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Sean Dobson / scobson@amherst.com / 512.342.3030

Testimony of Sean Dobson, CEO, Amherst Securities Group
before the
Subcommittee on Capital Markets and Government Sponsored Enterprises
of the
House of Representatives Committee on Financial Services
“An Examination of the Federal Housing Finance Agency’s Real Estate Owned (REO)
Pilot Program”

Mr. Chairman and Members of the Subcommittee, thank you for your invitation to testify today. My name is Sean Dobson, and I am the CEO of Amherst Holdings. Amherst Holdings consists of several enterprises all of which support single family housing finance in one way or another. Amherst Securities Group LP is a leading broker/dealer specializing in the trading of residential and commercial mortgage-backed securities; Amherst Advisory is an advisory and asset management platform managing funds invested in mortgages and Main Street Renewal is an entity we established to invest in single family rental properties. Across these platforms, Amherst tracks the housing and mortgage markets at the asset level. This includes monitoring monthly performance on over 40 million active mortgages and real estate transactions on over 80% of the taxable parcels in the United States.

My partners and I have been a part of the housing finance infrastructure of the U.S. for over 25 years. I want to point out that although we are a dedicated real estate finance platform, Amherst demurred on the opportunity to originate and underwrite of subprime, "alt-a", pay option mortgages and their highly-leveraged and over rated RMBS and CDO progeny that created the financial crises we are still living through today.

I am here to discuss our view of the U.S. housing markets and how we view the costs and benefits of properly managed bulk sale transactions. Since this topic can get pretty dry, I'll jump right to the bottom line. Last year over 1 million homes were lost to foreclosure; these homes were liquidated through a legacy process targeted to owner occupant buyers. Unfortunately, the bursting of the housing bubble and subsequent retraction of credit availability left very few qualified prospective owner occupant buyers. As is to be expected, these conditions mean that the majority of foreclosed homes are already being sold to investors¹. The current process has forced prices to generational lows and has housing caught in a reflexive downward spiral. Lower home prices are causing more mortgage defaults, which cause more distressed sales, which in turn lower prices, starting the cycle over again. Although recent headlines have been less negative, we should all be concerned about the 6-9 million unit backlog of unresolved and impaired mortgages. A disorderly liquidation of the distressed REO inventory will further undermine consumer confidence and presents a threat to the nascent recovery in the overall economy.

¹ Please see Exhibit 1



We believe that a well designed bulk sales program will have little upfront costs and can diffuse much of these macro risks while also alleviating the burden that abandoned and non-performing REO is having on communities and existing home owners currently making their mortgage payments. I would like to start to talk about these benefits from the ground up and then estimate the upfront costs.

Current occupants can be saved - As you likely know, the GSEs currently own thousands of homes that are "tenant occupied." In these cases, a borrower defaulted on a mortgage after leasing the property to a family. If these homes are liquidated via the current process, (one at a time), the leases will not be renewed, the families will be asked to move and the home will be sold, primarily to investors. The FNMA pilot programs for bulk sales are these tenant occupied homes. If a long term investor purchases these homes through a bulk sale, many of the tenants will be able to stay in place. By simply short circuiting the process we accomplish simple things -- children stay in their schools, neighborhoods are maintained and lives are not disrupted. At Amherst, we purchased the only auction of these types of homes ever conducted by Fannie Mae. We were able to maintain one-half of the occupants in their residence. If a successful market for occupied homes is established, this type of benefit could also accrue to owner occupants nearing foreclosure. Servicers should be financially incented to keep the home occupied and cash flowing as they would recover a higher price upon sale of the property.

Rental inflation can be minimized - Another first order benefit of a bulk disposition program is the increase in the speed at which housing is released back into the market. Due to the tightness of mortgage credit and the large number of families being displaced by foreclosures, apartment vacancies are falling and rents are rising sharply. Even with the anemic recovery in jobs, rents are rising and vacancies are below pre-crises levels². The current drawn out foreclosure process is keeping millions of housing units off the market, and is causing renting families to suffer rent inflation. It is also worth noting that this uptick in rental performance has increased multi-family unit construction, which is resulting in the banking system and the GSEs increasing their exposure to this asset class while millions of single-family housing units sit in disrepair awaiting a resolution. This is potentially a misallocation of capital that could haunt us later.

Home prices can be increased - Beyond these first order benefits we think a series of bulk sales will have a direct and positive impact on home prices. Currently, the investor base purchasing homes is highly fragmented and, as a consequence, experiences a high cost of capital relative to the overall market. While these investors should be commended for responding to the crisis by deploying private sector capital and resources to this sector, they have not been able to move home prices upward even as housing prices are at a generational low relative to affordability or rental value. As a comparison, the median apartment in the U.S. that rents for \$1,200 per month has a market value of \$162,000 while a home that rents for the same amount sells for closer to \$120,000, a 35% discount. In a healthy housing market, that price relationship is usually reversed. The causes for the discount are several, but our belief is that the primary villain is the lack of an efficient capital transfer mechanism for the asset. In other words, investment housing is a cottage industry and has very little access to equity or debt capital.

Single family property investors are generally very small operations and only own around three homes. The largest platforms we have encountered only own 1,000 units or so. This, of course, limits operational efficiency and increases the all-in cost of capital for single family investors. In contrast, the top ten public apartment REITs own, on average, 55,000 units. Therefore, the key to decreasing capital cost and thereby increasing home prices back towards some semblance of fair value is standardizing the single family leasing industry and creating a smooth capital transfer mechanism.

² Please see Exhibit 2



We have been investing in homes with this in mind for over two years, and believe, without question, operating in scale can be done safely. The largest hurdle to achieve this scale is the acquisition process. Foreclosure auctions are open outcry for single transactions and the realtor - servicer process is simply too clumsy. This asset class needs to attract hundreds of billions of dollars; there simply is not enough time for investors to negotiate hundreds of thousands of purchases one at a time.

The concept of housing as a threat to the economy can be arrested - The depths of the mortgage problems can be measured in several ways. The nation's REO inventory sits at around 400,000 units, yet this is but the tip of the proverbial iceberg³. Our data shows over 3.3 million mortgages, with underlying real estate valued around \$430 billion, have not received a payment in over twelve consecutive months. Behind that mountain of real estate lies another 6+ million units that are either delinquent or are so deeply credit impaired that they are hanging by a thread. When you contrast these horrific numbers to the 85,000 units of REO being sold each quarter for approximately \$11 billion dollars, I hope you see why we are concerned. Either the pace of liquidation has to increase, which under the current model could drive home prices even lower, or this back log will stand as a threat to the economy for at least another four years.

Because of the Fannie Mae pilot programs, we and others have embarked on building the appropriate platforms to shepherd the necessary capital to the market. This is a meaningful event because a simple way for equity capital to find its way to housing does not exist currently. The work we and others are doing could very well change the conversation around housing and create a back stop for home prices. With large credible buyers entering the market, the fear of the supply/demand imbalance should abate. Institutional investors creating a "credible threat" of higher home prices could serve to move potential home buyers off the side lines.

As it sits today, with a negative national dialogue around housing, there is little impetus for buyers to act. We believe that home building, real estate transactions, property improvement investment and all of the industries associated with housing are paused, waiting for a signal that a disorderly liquidation of the foreclosure backlog will not destroy asset values. *The nation needs to build sustainable demand in a large and credible way.* Without a reasonable expectation of a streamlined acquisition process, investors, like us, will not take the risk in building out this large national infrastructure and the benefit of a "credible threat" would not be realized by the housing markets. It is worth adding that without this infrastructure to pass capital from the markets to housing, the Federal Reserve's dramatic monetary policy efforts are pretty much in vain. It does not matter how low bond rates go or how many mortgages the Federal Reserve buys, the credit and capital transmission system will remain broken, or non-existent, unless it is repaired.

It is worth noting that converting a large portion of the distressed inventory to performing assets is a natural stimulant to the local and national economies. Property repair and renovation is done with local labor, occupant services are managed by local companies. Property owners are incentivized to keep the home in desirable condition to compete in the rental markets. As these investments are made, and neighborhoods are repopulated, confidence builds. This will likely attract more capital and lift asset prices. Kicking off this type of a virtuous cycle is what the housing market needs.

By now you must be saying, that bulk sales are the gift we've been waiting for.

1. Less trauma to current occupant families
2. More affordable housing supply

³ Please see Exhibit 3



3. Higher home prices
4. A reduction of REO and non-performing loans

But, there must be a catch. How much will it cost the taxpayer?

It may not cost anything – There is significant discussion about the level of price discount required to attract bulk buyers. We have heard discussions indicating that the current process achieves a sale price of around 94% of “value” and a bulk investor might not pay as much. We think the idea of single asset sales as the best execution is sound in that it tries to find an owner occupant buyer who by definition should pay the highest price for the home. The problem is that this is working, at best, half the time. Additionally, the process can get caught in a logic loop. For example, let’s say you were an REO seller and wanted to price your inventory relative to recent sales. If you looked at last month’s transactions and decided your home should sell for \$100,000 you might be happy to take \$94,000 as it is a very small discount. Of course, you are not the only REO seller and when you repeat the process next month you see that everyone also sold for \$94,000. This month when you compare comps, naturally you get \$94,000 as fair value. If you then sell for a 6% discount, you get \$88,000. You still only took a 6% discount, but at this pace home prices are seemingly falling at a 70% per annum rate! It is this process that has allowed home prices to fall to generational lows.

Another important set of facts to understand are the costs associated with a single asset sales process. The table below is our estimate of the direct expenses related to a single asset transaction. Commissions, repair costs, taxes and insurance can easily run 20% of asset price. These direct expenses do not begin to account for the comprehensive platforms the GSEs have been required to establish to manage the home from the point of foreclosure, through the rehabilitation process and on to the sales transaction. This management infrastructure is necessarily substantial. Therefore, a sale taking place at an earlier phase of the process can achieve a lower gross price of 20%-30% and can create an equal or higher net price for the REO seller.

Home Value	\$ 150,000	
Sales Price	\$ 141,000	94% of Value
Commission	\$ (8,460)	6% of Sales Price
Closing Costs	\$ (3,525)	2.5% of Sales Price
Repairs	\$ (7,000)	Average
Property Taxes	\$ (1,500)	6 months @ 2% per annum
Insurance	\$ (1,350)	6 months @ 90bps per annum
Costs	\$ (21,835)	
Net Proceeds	\$ 119,165	
Gross Recovery as % of "Value"	79.4%	Pre-administrative overheads

Over time, we do not believe that a bulk discount will prevail. After the first \$10-\$20 billion in sales, we believe capital will become more available and prices will rise. Even if the net proceeds from the first \$20 billion were 5% less than single asset sales, they could drive the price of the next \$400 billion in sales



much higher. While there may be some small costs to priming the pump, we believe these costs are minimal when compared to the larger picture.

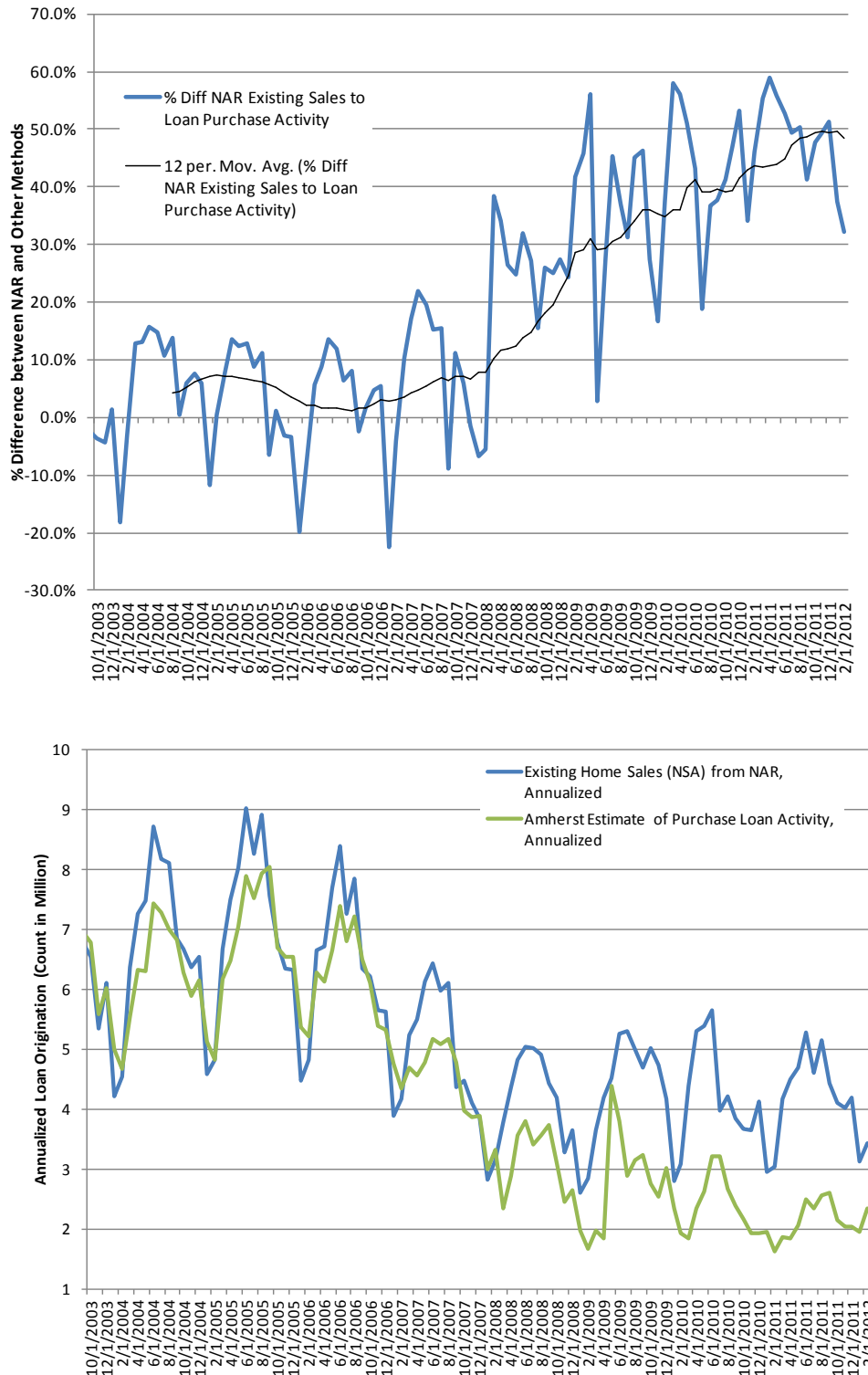
I want to be clear that given the current investor base, the GSEs are finding the best execution. The idea of bulk selling is meant to bring a new buyer to the market; one with a long investment horizon, properly priced capital and a reduced friction operating platform with scale pricing. The potential for bulk sales motivates these investors to get organized and allows monetary policy to actually reach the target assets.

No matter what your position is in this debate, it is hard to argue that the status quo is acceptable. The backlog of unresolved defaulted mortgages hangs as a pall over the U.S. economy. The lack of credit, lack of confidence and the continual threat of a tsunami of distressed sales have conspired to undermine housing and prevent the sectors normal contribution to overall economic activity and job growth.

Thank you for the opportunity to testify. I look forward to any follow up you may have.



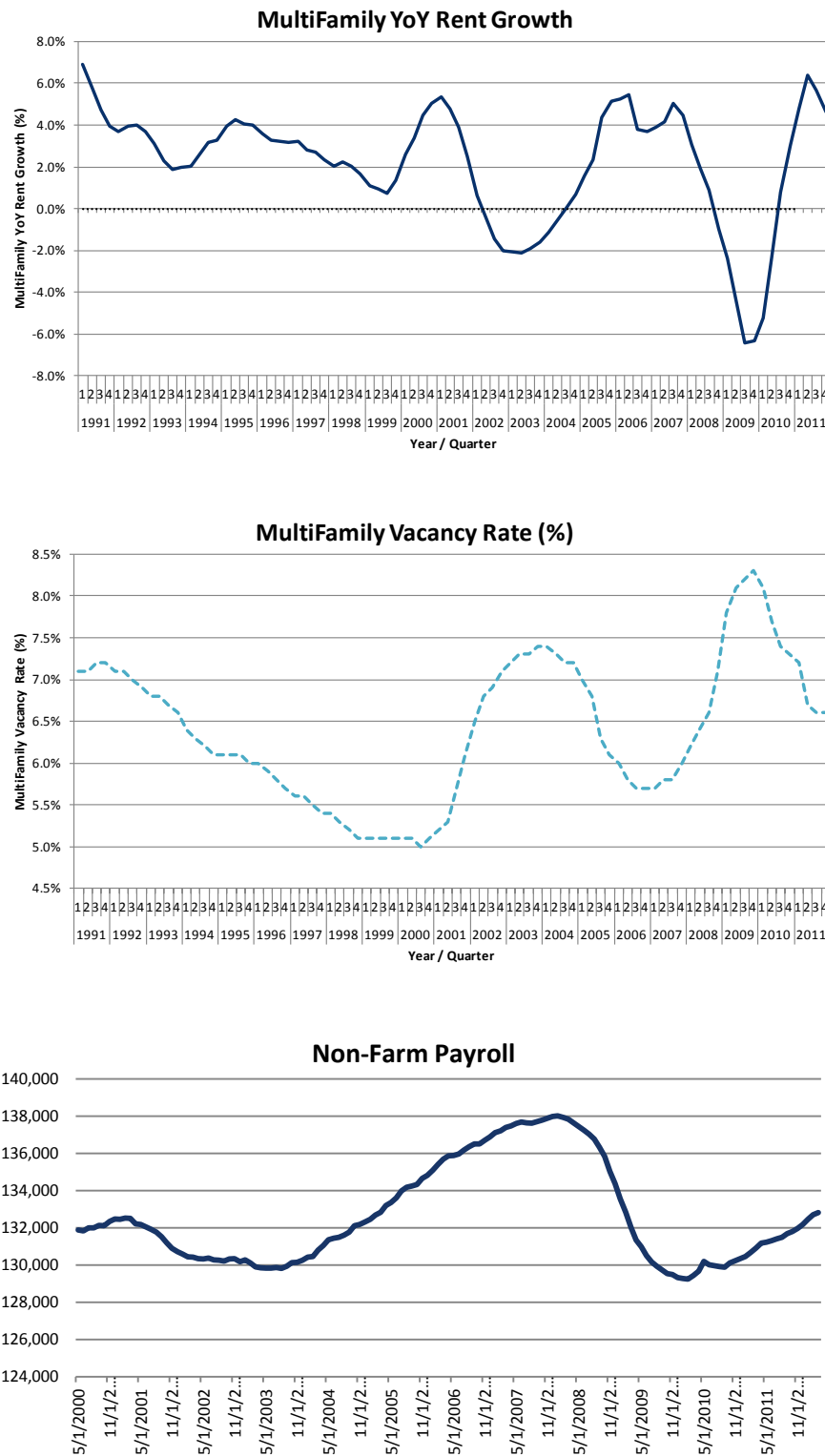
Exhibit 1: The Majority of Foreclosed Homes are Already Being Sold to Investors



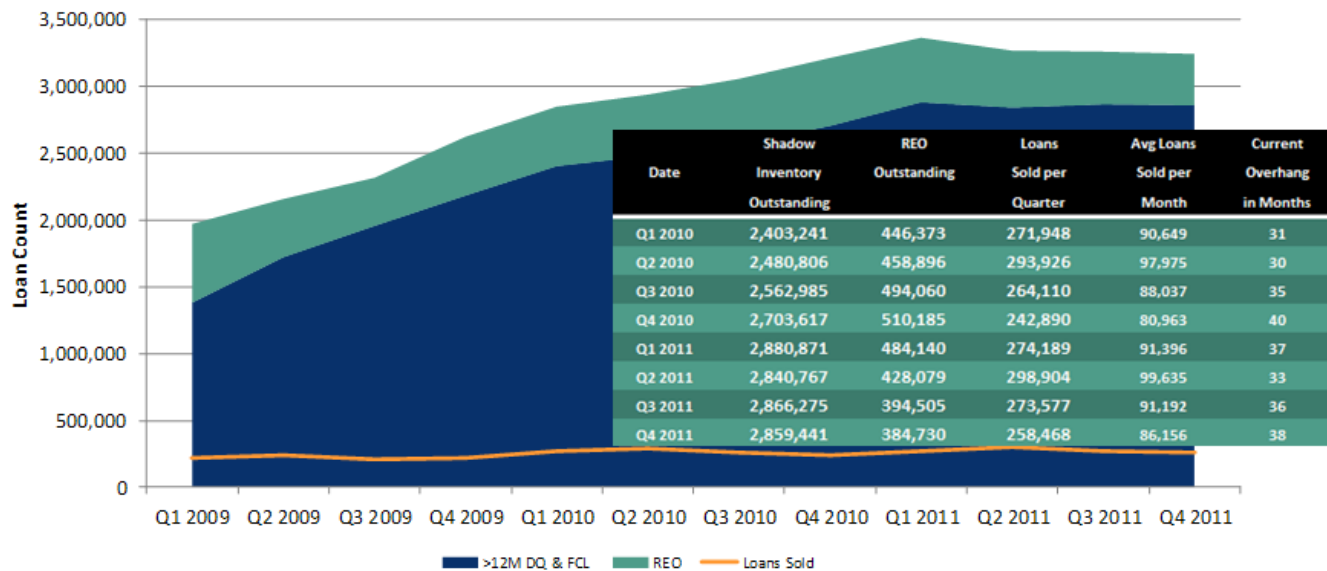
Source: CoreLogic, 1010Data, Amherst Securities as of Feb 2012



Exhibit 2: Even with Anemic Recovery in Jobs, Rents are Rising and Vacancies are Below Pre-Crisis Levels



Source: US Census, PPR, Amherst Securities

**Exhibit 3: The Depths of the Mortgage Problem**

- Despite Liquidations averaging 90k per month, since January 2009 the balance of the Shadow Inventory (loans greater than 12 months DQ, loans in foreclosure and REO properties) has increased by an average of 60k each month
- These figures DO NOT include any contribution from borrowers less than 12 months DQ, who have a very substantial chance of entering the Shadow Inventory over the next year, or re-performing borrowers, who have a reasonable chance of becoming delinquent again over the near term
- Current Overhang = (Shadow Inventory Outstanding + REO Outstanding) divided by Average Loans Sold Per Month

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, FDIC, Fannie Mae, Freddie Mac, FHA, 1010Data, Amherst Securities