortgage credit risk on its own. But we might ask whether there is reason to believe that the government will do better? If the government backstop is underpriced, taxpayers eventually may foot the bill again.

Second, if the government provides explicit credit support for the vast majority of mortgages in this country, it would likely want a say with regard to the allocation or pricing of mortgage credit for particular groups or geographic areas. The potential distortion of the pricing of credit risk from such government involvement risks further taxpayer involvement if things do not work out as hoped.

Third, regardless of any particular government allocation or pricing initiatives, explicit credit support for all but a small portion of mortgages, on top of the existing tax deductibility of mortgage interest, would further direct our nation's investment dollars toward housing. It would also drive up the price of housing, other things being equal. A task for lawmakers is to weigh such incentives and outcomes against the alternative uses of such funds.

Finally, what I have just discussed relates to the single-family mortgage market. A similar type of analysis could be performed for the multifamily market.

Conclusion

Few of us could have imagined in 2008 that we would be approaching the fifth anniversary of placing Fannie Mae and Freddie Mac in conservatorships and have made little meaningful progress to bring these government conservatorships to an end. The conservatorships were never intended to be a long-term solution, rather, as I stated at the beginning of my testimony they were meant primarily as a "time out" for the rapidly eroding mortgage market – an opportunity to provide some stability while Congress and the Administration could figure out how best to address future reforms to the housing finance system.

The U.S. housing finance system cannot really get going again until we remove this cloud of uncertainty and it will take legislation to do it. Fannie Mae and Freddie Mac were chartered by Congress and by law, only Congress can abolish or modify those charters and set forth a vision for a new secondary market structure. While FHFA is doing what it can to encourage private capital back into the marketplace, so long as there are two government-supported firms occupying this space, full private sector competition will be difficult, if not impossible, to achieve.

I have been observing a developing "consensus" among private market participants that the conforming conventional mortgage market cannot operate without the American taxpayer providing the ultimate credit guarantee for *most* of the market. As I have noted, that clearly is one policy outcome, but I do not believe it is the only outcome that can give our country a strong housing finance system. I believe that our country, and its financial system, are stronger than that. I believe it is possible to rebuild a secondary mortgage market that is deep, liquid, competitive, and operates without an ongoing reliance on taxpayers or, at least, a greatly reduced reliance on taxpayers, if that is what we set our minds to accomplishing.

Where lawmakers identify particular market failures requiring direct government involvement, there may be more targeted approaches to addressing those issues than a broad subsidy to credit. For example, if certain borrowers or communities are of concern, taxpayer support could be targeted directly to support the building or purchasing of housing rather than indirectly through subsidies to borrowing money. Individual communities have already undertaken this approach.

I have said before, however, that these choices are for elected officials to make, not me. I am offering to work with this Committee, its counterpart in the Senate, and the Administration to make these policy determinations and then set about ending these conservatorships and transitioning to a future housing finance system that can serve our children, grandchildren, and beyond.

Thank you again for inviting me here today. I look forward to discussing these important matters with all of you.

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

National Apartment Association

March 19, 2013

The Honorable Jeb Hensarling
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On behalf of the National Multi Housing Council (NMHC) and the National Apartment Association (NAA), we write to encourage the Committee on Financial Services to consider the unique needs of the multifamily industry as it considers proposals to overhaul Fannie Mae and Freddie Mac (the GSEs).

The National Multi Housing Council (NMHC) and National Apartment Association (NAA) Joint Legislative Program has issued a white paper outlining the key principles a reformed housing finance system needs to embrace to preserve liquidity and stability for the well-performing multifamily sector. We request that this white paper entitled, "Key Principles for Preserving Liquidity and Stability for Multifamily in a Reformed Housing Finance System," be submitted for the record.

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. NAA is the largest national federation of 170 state and local apartment associations comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. Yet those shortcomings were largely confined to the residential home mortgage sector. Fannie Mae and Freddie Mac's very successful multifamily lending programs were not part of the meltdown and have actually generated over $10 billion in net revenue to the government since being placed into conservatorship.

More than just performing well, the GSEs' multifamily programs serve a critical public policy role. Unfortunately, even during normal economic times, private capital alone cannot fully meet the industry's financing needs. The GSEs ensure that multifamily capital is available in all markets at all times, so the industry can provide housing from coast to coast and everywhere in between.

As Congress looks to enact GSE reform, we request that lawmakers retain the successful components of the existing multifamily programs in whatever succeeds them. We believe a reformed housing finance system should: (1) ensure mortgage liquidity in all markets at all times; (2) safeguard capital availability for the wide range of properties, sponsors and renters; (3) expand private capital participation; (4) limit and/or mitigate market disruptions; and (5) insulate the taxpayer from losses.

We appreciate the opportunity to be able to share our views with Committee. Please contact Cindy Chetti at NMHC at 202.974.2300 with any questions.

Sincerely,

Cindy V. Chetti
Senior Vice President of Government Affairs
National Multi Housing Council

Gregory Brown
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Key Principles for Preserving Liquidity and Stability for Multifamily in a Reformed Housing Finance System

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NMHC is a national association representing the interests of the larger and most prominent apartment firms in the U.S. NMHC's members are the principal officers of firms engaged in all aspects of the apartment industry, including ownership, development, management, and financing. NMHC advocates on behalf of rental housing, conducts apartment-related research, encourages the exchange of strategic business information, and promotes the desirability of apartment living.

www.nmhc.org

NAA

NATIONAL APARTMENT ASSOCIATION

NAA is the nation's largest and leading professional organization with 58,000 members of affiliated associations representing 6.5 million apartment units. Our members are recognized industry leaders who uphold the highest integrity and business practices through our Educational Institute's professional designations. NAA's advocacy initiatives span legislative and regulatory public policy at all levels of government to ensure apartment homes are a national priority.

www.naahq.org

Overview

One in three Americans rent, and 17 million of those households are building their lives in an apartment.[1] Apartments are helping meet the housing needs of people across all income levels in every corner of the country, from our cities to our smaller inner-ring suburbs and even to our rural communities.

Renters include young professionals; empty-nesters looking to downsize; people who want to live near their work; seniors on a fixed income; married couples without children; families working their way up the economic ladder; and even higher-income households who value the convenience or mobility that renting offers.

Today's apartment industry is a competitive and robust sector of our economy. In 2011, the most recent year for which full data are available, spending by the industry and the residents who live in their buildings generated a $1.1 trillion contribution to the national economy and supported 25.7 million jobs.[2]

Many factors influence the apartment industry's health and its ability to meet the nation's growing demand for rental housing, but the availability of consistently reliable and competitively priced capital is perhaps the most essential.

> One in three Americans rent, and apartments are helping meet the housing needs of 17 million households across all income levels in every corner of the country.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. But those flaws were largely confined to the single-family sector. The Government-Sponsored Enterprises' (GSE) (i.e., Fannie Mae and Freddie Mac) very successful multifamily programs were not part of the meltdown and have actually generated $7 billion in net profits to the government since conservatorship.[3]

More than just performing well, the GSEs' multifamily programs serve a critical public policy role by addressing a market failure in the housing finance system that results in an abundance of capital for high-end properties in top-tier markets, but leaves secondary and tertiary markets like Indianapolis, IN, or Topeka, KS, underserved. The GSEs ensure that multifamily capital was available in all markets and at all times, so the apartment industry can address the broad range of America's housing needs from coast to coast and everywhere in between.

Although there has been much discussion about reforming, and perhaps eliminating, the GSEs, there is no consensus as to how to move forward. As policymakers craft solutions to fix the single-family housing problems, they should be mindful not to do so at the expense of the much smaller and less understood, but vital, multifamily sector.

Multifamily finance operates very differently from single-family finance, and preserving liquidity for the multifamily sector requires a distinct and separate solution. Although that solution may come as part of a comprehensive housing finance reform measure that addresses both single-family and multifamily housing finance, a one-size-fits-all solution would have disastrous consequences for the nation's supply of workforce housing.

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA) urge lawmakers not only to pursue a separate solution for multifamily that recognizes the industry's unique needs, but also to retain the successful components of the existing multifamily programs in whatever succeeds them. We believe the goals of a reformed housing finance system for the multifamily sector should be to:

1. ensure mortgage liquidity in all markets at all times;
2. ensure capital availability for the wide range of properties, sponsors and renters;
3. expand private capital participation;
4. limit/mitigate market disruptions; and
5. insulate taxpayers from losses.

Background

Rental Housing Helps Build Lives and Communities, But Demand Is Surpassing New Supply

Communities across the country, both big and small, need access to a mix of housing options for their local economy to grow and prosper. Increasingly, that includes apartments. From year-end 2004 through year-end 2011, more than 5.4 million net new renter households were formed, growing their ranks from 33.0 million to 38.4 million, according to the U.S. Census Bureau.

Without consistently reliable and competitively priced capital, the apartment industry cannot meet the nation's growing demand for rental housing.

Renter households are expected to become an even larger portion of our overall housing picture going forward. The combined effect of population growth, demographic shifts, economic challenges and changing consumer preferences means renters could comprise fully half of all new households by the end of this decade, up to seven million additional renter households.[4]

To meet this expected demand, the industry must build at least 300,000 units annually and as many as 400,000 depending on economic conditions and the rate of new household formations.[5] Yet new development virtually halted for two years during the capital market collapse and still remains below average. The number of apartments started in 2011—167,400—was just barely enough to replace the units lost to destruction, demolition and obsolescence.[6] New apartment properties are needed in communities large and small in virtually every state to house all these new renters. A reformed housing finance system must ensure that reliable and appropriately priced capital is available to support this demand.

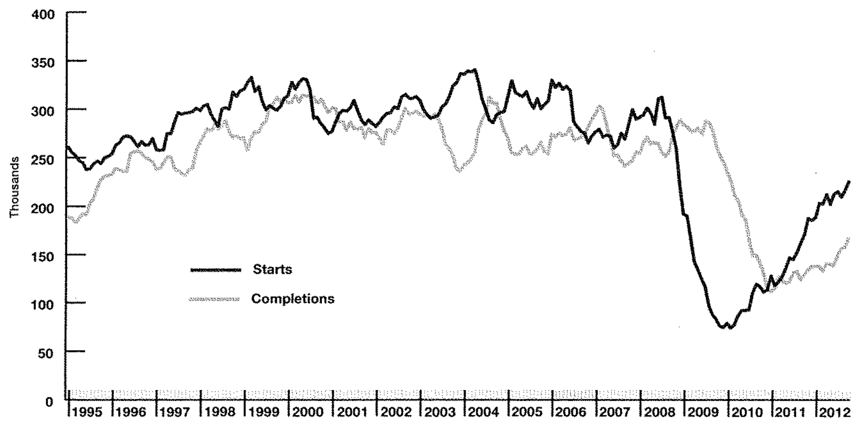
Liquidity Market Failure Underscores Role for Public Policy

Preserving liquidity for multifamily is about more than just building new apartments, however. It is also about ensuring there is sufficient capital to refinance the billions of dollars worth of existing mortgages that mature each year. Failure to do so puts millions of renters at risk.

Unlike residential mortgages, which are typically for 30-year terms, most multifamily mortgages are for a period of seven to 10 years. In 2013 alone, an estimated $100

Multifamily Starts and Completions Are Rebounding, But Remain Below Average and Demand

Multifamily (5+ units) Construction (6-month moving average)



Source: U.S. Census Bureau

billion in multifamily mortgages will need to be refinanced, many of which are not in areas that attract private capital.[7]

Institutional capital typically limits itself to top-tier markets and trophy assets. It is far less interested in secondary and tertiary markets, places like Tulsa, OK, and Schenectady, NY. Even in large urban areas where institutional capital is available, it is not available to all property types and in all submarkets. Yet these properties make up a significant portion of the nation's workforce housing.

The GSEs' multifamily programs have provided the capital for thousands of properties over the past 20 years that otherwise would not have been able to find a lender to refinance their mortgage when it came due. Without them, even though these properties were capable of covering their debt, they would likely have faced foreclosure, putting millions of renters at risk of losing their housing.

The market failure the GSEs' multifamily programs addressed was ensuring capital reaches markets deemed undesirable by institutional capital. It is imperative that a reformed system continue to fill this important public policy need.

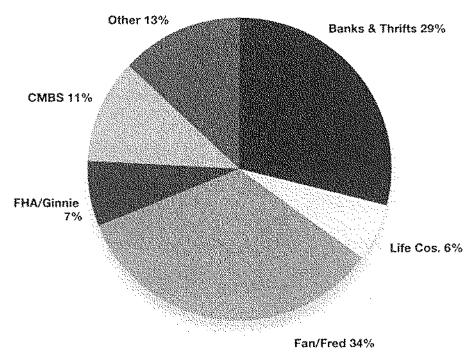
Private Capital Is Necessary, But a "Private-Only" System Leaves Vast Amounts of the Country Underfunded

Private capital is certainly an integral part of the multifamily housing finance system, and we support the return to a marketplace dominated by private capital. The apartment sector has historically relied on a wide range of capital sources outside of the GSEs. They include commercial banks, life insurance companies, commercial mortgage-backed securities (CMBS) and the Federal Housing Administration's (FHA) multifamily programs. But each of these has its own focus, strengths and limitations. Collectively, however, even during healthy economic times, these private-market sources simply have been unwilling or unable to meet all of the rental housing industry's capital needs.

Banks are limited by capital requirements and have rarely been a source of long-term financing. Life insurance companies have typically comprised less than 10 percent of the market, lend primarily to newer, high-end properties and enter and exit the multifamily market based on their investment needs and economic conditions. FHA has exceeded its capacity. The private-label CMBS market will be an important capital source, but because of the stricter regulatory environment post-financial crisis, it is unlikely to return to the volume it reached pre-crisis.

We are encouraged by the thawing in the private capital markets, but we are unconvinced by the claims of some private capital providers that they can fully replace the liquidity offered by the GSEs. Already in this recovery we are seeing the historical pattern of uneven access to capital repeat itself. The new private capital coming into the apartment sector is concentrating in a handful of cities and on trophy assets.

Who Holds the $844 Billion in Outstanding Multifamily Debt?



Source: Federal Reserve Board

Even with the increased role for the GSEs in the most recent financial crisis, private capital provides more than half of the outstanding mortgage debt. The GSEs account for approximately one third.

Apartment firms providing critical housing in secondary and tertiary markets and rural areas are not benefiting from the resurgence in private capital. Even in the larger markets, firms providing workforce housing find themselves equally shut out. A private-capital-only solution leaves vast amounts of the country out—places like Kansas City or Indianapolis. Affordable properties in these markets are not the only ones overlooked. Securing capital for conventional, market-rate properties in these smaller markets is difficult if not impossible; and where it is available, it is significantly more costly.

A "Private Only" System Leaves the Nation's Housing Vulnerable to Market Dislocations

The programs created by the GSEs also serve as a critical backstop that ensure the continued flow of capital to apartments when credit markets become impaired for reasons that have nothing to do with multifamily property operating performance.

This most recent financial crisis underscores the significance of the public policy goals the GSEs have served in providing liquidity. When virtually every other capital source left the market, the GSEs kept liquidity in the market and prevented a widespread rental housing depression. They played a similar role during the 1997-1998 Russian financial crisis and in the post-9/11 recession in 2001.[8]

Given the importance of housing, in particular for America's working families, there is a vital public policy role for government to play in preserving this liquidity. Whatever succeeds Fannie Mae and Freddie Mac should serve a similar role in the future as we design a new housing finance system.

A Separate Solution for Multifamily

While policymakers are understandably focused on reforming the GSEs' single-family programs, they must also understand the unique needs of the multifamily housing sector. The two sectors operate differently, have divergent performance records and require distinct reform solutions.

The businesses of multifamily finance and single-family finance differ in many ways. The capital sources for multifamily are not as wide or as deep as those financing single-family, and the loans themselves are not as easily commoditized. Moreover, the financing process; mortgage instruments; legal framework; loan terms and requirements; origination; secondary market investors; underlying assets; business expertise; and systems are all separate and unique from single-family home mortgage activities.

As a result, there are two distinct secondary markets for single-family and multifamily mortgage products, and each requires its own approach to reform. NMHC/NAA were pleased that the Federal Housing Finance Agency (FHFA) recognized in its February 21, 2012, strategic plan for privatizing the GSEs that "generating potential value for taxpayers and contracting the Enterprises' multifamily market footprint should be approached differently from single-family, and it may be accomplished using a much different and more direct method."

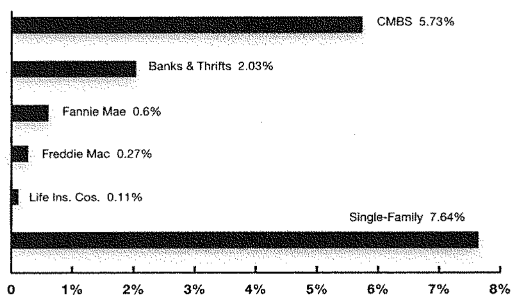
A Model That Works

As lawmakers look ahead to reforming Fannie Mae and Freddie Mac, they should recognize the critical role they have played in supporting the development of a strong, private apartment industry that is vital to meeting the housing needs of millions of Americans across the country.

The apartment industry did not overbuild in the housing boom, and the GSEs' multifamily programs did not contribute to the housing meltdown and are not broken. Unfortunately, the losses experienced in their single-family divisions have overshadowed the strong performance of their multifamily programs.

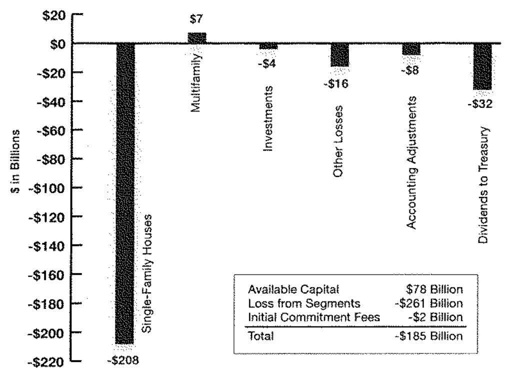
Thanks to strong credit risk management practices, the GSEs' multifamily programs have a serious delinquency/default rate of 0.51 percent compared to 8.7 percent for single-family mortgages. The GSEs have also outperformed all other sources of multifamily debt, including commercial banks, CMBS and FHA.

Delinquency Rates of Multifamily Debt Providers: GSEs Outperform Most Others



CMBS figures as of 10/30/2012; Fannie Mae and Freddie Mac as of 3Q 2012; banks, thrifts and life insurance companies as of 2Q 2012; single-family as of 10/30/212. **Sources:** Morningstar Monthly CMBS Delinquency Report 10/24/12; Federal Deposit Insurance Corporation, September 2012; Fannie Mae and Freddie Mac Third Quarter 10Q Filing; ACLI, July 2012; and MBA National Delinquency Survey, October 2012.

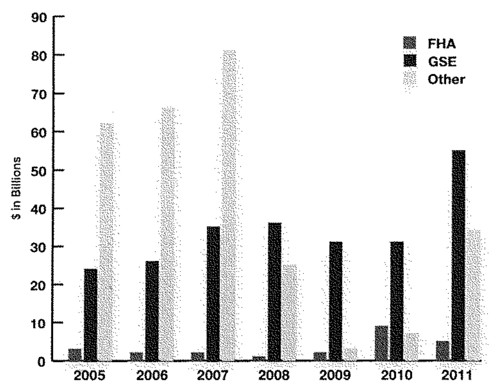
GSE Gains and Losses: Multifamily Programs Provide the Only Net Revenue (1Q 2008 through 3Q 2011)



Source: Capital changes between 1/1/2008 and 9/30/2011 are from the FHFA Conservator's Report on the Enterprises' Financial Performance, Third Quarter 2011, p 9. *Note: Numbers do not total due to rounding.*

GSEs' Share of Multifamily Mortgages Ebbs and Flows with Market Conditions, Serving as a Vital Backstop During Times of Crisis and Retreating in Strong Economic Times

Multifamily Mortgage Originations 2005–2010



Source(s): Information on private capital sources tabulated from the Mortgage Bankers Association's "Annual Report on Multifamily Lending." FHA data is provided by HUD, and GSE data is from their annual reports to FHFA. FHA and GSE data represent net new originations for the fiscal year for each and not total loan production. FHA data includes mortgage and refinance activity for conventional and LIHTC mortgage properties; health care, rural housing and construction lending are excluded. Originations by commercial banks, thrift institutions or other private debt capital providers are excluded.

The GSEs' multifamily programs have historically been well capitalized and have covered all losses through the loss reserves they collected. Even during conservatorship, the GSEs' multifamily programs have netted $7 billion in profit.

Through careful underwriting, the GSEs' multifamily models have met the test. They have attracted enormous amounts of private capital as a result of standardizing multifamily mortgage credit markets—from establishing strong due diligence requirements and documentation systems to industry-accepted risk-management standards.

They have created an effective risk-sharing partnership system that has helped finance millions of units of market-rate workforce housing without federal appropriations. They have spurred innovation in the marketplace to meet the wide range of borrower and property-type needs, as well as sustained liquidity in all economic climates. And they have done all of this while ensuring the safety and soundness of their multifamily lines of business and creating a mortgage credit standard.

As a result of the liquidity provided by the GSEs, the United States has the best and most stable rental housing sector in the world. They have counteracted the private sector's tendency to concentrate liquidity in certain geographic areas, as well as the ebb and flow of private capital from the multifamily sector based on broader economic conditions.

There are many reasons for the GSEs' strong apartment loan performance, including the following:

- sound and effective credit policy;
- prudent underwriting and loan terms and mortgage requirements;
- effective third-party assessment procedures (as part of the loan underwriting and due diligence process);
- strong contractual agreements with their origination and servicing partners;
- risk-sharing with and risk-retention by origination and servicing partners;
- effective loan portfolio management and oversight;

- standard mortgage documentation; and
- geographic and loan product diversification.

We urge lawmakers to retain the successful elements of the GSEs' multifamily programs in a reformed housing finance system.

Key Principles of a Reformed Multifamily Housing Finance System

More than 17 million American households rely on the apartment sector to provide them with their homes, and without federal participation, vast swaths of the country would be left without sufficient liquidity to build, maintain or refinance those apartment homes. NMHC/NAA offer these key principles to guide multifamily housing finance reform.

1. Provide Access to Federal Credit Support

__NMHC/NAA Position:__ Given the market failure of the private sector to meet the apartment industry's broad capital needs, an explicit federal guarantee for multifamily-backed mortgage securities should be available in all markets at all times.

Eliminating the federal guarantee would severely restrict private-investor appetite for multifamily-backed securities. Many investors, including sovereign wealth funds, investment funds and other institutional shareholders, purchase multifamily mortgage bonds precisely because they are implicitly backed by the federal government. They seek out these assets to diversify their portfolios and are willing to take lower returns because of the guarantee. Without it, they would likely move their money to Treasury and other high-grade corporate debt. They aren't likely to invest in higher-risk private-label multifamily bonds because of the higher risk.

Market Failure: A private-only housing finance system results in an abundance of capital for high-end properties in top-tier markets, but leaves secondary and tertiary markets like Indianapolis, IN, or Topeka, KS, underserved.

Eliminating the guarantee would also force the apartment industry to rely on the private-label CMBS market as the primary secondary market execution. While the CMBS market is rebounding and will be an important capital source for multifamily, there are strong concerns that CMBS will not have the capacity to fully replace the GSEs or even provide the liquidity they did before the financial crisis. Increased regulatory oversight, including Dodd-Frank and risk-retention rules, combined with investor demand for higher quality assets and more transparency, will combine to produce lower volumes and higher prices for privately securitized debt. To the extent that these changes initiate a "flight to quality," it will leave mature apartment communities with fewer amenities (i.e., Class B and C properties) that relied more extensively on CMBS pre-crisis without sufficient capital.

Finally, eliminating the guarantee would fundamentally change the economics of apartment investment and create volatility that would negatively reverberate through the housing system. It would also encourage investors to exit the multifamily sector and increase the cost of equity that apartment owners seek to develop and maintain their properties. Furthermore, it would reduce the capital available to refinance the industry's maturing debt, and it could push more borrowers into FHA's multifamily insured loan program, which could require greater direct government investment at higher costs to the taxpayer. There are also serious concerns about FHA's capacity to absorb increased demand. When demand for FHA financing significantly increased after the financial collapse, loan processing timelines went from 60 days prior to the recession to 18 to 24 months.

2. Provide Broad Liquidity Support at All Times, Not Just "Stop-Gap" or Emergency
NMHC/NAA Position: *Any federal credit facility should be available to the entire apartment sector and not be restricted to specific housing types or specific renter populations.*

Narrowing any future credit source would remove a tremendously important source of capital to a large portion of our industry, namely market-rate developers who actually provide a large volume of unsubsidized workforce housing. Such a facility should also be available at all times to ensure constancy in the U.S. housing market throughout all business cycles. It would be impossible to turn on and off a government-backed facility without seriously jeopardizing capital flows.

3. Focus Mission on Liquidity, Not Mandates
NMHC/NAA Position: *The public mission of a federally supported secondary market for multifamily should be clearly defined and focused primarily on using a government backstop to provide liquidity and not for specific affordable housing mandates.*

The industry supports a return to a system dominated by private capital; however, even in healthy economic times, private capital has not been able to meet the broad liquidity needs of the apartment industry.

Affordable housing mandates create conflicts within the secondary market, and some have claimed that affordable housing goals may have contributed to the housing crisis because of the distortions the mandates introduced into the GSEs' business practices. Instead of mandates, the new housing finance system should provide incentives to support the production and preservation of affordable multifamily housing. Absent incentives, the government should redirect the affordability mission to HUD/FHA and the Low-Income Housing Tax Credit program.

4. Restrict Federal Credit Support to the Security Level
NMHC/NAA Position: *The benefit of any federal guarantee should only accrue to the investors of multifamily mortgage-backed securities; it should not apply to the underlying multifamily mortgages or the entities issuing the securities.*

Providing a guarantee to the asset-backed security investor could be accomplished by either (1) modifying the current form of security or (2) making use of the Ginnie Mae guarantee. In the event of a borrower default, the losses would be incurred first by the parties that have retained first-loss risk, including risk-sharing originators/servicers and/or subordinate security investors. After that, the government guarantee would be used to pay the security investor; however, the security guarantor (i.e., the federal government) would look for reimbursement from the reformed/successor entity's risk-based capital reserves and from the mortgage originator if it had any retained risk. The reformed/successor issuing entity, in turn, would use the proceeds from the sale of the foreclosed property as reimbursement for the mortgage default. *(See Appendix I for a diagram outlining a possible government role in the mortgage origination process and the reimbursement process in the event of mortgage default.)*

5. Support Private Capital and Protect Taxpayers Through Effective Guarantee Structure and Pricing

   NMHC/NAA Position: *Borrowers should pay for the guarantee in the form of an appropriately priced credit enhancement fee that actuarially insures taxpayers against future losses. Additionally, the fee should be priced to ensure that any advantage the GSEs historically have enjoyed over private mortgage capital is addressed and market participants not using government guarantees are not crowded out. Finally, if deemed necessary and appropriate, an insurance fund could be established from mortgage proceeds as an additional back stop against losses.*

   Regardless of how the overall price paid to the government for the guarantee is established, the pricing should be (1) risk- and product-based as it is today; (2) reviewed, evaluated and reset on a scheduled basis; and (3) holistic and inclusive of the guarantee fee, risk-based capital, market-adjustment factors and other costs associated with the mortgage.[9]

6. Encourage Competition

   NMHC/NAA Position: *Other entities should be allowed to obtain a federal charter to compete with the GSEs or their successors if they can meet mandated requirements, including robust levels of core capital and significant experience in mortgage underwriting.*

7. Empower a Strong Regulator

   NMHC/NAA Position: *A strong and independent regulator with considerable expertise in multifamily lending is critical. To ensure sufficient financial resources and political independence, the regulator should be funded through industry assessments instead of congressional appropriations as is the case with the Federal Deposit Insurance Corporation, Federal Reserve and Office of the Comptroller of the Currency.*

   The regulator of any restructured/successor entity would establish capital standards and other regulatory requirements to protect taxpayers. They would also work with other regulators and entities that establish and enforce risk-based capital standards for real estate lending. This includes prudential regulators, associations and other institutions that oversee and represent banks, insurance companies, the private securities markets (CMBS) and pension funds.

8. Impose Effective Capital Requirements

***NMHC/NAA Position:** Effective capital reserve requirements, both for mortgages held in portfolio and those securitized, are vital to further protect taxpayers from future losses.*

In addition to capital requirements set by the new regulator, the reformed/successor entities would be required to comply with the systemic risk provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (e.g., maintaining required capital levels and a "living will" for systemically significant institutions describing how they will be dissolved in the case of failure). They would also be required to maintain a minimum corporate credit rating as determined by their regulator. Finally, they would be prohibited from risk-mitigation activities that involve credit default swaps and other highly leveraged types of derivatives.

9. Retain Limited Portfolio Lending (Without a Federal Guarantee) While Expanding Securitization

***NMHC/NAA Position:** Any restructured/successor entity should be able to retain restricted multifamily mortgage portfolios, although no government guarantee would apply to mortgages held in portfolio. Limited retained portfolios would be allowed for the following activities:*

1. Aggregate mortgages for the purpose of pooled securities execution;
2. Implement pilot mortgage programs and product modification testing;
3. Engage in targeted higher-risk transactions, including financing properties with rent-regulatory restrictions, off-campus student housing and senior and assisted living developments; and
4. Engage in pilot and other risk-sharing transactions for the purposes of workforce and affordable housing production with housing finance agencies, FHA and others.

We concur that a secondary market is critical to attract private capital to the multifamily sector. Already the GSEs' multifamily programs are shifting toward a securitization model. Since conservatorship, both Fannie Mae's and Freddie Mac's multifamily activities have, for the most part, relied on the sale of mortgage securities.[10] However, unlike single-family loans, multifamily loans are not easily "commoditized," and there are valid and necessary reasons to maintain some level of mortgages on the balance sheet of any entity.

To avoid a return to an over-reliance on portfolio lending, the following requirements should be applied to portfolio activities:

- No government guarantee of loans held in portfolio;
- Portfolio loans are subject to commercial bank mortgage risk-based capital standards; and
- Portfolio limits are to be established based both on absolute levels and as a percentage of guaranteed mortgage securities.

10. Reduce Existing Portfolios in a Responsible Manner

***NMHC/NAA Position:** In the event that it is necessary and appropriate to establish GSE-successor entities (with or without new private capital), the current GSE multifamily portfolios should largely be transferred to the federal government to* *allow taxpayers to capture the portfolios' positive income stream and to eliminate any market advantage the GSE-successor entities would gain by retaining them on their balance sheets. However, any GSE-successor entities should be allowed to retain the minimum number of mortgages currently held in portfolio that are necessary to make them operationally viable. The GSE-successor entities should be charged with continuing to service the mortgages transferred to government control and would be paid a fee for doing so.*

To eliminate any capital advantage the newly privatized GSE-successor entities could have, the current multifamily portfolios should largely be transferred to the federal government except to the degree they are necessary to make the successor entities operationally viable. With such a transfer, the government would receive all the income from loan repayments, and the successor entities would be paid a fee for continuing to provide asset-management services for the transferred mortgages.

The two GSEs currently have combined portfolio mortgage holdings of approximately $300 billion, an amount that is forecast to continue to shrink both through natural attrition and the government-imposed liquidation of overall mortgage assets. (By contrast, the GSEs together hold more than $1.2 trillion in single-family mortgages in portfolio.) With default rates of less than one percent, the multifamily portfolios are expected to be profitable on an aggregate basis.[11] Under this proposed scenario, the government could realize revenue gains while the current portfolio continues to shrink.

A Separate Solution: The meaningful differences between the single-family and multifamily sectors require separate solutions for each. A solution that doesn't recognize the unique needs of the multifamily sector would have disastrous consequences for the nation's supply of workforce housing.

11. Create Certainty and Retain Existing Resources/ Capacity During the Transition

NMHC/NAA Position: *To avoid market disruption, it is important that policymakers clearly define the role of the government in a reformed system and the timeline for transition. Without that certainty, private capital providers (e.g., warehouse lenders and institutional investors) are likely to limit their exposure to the market, which could cause a serious capital shortfall to rental housing. In addition, during the transition years, we believe it is critical to retain many of the resources and capacity of the existing GSEs. The two firms have extensive personnel and technology expertise, as well as established third-party relationships with lenders, mortgage servicers, appraisers, engineers and other service providers, which are critical to a well-functioning secondary market.*

Private capital is returning to the market, but as has been the case historically, it is concentrating in a handful of cities and on trophy assets.

Key Differences Between Current/Past Status and a Reformed System

The key principles outlined by NMHC/NAA for a reformed multifamily housing finance system reflect meaningful differences between the current and historical GSE structure and a future one. The four main differences are:

1. **Government Guarantee at the Security Level Only.**
   NMHC/NAA's key principles would only apply the government guarantee to the unsubordinated mortgage security investor. The government claims for mortgage losses would inure to the successor entity, and the entity would compensate the government for any losses through reserves and shareholder capital. In the event of bankruptcy by the restructured/successor entity, the government would be the preferred creditor.

2. **Separately Account for Multifamily Activities.**
   Given the need for a unique multifamily solution and the fact that single-family and multifamily have different credit risk, mortgage purchase, aggregation and securitization, any reformed system must separately account for—and report on—its multifamily financing and securitization activities.

3. **Market Pricing.**
   The pricing of the federal guarantee must be done in such a way that it not only attracts mortgage-security investors, but also compensates the government for the value of the securities' insurance, funds needed risk-based capital reserves and does not crowd out private capital.

4. **Limited Retained Mortgage Portfolio.**
   The restructured/successor entities should be permitted to have a limited retained mortgage portfolio to support securitization activities and address overall mortgage credit risk. Mortgages retained in the portfolio after conservatorship would not be backed by the federal guarantee and would have higher capital reserve requirements than securitized mortgages. To prevent a return to a portfolio-based financing system, an overall portfolio cap would be imposed.

Conclusion

Steady, reliable and reasonably priced capital is essential to the apartment sector's ability to meet the nation's growing housing needs. While it is important for the nation to transition back to a housing finance system dominated by private capital, history suggests that a private-market only solution will provide insufficient capital to support the broad range of apartments needed throughout the entire U.S.

Given that market failure, there is an appropriate role for government to play in ensuring there is sufficient capital available to build, maintain and refinance housing for its citizens.

A reformed housing finance system should retain the successful components of the existing multifamily programs in whatever succeeds them.

The existing GSEs provide a model for how that role can be served. Ultimately policymakers will need to determine if it makes sense to fundamentally change the structure of the GSEs (charter, capital, etc.) and keep them part of the system, albeit a smaller part, or wind them down completely. But lawmakers should be aware that whatever action they take, they must consider multifamily separately from single-family. Furthermore, policymakers are warned that winding down the GSEs without having a clear picture of what sources of capital can reasonably replace them is very risky and could easily result in severe disruptions to our housing system.

We look forward to working with both policymakers and stakeholders to further the debate and work toward a comprehensive and sustainable policy.

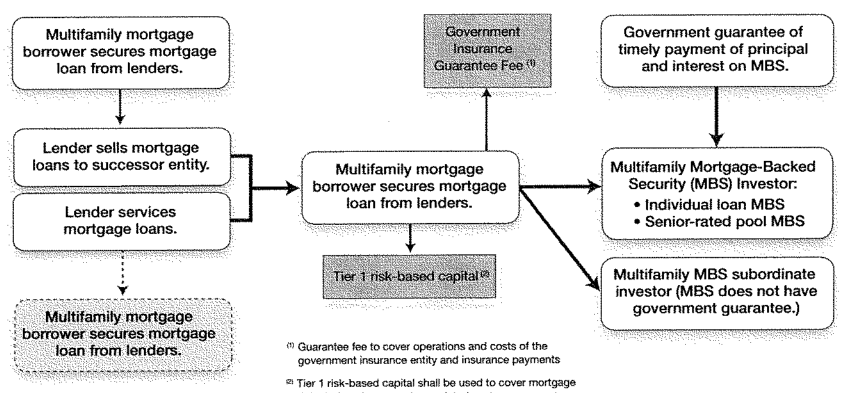
Appendix I

Proposed Successor Entity Mortgage Origination, Servicing and Securitization

The government should collect a guarantee fee on each mortgage-backed security issued by a GSE-successor entity and use those fees to pay security investors for defaults that occur in the normal course of business and to build reserves against significant losses due to structural or market failures.

As is outlined in this diagram, in the case that a GSE-successor entity experiences a loss during the normal course of business (i.e., a loss with regard to a limited number of loans), the government guarantee would compensate security investors for losses. The GSE-successor entity would then repay the government insurer for the outlay

Proposed Successor Entity Mortgage Origination, Servicing and Securitization



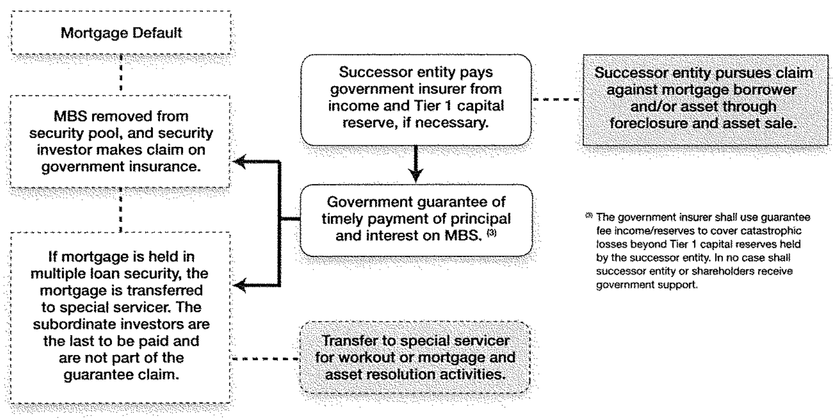
(1) Guarantee fee to cover operations and costs of the government insurance entity and insurance payments

(2) Tier 1 risk-based capital shall be used to cover mortgage default, foreclosure and associated costs necessary to reimburse the government insurer.

by looking to income and, if necessary, Tier 1 risk-based capital. Finally, the GSE-successor entity would then seek to recover its repayment by pursuing claims against the mortgage borrower or selling the underlying assets.

In the event of a failure of a GSE-successor entity, the government insurer would compensate security investors for losses. The government would seek reimbursement by seizing all capital held by the failed entity before tapping guarantee fees held in reserve. As the GSE-successor entity is wound down, the government would be entitled to any proceeds arising from the sale of mortgage real estate assets. Shareholders of the GSE-successor entity would fully lose their investment stake and be prohibited from receiving government compensation.

Mortgage Default, Guarantee Claim and Loss Mitigation Flow



(3) The government insurer shall use guarantee fee income/reserves to cover catastrophic losses beyond Tier 1 capital reserves held by the successor entity. In no case shall successor entity or shareholders receive government support.

NOTES

1. NMHC/NAA tabulations of data from the U.S. Census Bureau's 2011 Current Population Survey. *See: www.NMHC.org/goto/55508.*

2. NAA and NMHC (with data and research provided by Stephen J. Fuller), "The Makings of the Trillion Dollar Apartment Industry: How 35 Million Apartment Residents Drove a Trillion Dollar Contribution to the National Economy." February, 2013.

3. According to a report by the Office of Inspector General of the Federal Housing Finance Agency, the multifamily programs for the two Government-Sponsored Enterprises (GSE) created net profits of $7 billion through the third quarter of 2011. The assumption is additional net revenues have been earned since that time.

4. The estimate is based on NMHC/NAA tabulations of forecasts from the U.S. Census Bureau. The 2010 household formation rate of 37.8 percent was applied to the Census Bureau's high-immigration population projections from 2010 to 2020 to estimate the increase in number of households over the decade, namely 14.4 million *(see www.census.gov/population/www/projections/2009hnmsDownload.html for population projections).* A 50-50 split between the number of new owner households and new renter households was assumed for the newly formed households. The number of newly formed renter households (7.2 million) was then added to the number of existing renter-occupied households in 2010 to estimate the total number of renter-occupied households in 2020.

5. Seven million new renter households in the decade breaks down to roughly 700,000 new renter households formed annually. Overall, about 43 percent of renters live in apartments. If the same rate applies to these additional renters, that would mean 300,000 additional apartments would be needed each year.

6. New privately owned housing units started in structures with five units or more, as reported by the U.S. Census Bureau. *See: www.census.gov/construction/nrc/pdf/startsan.pdf.*

7. "Commercial Real Estate Financing Loan Maturity Volumes as of December 31, 2011," Mortgage Bankers Association.

8. In the aftermath of the S&L crisis, depository institutions' net credit to multifamily borrowers fell by $39.4 billion, while the GSEs increased their multifamily mortgage credit by $8.9 billion. Similarly, beginning in 4Q 2007 through year-end 2011 (a time period encompassing the Great Recession and the implosion of the financial markets), depository institution multifamily mortgage credit dropped by $8.5 billion, and CMBS multifamily holdings plunged by $33.2 billion. During those same years, net multifamily credit extended by the GSEs rose by $106.1 billion. Data are NMHC/NAA tabulations of data from the Federal Reserve: *(www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm).*

9. Although NMHC/NAA take no position on how an actuarially fair guarantee fee should be set, one option would be to mandate that the regulator employ the rulemaking process and require the fee be reviewed no less than once per year. Under this scenario, the regulator could issue a proposed rule adjusting the guarantee fee based on an analysis of actuarial reports prepared by (1) the regulator; (2) the restructured/successor entities; and (3) an independent consultant retained by the regulator. The public would have an opportunity to comment on the proposed rule adjusting the guarantee fee before the regulator sets the final fee.

10. Fannie Mae issues mortgage-backed, pass-through securities backed by individual multifamily mortgages through their Delegated Underwriting and Servicing (DUS)-MBS lenders and program. They also issue pool-based securities of multifamily mortgages they aggregate through their GeMS and GeMS Mega securities offerings. Freddie Mac uses a pool-based securities execution similar to private-label commercial mortgage-backed securities through its Commercial Mortgage Execution (CME) facility. Unlike the Fannie Mae execution, Freddie Mac directs a small portion of the cash flow to securities that do not have any guarantee of payment or performance and that are subordinate to the cash flow of the government-guaranteed securities. As such, the investors receive a higher interest rate return, but they are at risk of losing a portion or all of their principal and interest should there be a material mortgage default or failure.

11. According to Fannie Mae's First Quarter 2012 Form 10-Q, as of March 31, 2012, the serious delinquency rate for its multifamily guaranty program was 0.37 percent. Freddie Mac reported in its First Quarter 2012 Form 10-Q a total delinquency rate of 0.23 percent for its multifamily segment. *See: www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q12012.pdf and www.freddiemac.com/investors/er/pdf/10q_1q12.pdf.*

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Congress of the United States
Washington, DC 20515

November 7, 2012

Federal Housing Finance Agency
Office of the Director
1700 G Street NW
Washington, D.C. 20552-0003

Dear Acting Director DeMarco,

We write as members of the New York congressional delegation to express grave concern about the Federal Housing Finance Agency's recent proposal, *Federal Register* Notice [No. 2012-N-13], to increase the fee paid by home buyers in five states in order to guarantee Government Sponsored Enterprise (GSE) mortgages, also known as the G-fee. This proposal would single out New York for a very sharp G-fee increase – the largest increase among all states included in this proposal. We believe this proposal is unfair and unjustified.

Unfairly Penalizes New York for Having Strong Consumer Protections

New York has some of the strongest consumer protections in place across the country in order to provide struggling borrowers the opportunity to contest wrongful foreclosures, seek loss mitigation and stay in their homes rather than move quickly to foreclosure. These protections arose in the wake of the financial crisis and followed revelations of abuses that resulted in many wrongful foreclosures.

Unfortunately, it appears New York is being unfairly penalized for these added consumer protections. It appears that the FHFA justifies a higher G-fee by looking only at the length of the foreclosure timeline in each state, rather than overall foreclosure levels, the outcome and the benefits to homeowners, communities and investors. This rationale contradicts past FHFA policies which supported slowing the foreclosure process down to ensure struggling borrowers can pursue other options such as mortgage modification and short sales. Moreover, it can be more expensive for all parties involved to immediately pursue foreclosure rather than consider opportunities for loss mitigation. Oftentimes, if loss mitigation occurs soon after the initial delinquency phase, it can, in fact, reduce costs to the GSEs. Yet, the FHFA is penalizing New York for providing homeowners more cost-effective options to avoid foreclosure.

The Rationale behind G-Fee Increase is Deeply Flawed

In addition to unfairly penalizing New York for enforcing strong consumer protections during the foreclosure process, the FHFA's rationale behind the proposed G-fee increase appears short-sighted. While New York is a judicial foreclosure state and therefore has a longer foreclosure timeline relative to other states, the FHFA's proposal ignores the fact that it also has a lower rate of foreclosure than other states that will not face an increase in the G-fee. According to Realty Trac, 1 in 2,500 New York homes are in foreclosure compared to states like Arizona and Nevada where the numbers average roughly 1 in 350. Homes in these states are roughly seven times more likely to go into foreclosure than in New York. The proposal also ignores the fact that it was the actions of some mortgage servicers through highly publicized scandals such as robo-signing, chain of title problems, and other illegal actions, which artificially reduced the foreclosure timelines in some states. The proposal will penalize borrowers in states that provide a judicial process to settle disputes between those borrowers and their lenders.

Furthermore, we believe that instead of reflecting the characteristics of today's housing market, the proposal is based on conditions present during the financial crisis and therefore penalizes new borrowers. Over the past four years, credit quality has significantly improved and overall loan volume has decreased. With housing prices stabilizing, troubled borrowers are more likely able to sell properties in today's market than they were during the crisis when housing prices were artificially inflated. As conditions in the housing market improve, risks to the ability of GSEs to provide guarantees should continue to decline.

An Unjustified G-Fee Increase Could Hurt the Struggling Housing Industry

Finally, we believe that the proposal could have a negative impact on our recovering housing market both in New York and nationally. While recent census data reflect increases in home prices, sales and construction in the national single family housing market, we fear that this additional fee could undermine these positive trends, rather than encourage an ongoing recovery. Moreover, New York's housing market recovery is still nascent. At a time when qualified potential borrowers should be encouraged to take advantage of historically low mortgage interest rates, the proposed G-fee increase could affect monthly payments in a way that might deter new home sales.

The GSEs were created to help foster a national mortgage system, and since then, have helped create liquidity for lenders who operate across state lines. We understand that the GSEs must manage the risks associated with guaranteeing the loans they purchase. However, we do not believe that the current proposal adequately considers the full scope of risks faced by the GSEs, but rather unfairly singles out a handful of states simply because they provide strong consumer protections to borrowers. FHFA should instead work to reinforce national servicing standards and to realign incentives so that all borrowers can be assured timely and fair foreclosure proceedings.

Sincerely,

CHARLES SCHUMER
United States Senator

KIRSTEN GILLIBRAND
United States Senator

CAROLYN B. MALONEY
Member of Congress

GARY L. ACKERMAN
Member of Congress

GREGORY W. MEEKS
Member of Congress

CHARLES B. RANGEL
Member of Congress

CAROLYN MCCARTHY
Member of Congress

NYDIA M. VELAZQUEZ
Member of Congress

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Member of Congress

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Member of Congress

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Member of Congress

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March 19, 2013

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Re: The House Committee on Financial Services hearing on "Sustainable Housing Finance: An Update from the Federal Housing Finance Agency on the GSE Conservatorships"

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of Empowering and Strengthening Ohio's People (ESOP), a housing counseling and nonprofit advocacy organization representing homeowners in Ohio and across the nation, we write to you concerning today's House Committee on Financial Services hearing: "Sustainable Housing Finance: An Update from the Federal Housing Finance Agency on the GSE Conservatorships."

We thank you for holding this important hearing. The Federal Housing Finance Agency (FHFA) was created by Congress under the Housing and Economic Recovery Act. FHFA currently operates as an independent agency and is the conservator for the Federal National Mortgage Association, commonly known as "Fannie Mae," and the Federal Home Loan Mortgage Corporation, also known as "Freddie Mac." Together, FHFA controls and/owns approximately 50% of all mortgages in the U.S.

Both Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) chartered by the federal government; however they are owned by private shareholders, creating a public-private hybrid. Because FHFA currently holds a dominant presence in the U.S. housing market, its solvency is critical to the stability and security of homeowners and neighborhoods nationwide.

Since the financial crisis and collapse of the GSEs, homeowners have ben struggling to regain the value in their homes and salvage what little equity they have left. In states like Ohio, Michigan, Nevada, Florida, California and Arizona, homeowners are grossly underwater. According to Policy Matters Ohio, our state has the fourth highest number of underwater mortgages in the nation, meaning homeowners owe far more on their homes than they are worth. This underwater epidemic traps homeowners in their homes, making them unable to save for their child's college education, retirement, or live a life free of debt.

In FHFA's latest strategic plan for fiscal years 2013-2017, the FHFA sets four goals: (1) Safe and sound housing GSEs; (2) Stability, liquidity, and access in housing finance; (3) Preserving and conserving Enterprise assets, and (4) Preparing for the future housing finance in the United States.[1] However, recent decisions carried out by the acting director, Edward DeMarco, raise serious concerns about how the FHFA plans to achieves its goals.

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[1] FHFA, *Strategic Plan Fiscal Years 2013-2017: Preparing a Foundation for a More Efficient and Effective Housing Finance System* http://www.fhfa.gov/webfiles/24790/Fina%20FHFA%20Strategic%20Plan-10-9-12.pdf

Most recently, Mr. DeMarco's refusal to allow Fannie Mae and Freddie Mac to participate in principal correction programs as a loss mitigation tool is deeply troublesome. Mr. DeMarco has decided to ignore the numerous academics and policymakers who have advocated for some form of targeted principal correction program for underwater homeowners. For example, Federal Reserve Chairman Ben Bernanke stated, "principal [correction] has the potential to decrease the probability of default (and thus the deadweight costs of foreclosure) and to improve migration between labor markets." Additionally, Bernanke has gone on to say that principal correction could lower default rates, particularly for homeowners at risk of strategic default.

Fannie Mae and Freddie Mac were chartered as GSEs to provide liquidity in the mortgage market and to promote homeownership for underserved groups and locations. We know that, all else being equal, minority neighborhoods are more underwater than white neighborhoods. Therefore, FHFA's refusal to consider principal correction loan modifications has a much higher burden on minority homeowners. Under the recently reaffirmed fair housing theory of "disparate impact" discrimination, Mr. DeMarco's policy disproportionately harms minority homeowners. FHFA's own analysis showed that a principal correction program could have actually saved FHFA money. Instead it leaves minority and underserved communities drowning in negative equity, betraying a core principal of Fannie Mae and Freddie Mac's original charter, thus running counter to FHFA's strategic goal of stability and liquidity in the housing market. (See the Attached "Race, Ethnicity and Negative Equity in Lucas County, Ohio," for an example of how the fair housing discrimination issue plays out in one urban Ohio county.)

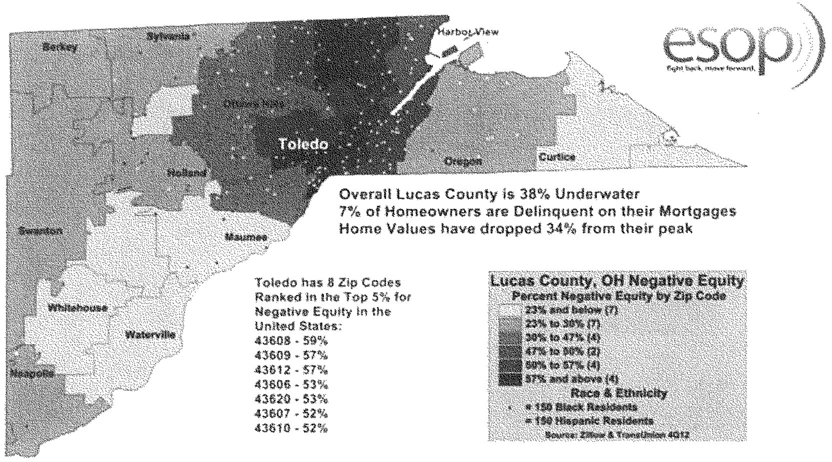
While we understand and respect differing ideologies, the FHFA is supposed to be an independent agency, one that must follow and act in the interest of the American people. Homeowners, academics and industry leaders across the nation are demanding principal correction. ESOP was also disappointed to learn that Mr. DeMarco pulled the plug on a pilot program with Citibank to implement a shared appreciation mortgage model for a select group of homeowners. Currently, Ocwen Financial is the only private sector company that provides principal correction for homeowners using a shared appreciation model. Ocwen Financial operates in 49 states, and has serviced many loans for ESOP clients. This program has ensured neighborhood stability by keeping homeowners in their homes, reducing the principal on mortgages to accurately reflect its value and provide savings for investors by keeping a current and performing loan in the portfolio.

However, Mr. DeMarco has continued to stand in the way of real relief for homeowners across the nation, thus stunting our economy's progress. When the American people bailed out the GSEs, we did so with the understanding that the GSEs would, in time, pay back the homeowners and stabilize our neighborhoods. We urge you and your committee to hold the FHFA accountable to the American people and ensure that it lives up to its mission, for the sake of our communities and homeowners across the nation.

Respectfully,

Mark Seifert
Executive Director, Empowering and Strengthening Ohio's People

Race, Ethnicity and Negative Equity in Lucas County, Ohio



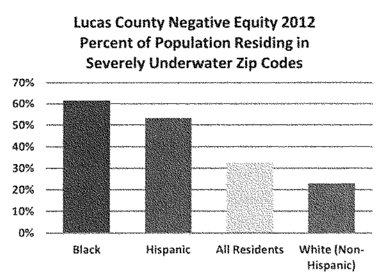
NEGATIVE EQUITY & FHFA FAIR HOUSING DISCRIMINATION

When it comes to living in neighborhoods that are deeply underwater, not everyone is created equal. In fact---as is true in most other areas of the United States---to be Black or Hispanic in Lucas County, Ohio, means that you are two to three times more likely to suffer from severe negative equity on your home than if you are non-Hispanic and white. The table below captures the stark reality of this "disparate impact" by cataloguing the demographics of Toledo's most severely underwater zip codes. All of the neighborhoods listed below are in the top 5% of postal codes nationally for their high percentage of underwater mortgages.

	Black	Hispanic	White (Non-Hispanic)	Total Population
Lucas County	83,926	26,974	313,596	441,815
43608	9,363	1,852	4,675	16,475
43604	4,984	718	2,908	8,863
43612	3,284	2,173	22,992	29,548
43620	3,994	180	1,417	5,714
43605	3,132	4,922	18,693	27,873
43607	17,679	664	7,216	26,839
43610	4,100	134	799	5,199
43609	5,039	3,720	13,319	23,133
Deeply UW Zips Totals	51,595	14,363	72,019	143,644
% Deeply UW	61.5%	53.2%	23.0%	32.5%

The map, table and graph demonstrate what drives negative equity is not borrower (mis)conduct. Negative equity is driven by race and ethnicity, and the skewed economics of "disparate impact," aggravated by institutional (FHFA-controlled) mortgage servicing discrimination.

If I am an African American homeowner in Toledo, Ohio, I am twice as likely to be living in a severely underwater neighborhood as are all Lucas County residents combined. If I am Hispanic, I am two times more likely to be living in a deeply underwater neighborhood than if I was a non-Hispanic, white homeowner. And a Black family living in Lucas County is almost three times as likely to suffer the onerous, life-limiting constraints of debt servitude, (or what we refer to in polite company as "being underwater") as a white, non-Hispanic family.



These "disequities" devolve from race, not conduct. Dubious "moral hazard" constructs notwithstanding, negative equity doesn't respect the behavior, ethics or financial savvy of a homeowner. The fact is, negative equity drowns everyone in the vicinity of a minority neighborhood because of mere segregated, adjacency. So while the blanket FHFA policy of refusing to allow mortgage principal correction appears racially "neutral," the reality is that FHFA's policy doesn't harm white, non-Hispanic homeowners nearly so often, nor as much, as it harms Black and Hispanic homeowners and neighborhoods..

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

July 30, 2013

The Honorable Keith Ellison
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20510

Dear Representative Ellison:

In response to the questions for the record that you submitted to the Federal Housing Finance Agency (FHFA) following the March 19, 2013, Committee on Financial Services hearing, I am providing the following information.

On the National Housing Trust Fund

Q. Please describe your understanding of why the Federal Housing Finance Agency is not required to contribute to the National Housing Trust Fund per the Housing and Economic Recovery Act of 2008. Please clarify when you believe that the Trust Fund can receive investments per the Housing and Economic Recovery Act of 2008.

Since the FHFA has not chosen to prioritize affordable housing investments, despite specific Congressional requirements including affordable housing goals, rural housing goals, manufactured housing goals and the Trust Fund, please explain when and how the FHFA will expand the GSEs contribution to affordable housing.

The trust funds and other requirements of the Housing and Economic Recovery Act contemplate action by FHFA in line with all conservatorship policies. The conservatorship authorities of the Act authorize extraordinary actions by the Director and any activity undertaken under normal circumstances falls within the ambit of the Director for modification, suspension or other direction in line with the conservatorship goals and obligations of the Director.

FHFA, as Conservator, has plenary authority to make all business decisions for each Enterprise, including whether to fund the Housing Trust Fund and Capital Magnet Fund set asides. Decisions of the Director as conservator not to set aside money for the funds are consistent with the obligations of the conservator to preserve and conserve enterprise assets, to protect the investments of the taxpayers and to stabilize the Enterprises and maintain their market presence.

The Enterprises are sustained only by the backstop provided by the taxpayers pursuant to the Preferred Stock Purchase Agreements with the Treasury Department. The Enterprises are required, in exchange for the backstop that keeps them out of receivership and operating as businesses, to pay to the taxpayers, through the Treasury Department, a quarterly dividend, initially computed as a percentage return on the amount invested. The dividend requirement has never changed, but because the computation of the dividend resulted in a perverse circular pattern of requiring more investment just to pay the dividend, the computation of the dividend changed. The dividend now is computed as all net worth reported quarterly. The new method of computing the dividend payment is more in line with traditional dividends— contingent on earnings and determined by the amount of earnings. It does not change the fundamental situation facing the Enterprise. Further, if an Enterprise does not have earnings or if an Enterprise suffers a loss, no dividend will be paid for that quarter and a draw on Treasury may be required.

The financial condition of the Enterprises remains uncertain. FHFA continues to consider each Enterprise's condition a matter of "critical concern." The statute governing the trust funds provides for non-payment when such a transfer would lead an Enterprise to fall within the "undercapitalized" status.

Today, both Enterprises will be "critically undercapitalized" immediately following their next dividend payments and each would be seriously insolvent without massive taxpayer investments. Their current status is well below undercapitalized, the statutory standard for suspension of payments.

Conditions requiring conservatorship have continued and the capital weakness is readily apparent by Enterprise dependency on the taxpayers to avoid liquidation through receivership. Suspension of the set asides is expressly anticipated in these circumstances and the conservator's decision not to fund the set asides is fully consistent with the Director's obligations under the law. Because of the all of the above considerations, no change in FHFA policy on the Trust Fund has been made.

On the Prohibition on Sellers

Q. At the hearing you mentioned that the FHFA has a blanket prohibition against underwater homes sold at current market values to anyone who will sell them back to the current (or previous) homeowner or their families. Is this the case even when the home has foreclosed and there is no other offer available? Please explain your reasoning. In your response to a question, you noted that there were incidences of fraud in sales to previous owners. Please detail those incidences.

Short sales are intended for borrowers who are planning to move from their homes and cannot pay off their outstanding loan balance. FHFA worked with the GSEs in 2012 to overhaul the program. The changes consolidated four existing (and often conflicting) short sales programs into a single uniform program, with the intent of making it easier and faster for borrowers to qualify. The new short sales program has a streamlined component that enables servicers to quickly and easily qualify current borrowers facing certain hardships including: death, divorce, disability, and distant employment transfer/relocation. The new program also provides a streamlined short sale approach for borrowers most in need, including those who have missed several mortgage payments and have low credit scores, by substantially reducing or eliminating the documentation required to demonstrate hardship. The program also waives the GSEs' right to pursue deficiency judgments when a borrower has income or assets, in favor of more effective financial agreements to make cash contributions or sign promissory notes.

The FHFA / GSE policy requiring "arm's-length" transactions for short sales is an industry standard. Both the Federal Housing Administration and the Home Affordable Foreclosure Alternatives program (the Administration's Making Home Affordable short sales program) require arm's-length transactions.

Arm's-length short sale requirements are intended to prevent conflicts of interest where parties collude to push down sale prices and hide better offers from the bank, investor, and guarantor in order to profit themselves.

Short sales have been vulnerable to a variety of fraudulent practices:

- Manipulating bid: Discouraging legitimate bids by putting in false offers on a property and making sure their accomplices get the property for a predetermined low bid.
- Manipulating the listing price: Overstating repair costs and/or minimizing the as-is condition to obtain an artificially low broker price opinion.
- Flipping schemes: A short sale transaction is based on falsified loan documents and title documents, then selling the property to a legitimate buyer at a higher price, often within hours of closing.
- Manipulating HUD-1 settlement statement: Altering fees and charges on the closing disclosure to conceal or obscure net proceeds.

As a result of the potential for fraud, in line with industry standards, borrowers are not permitted alternative arrangements to "sell" and repurchase their own properties to eliminate outstanding, unpaid indebtedness. Such arrangements would result in a cost to taxpayers, who are covering the losses incurred by Fannie Mae and Freddie Mac. The rules are intended to assist homeowners early in default situations and to prevent homeowners who can afford modified mortgage payments from pursuing or engaging in arrangements that allow them to extricate themselves from their financial obligations, at the expense of the US taxpayer. For borrowers who want to remain in their home, the Enterprises have developed a suite of loss mitigation tools.

On the Protecting Tenants at Foreclosure Act

Q. The Housing and Economic Recovery Act requires that any buyer of a home that was rented out must provide at least 90 days-notice prior to eviction. How have the GSEs complied with the Protecting Tenants at Foreclosure law?

Do you have any data where purchasers have not followed the law?

What did you do to ensure compliance?

The Protecting Tenants at Foreclosure Act requires *immediate successors in interest of foreclosed properties* ("Purchaser") to give bona fide, non-owner tenants at least 90 days advance notice before they are evicted from the premises. The Act prohibits a Purchaser from evicting a bona fide tenant who was occupying the foreclosure property at the time of the sale before expiration of a written lease agreement unless the Purchaser decides to occupy the property as a primary residence. If the Purchaser decides to occupy the property as a primary residence, the Purchaser must give the tenant 90 days advance notice before evicting the tenant.

For example, after the properties complete the foreclosure process and are considered REO, tenants and former borrowers are contacted by letter and attempts are made to contact them in person.

Freddie Mac's eviction attorneys will send the 90 day notice to the occupants in the first

Communication, but will also invite the tenants to notify the eviction attorney if they are a bona fide tenant with a lease under the Act. If the occupant responds after the 10 days claiming that they have a bona fide lease, the eviction process will be stopped until the lease can be assessed and, if bona fide, the tenant's lease will be honored and/or the tenant will be enrolled in Freddie Mac's REO rental initiative. Freddie Mac will not commence eviction activity until after the 91st day on tenant occupied properties.

As the immediate successor in interest, Fannie Mae's general practice is to provide at least 90 days notice of the end of the lease term and termination of the tenancy at the outset of any leasing engagement with a bona fide tenant. This ensures that all tenants have received appropriate notice under the law prior to the end of their lease term.

We do not have any data where purchasers of foreclosed properties have not followed the law. The law applies to all parties involved with a tenant, not just the Enterprises.

On Building a Private-sector Secondary Mortgage Market

Q. Your testimony noted that FHFA's first goal is to "build a new infrastructure for the secondary mortgage market."

Do you see a role for the Federal Home Loan Banks in the "building goal?" Please describe any discussions the FHFA has had with the Federal Home Loan Banks (FHLBanks) about increasing their role as a secondary mortgage market.

What does FHFA believe the impact will be of increases in capital under Basel III?

Resolving the conservatorships of Fannie Mae and Freddie Mac are central to the future of the secondary mortgage market, but the FHLBanks can and should be a part of the larger discussion of our housing finance system. The FHLBanks have long been a conduit to global capital markets and they currently provide secondary mortgage market services to their members in several ways. Through their Acquired Member Asset (AMA) programs, the FHLBanks buy whole loan mortgages directly from members and hold them in portfolio. Importantly, these programs demonstrate one approach to lender risk retention in mortgage lending and the credit performance of these loans was better than most other segments of the market the past several years. Several FHLBanks participate in the MPF Xtra program aggregating loans from originators and passing them on to Fannie Mae for securitization.

Clearly, the FHLBanks could continue playing their traditional role in supporting housing finance. And they may be able to expand upon the limited loan aggregation role they are playing today.

The FHLBank System can help preserve the option for local financial institutions to make mortgages in their communities, and hold those mortgages on the their balance sheet by developing more and innovative funding products that reduce interest rate risk to their members and that global capital markets participants would purchase.

For smaller institutions that do not want to hold mortgages on their balance sheet, the question of how will they have access to capital market investors arises. An often suggested solution is to establish some type of cooperative to meet the needs of these institutions. I would note that we already have one in the FHLBanks. The aggregation function would seem to be a clear role for the

FHLBanks in this type of approach. Much like they do with other functions, the FHLBanks would be providing a service to members, and one that would not require taking on the same amount of credit risk as in a guarantor role.

We have not made any formal estimates about the specific effect that the Basel III accords will have on the FHLBanks.

There are, however, two other aspects of Basel III that have negative implications for the FHLBanks. Basel III sets forth certain liquidity requirements. While we agree that institutions should hold sufficient high-quality liquid assets, the implementation of the Basel III "Liquidity Coverage Ratio" is problematical because it assigns FHLBank consolidated obligations to be "Level II" assets. Such assets can count to no more than 40 percent of the aggregate liquidity requirements, and Level II assets are subject to a 15 percent haircut. FHLBank obligations are among the most liquid securities in the world, they benefit from "flights to quality," and the interest rate on consolidated obligations is only slightly above that on comparable-maturity Treasury obligations.

The second aspect of the Basel III liquidity rules that adversely affect the FHLBanks deals with what a depository institution can count for liquidity. The Basel III rules give no credit to unused borrowing capacity at an FHLBank even if that depository has an approved line and pre-positioned collateral. The Basel III rules specifically exclude agreements that are contractually revocable, such as an FHLBank deciding not to extend credit because of the deterioration of the financial condition of the member. The FHLBanks added significant liquidity in the 2007-2008 crisis when their advances outstanding increased from $640 billion at June 30, 2007 to $1.011 trillion at September 30, 2008.

On Federal Home Loan Bank Corporate Governance

Q. The Housing and Economic Recovery Act ended Administration approval for the community and public interest directors. Please describe any possible effects on the diversity of the boards. Please clarify what percentage of public and community interest directors and elected directors are women, African American, Latino, Asian Pacific American, Native American and from rural areas for each Bank. Please also define geographic representation for each Bank. Please provide analysis over the past five years.

The boards of directors of the Federal Home Loan Banks ("Banks") are elected in accordance with section 7 of the Federal Home Loan Bank Act (the "Bank Act"), as amended by section 1202 of the Housing and Economic Recovery Act ("HERA"), and implementing regulations issued by FHFA at 12 C.F.R. Part 1261 (2013). In accordance with the Bank Act, each Bank's board is made up of two types of directors: (1) "member directors," who typically are officers or directors of the depository institutions that make up the majority of each Bank's membership base, and (2) "independent directors," who are unaffiliated with the Bank or its members and who must have knowledge and experience in certain areas.

At least two of the independent directors must have more than four years of experience in representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections. These directors are "public interest directors" for purposes of the Bank Act and FHFA regulations. The other independent directors must have demonstrated knowledge or experience in financial management, auditing and accounting, risk management practices, derivatives, project development, or organizational management. The HERA amendments revised the structure of the Bank boards of directors by requiring that all independent directors be elected by the member institutions.

FHFA does not require the collection or submission of information on the gender, race, or ethnicity of the individuals who make up the boards of directors of the Banks. Accordingly, FHFA does not have information on what percentage of each Bank's directors are women, African American, Latino, Asian Pacific American, or Native American. Similarly, FHFA does not have information about what percentage of directors are from rural areas. The attached list shows the states and U.S. territories within the district of each Bank.

Subsequent to the enactment of HERA, FHFA has taken the following actions to promote diversity among Bank directors:

- In 2009, the Director of FHFA sent a letter to each Bank about the annual designation of member and independent directorships for the following year. The letter encouraged the Banks' boards of directors to take into account the value of demographic diversity as they nominate independent directors and solicit nominations for member directors.
- In 2010, FHFA adopted regulations implementing Section 1116 of HERA on minority and women inclusion. The regulations set minimum requirements for the regulated entities' diversity programs and include a provision encouraging the Banks to consider the diversity of prospective candidates when considering nominees to their boards of directors.
- FHFA's Office of Minority and Women Inclusion ("OMWI") is currently engaging in a listening tour of all the Banks, one topic of which is demographic diversity within boards of directors.
- FHFA's OMWI plans to hold a conference for all FHFA regulated entities entitled *OMWI Fundamentals –Nuts and Bolts, Information Sharing and Networking*, during the week of November 18th. Board diversity will be a topic of the conference, and participants will include Bank executives and directors.

On Letters of Credit to Support Tax-exempt Non-housing Municipal Bonds

Q. The Housing and Economic Recovery Act facilitates the use of FHLBank letters of credit to support tax -exempt non housing municipal bond issuances by permitting their use without jeopardizing the tax-exempt status of the bonds. Please share information on the FHLBanks' use of credit for these purposes.

The FHLBanks issued 251 letters of credit under this authority, totaling $5.4 billion. Currently 176 of these letters of credit—totaling $3.2 billion—remain outstanding. The letters of credit have supported various projects, including educational institutions, economic development projects, health care facilities and hospitals, and infrastructure improvements. Examples include student housing at universities, hospitals, shopping centers, office buildings, nursing homes and assisted living facilities, water and sewer projects, museums and centers for the performing arts. The majority of these letters of credit were for relatively small amounts, with an average size of $21.6 million.

On High-cost Force-placed Insurance

Q. The problems with high cost force placed insurance are well known. Insurance companies provide kick-backs to servicers that stick struggling homeowners with outrageously expensive gap *homeowners insurance. What is the FHFA doing to actively put in place policies that would put an end to the worst abuses, and save money for homeowners and taxpayers alike?*

FHFA is taking a multi-pronged approach to address the issues presented by LPI (also known as force-placed insurance). The steps include:

1. FHFA has assembled a working group of federal and state regulators to discuss LPI practices and inform the development of a broad-based strategy for ensuring that the Enterprises, taxpayers, and borrowers are properly protected. The working group will meet with stakeholders - mortgage servicers, consumer advocates, insurance carriers, and insurance intermediaries - to solicit input.

2. FHFA published in the *Federal Register* a notice requesting input on the restriction of two practices – servicers' receiving sales commissions and servicers' receiving remuneration through reinsurance contracts with insurers that offer LPI. FHFA finds these practices create incentives for servicers to seek out higher-priced coverage, resulting in costs ultimately borne by the Enterprises, taxpayers, and borrowers.

3. FHFA is undertaking a special review of Fannie Mae's and Freddie Mac's framework for managing LPI claims and data collection process.

4. FHFA has directed Fannie Mae and Freddie Mac to enhance their collection of LPI data from servicers and to align their data reporting requirements for this information.

FHFA expects to have conclusions and next steps from all of these activities by the third quarter of this year.

On Community Development Financial Institutions (CDFIs)

Q. How many CDFIs have become members of the Federal Home Loan Banks? Of those, how many CDFIs took advances from the FHLBanks? What is the FHFA doing to encourage more CDFIs to gain access to lending capital by joining the Federal Home Loan Banks?

There are two categories of CDFIs certified by the Treasury Department's CDFI Fund: 1) federally insured depository CDFIs and 2) non-federally insured CDFIs. Prior to 2008, only insured depository CDFIs were eligible to become members of a Federal Home Loan Bank (FHLBank). Depository CDFIs have been well-represented in the FHLBank System. In 2008, the Housing and Economic Recovery Act (HERA) authorized non-federally insured CDFIs to also become members of an FHLBank. These newly-eligible CDFIs pursuant to HERA include community development loan funds and venture capital funds.

Following HERA, FHFA amended its membership regulation to establish appropriate membership standards for the newly-eligible CDFIs. In implementing the CDFI membership provisions of HERA, FHFA staff reached out to CDFIs and to the FHLBanks to understand their business and liquidity needs. FHFA's regulations were well-received and as of March 31, 2013, the FHLBanks reported that 15 CDFIs were members and five of the CDFIs had a combined total of $37.6 million in advances outstanding. (This report includes only those CDFIs newly eligible since HERA; other types of CDFI members, as federally insured depository institutions, are included in the counts of banks and credit unions.)

FHFA staff continues to work with the CDFI Fund and has met with CDFI stakeholders and associations to provide information and training on the FHLBank System and membership requirements for CDFIs. FHFA staff also provides guidance and interpretations to the FHLBanks on issues relating to CDFI membership.

Some FHLBanks may also support non-depository CDFIs in in other ways. For example, one FHLBank is in the process of establishing an independent loan fund, has reached out to CDFIs in designing the fund, and expects significant lending to them. Another FHLBank has established a revolving loan fund through its Affordable Housing Program that should be of value to CDFIs.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
Acting Director

Attachment

Federal Home Loan Bank System: States and Territories

Federal Home Loan Bank of Atlanta
- Alabama
- Florida
- Georgia
- Maryland
- North Carolina
- South Carolina
- Virginia
- District of Columbia

Federal Home Loan Bank of Boston
- Connecticut
- Maine
- Massachusetts
- New Hampshire
- Rhode Island
- Vermont

Federal Home Loan Bank of Chicago
- Illinois
- Wisconsin

Federal Home Loan Bank of Cincinnati
- Kentucky
- Ohio
- Tennessee

Federal Home Loan Bank of Dallas
- Arkansas
- Louisiana
- Mississippi
- New Mexico
- Texas

Federal Home Loan Bank of Des Moines
- Iowa
- Minnesota
- Missouri
- North Dakota
- South Dakota

Federal Home Loan Bank of Indianapolis
- Indiana
- Michigan

Federal Home Loan Bank of New York
- New Jersey
- New York
- Puerto Rico
- U.S. Virgin Islands

Federal Home Loan Bank of Pittsburgh
- Delaware
- Pennsylvania
- West Virginia

Federal Home Loan Bank of San Francisco
- Arizona
- California
- Nevada

Federal Home Loan Bank of Seattle
- Alaska
- Hawaii
- Idaho
- Montana
- Oregon
- Utah
- Washington
- Wyoming
- American Samoa
- Northern Mariana Islands
- Guam

Federal Home Loan Bank of Topeka
- Colorado
- Kansas
- Nebraska
- Oklahoma

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

July 22, 2013

The Honorable Ed Royce
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20510

Dear Representative Royce:

In response to the questions for the record that you submitted to the Federal Housing Finance Agency (FHFA) following the March 19, 2013, Committee on Financial Services hearing, I am providing the following information.

On Deferred Tax Assets

Q. On March 14, 2013 Fannie Mae disclosed that it would delay its 2012 earnings release, as it evaluates whether or not conditions exist that would require it to release any portion of its valuation allowance as deferred tax assets, which would have a material impact on their financial statements and could result in a significant payment to Treasury. Freddie Mac has indicated it continues to maintain its valuation allowance, and acknowledged the possibility it will need to assess a possible reduction in that allowance in the future. According to the most recent figures, Freddie Mac has a valuation allowance of $31.7B and Fannie Mae has an allowance of $61.5B.

What role, if any, is FHFA playing in Fannie Mae's decision to modify the current accounting treatment of these deferred tax assets? What actions, if any, do you plan to take with regard to this decision?

Respecting FHFA's role in Fannie Mae's deferred tax asset accounting matters, FHFA acts primarily in its role as conservator of Fannie Mae and Freddie Mac ("Enterprises"). This role is described in FHFA's 2011 Annual Report to Congress, in the section entitled "Conservatorship of the Enterprises." In pertinent part it states:

"As conservator, FHFA has the powers of the management, boards, and shareholders of the Enterprises. Although FHFA has broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations.

At the start of the conservatorships, FHFA made clear the Enterprises would be responsible for continuing normal business activities and day-to-day operations. We oversee safety and soundness as their regulator and have a more active role as conservator."

In this context, FHFA reviews and approves all critical decisions made by the Enterprises, including critical accounting decisions. FHFA expects the Enterprises to follow U.S. generally accepted accounting principles (GAAP). When reasonable people can come to different conclusions regarding the same facts and circumstances under GAAP, FHFA works with the Enterprises and their independent auditors. If needed, the SEC will be consulted in order to reach an appropriate resolution in accordance with GAAP. The deferred tax asset accounting guidance has been such an area. FHFA deems the deferred tax assets a critical matter, for several reasons. As of December 31, 2012, the deferred tax assets and the related valuation allowances were material to the financial statements for both Enterprises. Based on the current positive net income positions of the enterprises, the amount of any valuation allowance release triggers a dollar-for-dollar cash dividend to the Treasury, under the terms of the senior preferred stock purchase agreement. Additionally, from a supervisory perspective, the safety and soundness of significant decisions, such as with the DTA valuation allowance, is of keen interest and concern.

Q. If the housing market continues to improve, it will obviously increase the value of these assets; if this is the case, will there be a structure put in place to approve any future DTA claims at Fannie Mae or Freddie Mac?

FHFA continues to review the accounting policies, operating procedures and the financial reporting controls related to the deferred tax asset. We have required improvements where necessary. The criteria for assessing the DTA are founded upon the accounting standards issued by the Financial Accounting Standards Board, which in turn form the basis for formulation of the detailed tax accounting policies of the Enterprises. The applicable standard is Accounting Standards Codification (ASC) 740 (formerly known as "Statement 109: Accounting for Income Taxes"). On a quarterly basis, the enterprises update the determination regarding whether a deferred tax asset valuation allowance is needed. This determination is based upon an evaluation of the facts and circumstances of the quarter which have a bearing upon the future realizability of the deferred tax assets. Principally, the determination of the continued need for the valuation allowance rests upon whether it is deemed more likely than not sufficient taxable income will be earned by the enterprise, to realize its deferred tax assets. This is a facts and circumstances intensive determination, involving the weighing of all available evidence, positive and negative. There are several stakeholders involved in this process including: the executive managements of the enterprises and their boards, the external public accounting firms, several offices within FHFA including the Division of Enterprise Regulation, and the US Securities and Exchange Commission.

The culmination of the quarterly financial accounting process, including the deferred tax assets, is the review and acknowledgment by the Director of FHFA, on the filings with the US Securities and Exchange Commission. The acknowledgement is delivered in the form of a letter to each Enterprise from the Director, wherein the Director affirms to each Enterprise that: "... to FHFA's knowledge, and without independent investigation, FHFA did not identify any untrue statements of material facts or omissions of material facts that would be necessary to make the Form 10-Q (or the annual Form 10-K) and press release not misleading. This includes review of representations regarding the conservatorship's operations and activities." This letter provides comfort to the Enterprises that, for example, there are no imminent governmental policies to be announced which the Enterprises should have taken into account, when they made their critical accounting estimates, including the deferred tax asset valuation allowance.

For the 4th quarter 2012, Fannie Mae and Freddie Mac concluded, and FHFA concurred, that there should be no release of the deferred tax asset valuation allowance. At that time, because Fannie Mae's facts and circumstances appeared to be evolving towards a conclusion that release may soon be appropriate, and given the magnitude of the financial reporting effects at hand, the US Securities and Exchange Commission was consulted. Release in the first quarter of 2013 was expected to depend upon a continuation of the current strongly profitable trend and the fact that release in the first quarter would not diminish the amount of potential financial support from the US Treasury. As these expectations were subsequently realized, the valuation allowance was released by Fannie Mae in the first quarter of 2013. In contrast, as of March 31, 2013, Freddie Mac determined that the negative evidence supporting maintaining a valuation allowance outweighed the positive evidence supporting a release of the valuation allowance and, as a result, concluded that at March 31, 2013, it was not yet more likely than not that it will be able to realize its net deferred tax assets. Therefore, Freddie Mac continues to record its valuation allowance. The SEC was also consulted and did not object to the accounting treatment. The SEC will be consulted further in future quarters, if necessary.

Q. Are you concerned that a decision with regards to DTAs could have an impact on the ability to 'contract' the GSEs and reduce their market presence?

Future governmental actions regarding the Enterprises' business model that wind down operations in a manner that calls into question the future realizability of the remaining deferred tax assets would potentially require Fannie Mae to re-establish its deferred tax asset valuation allowance. Freddie Mac would be affected in a similar manner, should their valuation allowance on the deferred tax asset have been released beforehand. Any government action that provides for a systematic wind down over time, which would not cause significant changes to future expected earnings, should not have a material effect on the deferred tax asset.

On the Periodic Commitment Fee

Q. Under the original Preferred Stock Purchase Agreements, the GSEs were supposed to pay a quarterly periodic commitment fee. However, Treasury never set a level for the fee and has continually waived it each quarter, stating it would cause undue stress. The 2012 Amendments to the PSPAs retains the fee, but suspend it indefinitely in lieu of the quarterly sweeps of net worth.

A report released by the FHFA Inspector General on March 20, 2013 appears to conclude that the newly instituted quarterly sweep of net worth at the GSEs obviates the need for the periodic *commitment fee. Is this your view? Is it appropriate for Treasury to continue its practice of waiving this fee?*

In the absence of adverse conditions in the U.S. mortgage market, shouldn't this fee be applied pursuant to the Preferred Stock Purchase Agreement? As conservator, do you have any concerns if Treasury made the decision to apply this fee?

The Periodic Commitment Fee included in the Senior Preferred Stock Purchase Agreements (PSPAs) was intended to fully compensate the Treasury Department for the financial support provided under the Agreements. The change in dividends in the 2012 PSPA amendments to a net worth sweep does obviate the need for the Periodic Commitment Fee, as charging an additional fee above the net worth sweep would generally require Fannie Mae and Freddie Mac to borrow from Treasury to pay the fee.

On the California Structural Pest Control Inquiry

Q. Have you responded to the November 28, 2012 letter from Curtis Good, President of the California Structural Pest Control Board, expressing concern about Freddie Mac's policy precluding termite vendors from performing termite damage repair work?

Specifically, the letter asks if Freddie Mac's HomeSteps program prevents plumbing, heating and air conditioning contractors that perform inspections of plumbing, heating or air conditioning systems from selling replacement systems to consumers.

Could you please comment on this policy and the impact to consumers?

Freddie Mac's HomeSteps program termite policy has been in effect since the 1990s. The policy reduces Freddie Mac's costs associated with maintaining its REO properties, thereby benefiting taxpayers who are supporting Freddie Mac. The reason for the process is repair contractors are able to complete termite repairs at a noticeably less expense than termite companies.

The driving force behind the policy is to manage expenses associated with the repair of termite damage. Consumer complaints were not a factor in this instance, as the consumer is not impacted by maintenance and repair expenses associated with properties that are owned by Freddie Mac. Instead, the policy is driven by efforts to control costs.

The policy has no material effect on consumers. Consumers are not impacted by REO repair costs. The policy reduces costs to Freddie Mac and taxpayers.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
Acting Director