U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410

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"Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs"

Hearing before the House Financial Services Committee's Subcommittee on Insurance, Housing, and Community Opportunity
Wednesday, March 2, 2011

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Department of Housing and Urban Development's efforts as part of the Obama Administration's work to stem the Nation's foreclosure crisis. The Federal Housing Administration, HUD and the entire Administration are committed to ensuring that the government continues to facilitate the recovery of the housing market.

Today, I want to discuss two HUD programs, the FHA Refinance Option and the Emergency Homeowners Loan Program and their contributions to these overall efforts.

Administration Efforts to Stabilize the Housing Market

Madam Chairwoman, this Administration quickly took several steps to confront the economic crisis as soon as taking office two years ago, including steps to stabilize a housing market that was declining rapidly with seemingly no bottom.

House prices were in freefall -- having fallen every month for 20 straight months before President Obama took office. Home equity had been slashed in half—losing $6 trillion total—which wiped out wealth for many families. And we were losing an average of 753,000 jobs a month and were in the middle of 22 straight months of job losses.

With the market collapsing and private capital in retreat, the Administration had no choice but to take action.

Federal Reserve and Treasury Department mortgage-backed securities purchase programs helped keep mortgage interest rates at record lows. To ensure mortgages were available at those low rates, the Administration also provided critical support for Fannie Mae and Freddie Mac, while the FHA and Ginnie Mae stepped in to play a larger role in the home purchase market and enabled a robust refinancing market to emerge. As reported in the Obama Administration's January Housing Scorecard[1], since April 2009, nearly 10 million homeowners have been able to refinance their mortgages to benefit from lower interest rates, saving them an average of $140 per month or $17.6 billion annually.

And collectively, the FHA's loss mitigation policies and the Administration's Home Affordable Modification Program (HAMP) set an example for mortgage modification efforts that the private market took too long to adopt but has finally begun to incorporate into their servicing practices. More than 4.1 million distressed borrowers have received mortgage assistance since April 2009—including HAMP modifications, FHA loss mitigation activities, and voluntary private efforts as part of the HOPE NOW alliance—more than twice the number of foreclosures completed during that time. Monthly foreclosure starts are down more than 30,000 per month from this same time one year ago. While the sharp decline may be partially attributed to servicer process reviews in light of foreclosure processing deficiencies, and this number may trend upwards as servicers revise and resubmit foreclosure paperwork in coming months, we are seeing encouraging signs that fewer families are entering delinquency in the first place. And most importantly, the Administration's broader economic policies have produced 14 straight months of job growth in the private sector.

Independent economists, including Mark Zandi of Moody's Analytics have indicated that these combined government efforts, while not sufficient on their own to enable the market to fully recover, were appropriate policy actions to help stem the vicious cycle of steadily declining house prices leading to escalating loan defaults. Furthermore, as recently as this month, Zandi has stated that due to the "better job market and house prices that are closer to their equilibrium values… any further price declines [could be forestalled through] an additional 500,000 solid modifications (preferably principal writedowns) over the coming year."

I would like to take this opportunity to discuss how the FHA Short Refinance Option and the Emergency Homeowners Loan Program, in conjunction with HAMP and other modification efforts, are responsible efforts that have the potential to further stabilize the housing market and keep homeowners out of foreclosure.

Keeping Families in their Homes, Spurring Economic Recovery

The lingering effects of the most severe economic downturn since the Great Depression have had devastating impacts on the Nation's homeowners. But the economic environment is very different today from when the Administration took office. Where the challenge then was increasing defaults and foreclosures due to risky loans, today it is the ripple effects of those bad loans on our communities and our economy. In particular, job losses and price drops have meant that we see foreclosures and defaults in prime loans as well. And while unemployment rates

[1] The Obama Administration Housing Scorecard is posted monthly at http://portal.hud.gov/hudportal/HUD?src=/initiatives/Housing_Scorecard

have seen a decline, today two of the biggest threats to our housing recovery remain unemployment and underwater borrowers.

As a result, foreclosures are increasingly being driven by homeowners who find themselves unemployed or underemployed and can no longer make payments that were once affordable. Many more have, through no fault of their own, experienced declines in their income, inching them closer to foreclosure. And making matters worse, these borrowers often can't move to find a new job because they can't sell their homes due to owing more on their house than it is worth.

In light of these issues, which are of importance not only to our housing market but our broader economy, this Administration and Congress have taken steps to maintain stable, affordable housing for millions of homeowners.

In March 2010, the Federal Housing Administration announced the FHA Refinance Option to assist non-FHA borrowers to refinance their underwater mortgage into a sustainable fixed rate, FHA-insured mortgage by providing an additional opportunity for lenders to voluntarily offer principal writedowns and restructure loans for some families who owe more than their home is worth.

Then, in July 2010, as part of the Dodd-Frank Wall Street Reform Act, Congress provided HUD authority and funds to assist unemployed and underemployed homeowners struggling to make their mortgage payments via the Emergency Homeowners Relief Fund.

The Challenge of Underwater Homeowners and the Potential for Principal Writedowns to Help Stabilize the Market

An estimated 11 to 15 million mortgages, or approximately one-fourth of outstanding mortgages, are for amounts that exceed the value of the underlying home. However, it is important to put this number into context as this includes owner-occupied homes as well as mortgages on second homes and investment properties. While it is difficult to estimate the precise percentage of underwater mortgages that are on owner-occupied homes, it is important to note that the Administration's efforts are specifically targeted to assisting borrowers to remain in their primary residence.

Many such homeowners now find themselves owing more on their home than its current market value. Many of these homeowners are underwater due to sharp price declines in their local housing markets due to no fault of their own – some happened to buy at the peak of the boom, while others have suffered from the impact of foreclosures on properties in their neighborhoods. In many cases, neighbors lost their jobs or suffered other types of financial distress, leading to resale at much lower prices, sharply lowering the market value of the other homes in the neighborhood. Underwater homeowners are often facing unaffordable monthly payments, putting them at an increased risk of default, which would lead to further destabilization of the housing market and the local economy. Facilitating principal writedowns for homeowners who are now in mortgages that place them dangerously close to default will enable them to restructure their debt, refinancing into more sustainable loans. By lowering their risk of default, these efforts will also improve prospects for their neighbors by lowering the likelihood that the local housing market will suffer from more foreclosures.

It is also important to note that the majority of underwater homeowners are still current on their mortgage. While many underwater borrowers are at imminent risk of foreclosure, the majority of underwater borrowers are still making their monthly mortgage payments.

FHA is well aware of the potential for moral hazard in principal reduction. That is why we carefully designed the guidelines of the FHA Short Refinance Option to discourage borrowers from purposefully becoming delinquent on their loan, otherwise known as strategically defaulting, solely to receive a principal writedown. To this end, borrowers are required to be current on their existing loan to be eligible to refinance into a FHA-insured mortgage.

Principal writedowns can be difficult to implement due to the multiple entities that must be coordinated, including investors, servicers, originators, and the borrower. Despite this difficulty, they have been shown to be an attractive option that can be both more sustainable for the borrower and fair for the investor.

FHA Short Refinance Option

The FHA Short Refinance Option offers a cost effective approach to assisting underwater borrowers and divides theses costs are between the private sector and the federal government. It seeks to realign property values and mortgage obligations resulting in sustainable long term homeownership.

FHA underwriting requirements are utilized and the program is voluntary for servicers. Therefore, not all underwater borrowers who qualify may be able to participate in the program.

The existing first lien holder must write off at least 10 percent of the unpaid principal balance. Then, borrowers are able to refinance an underwater, non-FHA-insured mortgage into an FHA-insured mortgage at 97.75% of the home's value. Non-extinguished existing subordinate mortgages must be re-subordinated and the new loan may not have a combined loan-to-value (CLTV) ratio greater than 115 percent. By moving borrowers to 115 percent or below, the program will strengthen the borrowers' position. Many first-lien investors and analysts of loan defaults have shown that providing principal writedowns for loans that are more than 20% underwater significantly improves loan performance and reduces the likelihood for those loans to default. As a result, the cost of providing the principal writedown, which is borne by the private sector, is lower than the eventual loss if the loan were to default and the home go to foreclosure. The FHA refinance option provides a vehicle for many investors and lenders to reduce their expected losses while also providing responsible borrowers with meaningful debt relief and better enabling them to afford to remain in their home.

The new loan must conform to FHA's underwriting requirements, so performance would likely fall within acceptable risk thresholds for FHA. That being said, there is reasonable concern that there may be a performance differential – these loans may perform worse than refinanced loans that were not previously underwater. As such, loans that conform to all guidelines of the FHA refinance option will be counted separately towards lender performance monitoring through Credit Watch – the system by which FHA suspends or terminates lenders for high default rates. Originating these loans will not hinder a servicer's ability to pursue other lines of business, mitigating a potential barrier to servicers' and investors' willingness to offer principal writedowns to borrowers.

Of the $11 billion of TARP funds allocated to support the FHA refinance option, up to $8 billion will be made available to provide coverage to lenders for a share of potential losses on these loans, mitigating detrimental impacts to FHA's capital reserve as a result of facilitating the private sector to provide principal writedowns to underwater borrowers in conjunction with these refinancings. No TARP funds will go to the FHA itself for any loans.

Cancelling the program prematurely could cost the taxpayer in two ways, without providing any benefits to homeowners. First, the letter of credit to enable the loss share coverage would have to be terminated and is subject to cancellation fees. Secondly, the cancellation of the loss share agreement would mean that FHA could no longer support new guarantees under this program, as it is contingent on TARP loss sharing to mitigate FHA's MMI fund exposure to risk.

Utilization Status of the FHA Short Refinance Option

FHA Short Refinance Option first became available on September 7, 2010. As of February 11, 2011, 23 FHA approved lenders are participating in this program and 245 FHA case numbers have been requested, of which 44 loans have been endorsed. In addition, 17 lenders including the major second lien holders have executed Service Participation Agreement with Treasury to receive incentive payments for extinguishment under FHA 2LP. The chart below lists the average information for the loans endorsed to date.

FHA Short Refinance – Average Loan Profile	
Appraised Value	$285,403
Unpaid Principal Balance - 1st lien	$308,982
Write off	$77,546
FHA Insured Loan	$248,415
Loan-to-Value	91.41%
Qualifying Ratios to Income (mortgage payment / total debt)	25.28/40.92
Credit Score	711

Although the number of loans endorsed to date is relatively low, the offering has only been available for a few months while systems and operational infrastructure must often be developed to utilize this option, in addition to the significant coordination required throughout the mortgage chain. Lenders and/or investors select the loans to be refinanced. Borrowers have to agree to apply for a new loan and submit full documentation requirements. Lenders and/or investors have to agree to provide the principal write off. Servicers have to agree to cooperate with the lender, investor, and borrower. And originators have to agree to provide a new loan.

Wells Fargo and GMAC/Ally both recently announced publicly that they will soon begin pilots with a select population of their loans held on portfolio. Based on additional discussions, several more lenders are in the process of developing the capability to utilize the FHA Short Refinance option by midyear and intend to collectively assist several thousand more homeowners.

Economic Rationale

Under FHA's Short Refinance Option, the borrowers' average credit score was 711. This credit score indicates that the borrowers are not irresponsible, but rather are borrowers with loans whose investors believe principal write down is a valuable option for both the borrower and the investor.

Many analysts have identified a strong correlation between loan-to-value ratios of homeowners and the likelihood that they will default. In many cases, providing a principal writedown to a borrower is more economically rational for an investor or lender than not doing so, as lenders lose significant value when a home goes to foreclosure. Many first-lien investors and analysts of loan defaults have shown that providing principal writedowns for loans that are more than 20% underwater significantly improves loan performance and reduces the potential for those loans to default. As a result, the cost of providing the principal writedown, which is borne by the private sector, is lower than the eventual loss if the loan were to default and the home go to foreclosure. The FHA refinance option provides a vehicle for many investors and lenders to reduce their expected losses while also providing responsible borrowers with meaningful debt relief and better enabling them to afford to remain in their home.

The FHA refinance option is voluntary and both homeowners and investors must agree to the transaction. Early in the housing crisis, principal writedowns were limited, due in part to uncertainty about where house prices would stabilize. Now that housing prices have been relatively more stable for an extended period, lenders can make more accurate calculations about the expected returns from principal writedowns. In this new phase of recovering from the housing crisis, principal reduction should offer an important additional path to interest rate reductions or forbearance to effectively prevent foreclosure – even when the different approaches might result in the same monthly payment for the homeowner. In short, providing homeowners with a path to positive equity can be a very helpful factor to prevent loan defaults.

Critically, the vast majority of the burden of writing down these loans will fall where it belongs, on the lenders and investors, not on the taxpayer. As mentioned earlier, the private sector has increasingly recognized that a principal writedown can be an economically rational alternative to a foreclosure to preserve value in their mortgage holdings. FHA Short Refinance supports the efforts already underway in the market and offer incentives to expand their reach to loans in which the servicer of the loan may differ from the investor and to overcome obstacles to market coordination, including the presence of a second lien and stresses on the capacity of servicers to perform modifications.

The changes to the FHA Refinance program to assist borrowers in negative equity positions is one tool that has the potential to assist in stabilizing the mortgage finance market that continues to experience volatility. This program is intended to maintain affordable homeownership, prevent foreclosures and mitigate the potential for "strategic defaults" wherein a homeowner determines that it is in his or her financial interest to default on the mortgage rather than continue paying. The benefit of this program is to make mortgage payments more affordable and prevent dramatic declines in property values in order to prevent foreclosures that impose costs on borrowers, lenders and neighboring property owners.

This program is not intended to address the entirety of the negative equity problem but is part of the overall efforts to give borrowers an opportunity to stay in their homes. This program decreases the likelihood that homeowners go into foreclosure, thereby decreasing the values of other homes nearby, which in turn would push more neighborhoods underwater and increase foreclosures.

Emergency Homeowners Loan Program

As noted above, many homeowners through no fault of their own have experienced a significant reduction in income and are at risk of foreclosure due to involuntary unemployment, underemployment, or a medical condition. In past cycles, many of these struggling homeowners could have sold their homes and relocated to more affordable housing situations located in areas where jobs are more plentiful. But with millions of these unemployed borrowers underwater on their mortgages, they are trapped in homes that they cannot afford and often are unable to maintain – to the detriment of both themselves and their neighbors. In addition to providing a helping hand to unemployed homeowners forced to ride out the economic storm, the Emergency Homeowners Loan Program (EHLP) may also provide homeowners the time needed to gain access to workforce training that will enable them to obtain higher paying jobs when they are re-employed.

EHLP is a $1 billion initiative to provide assistance to distressed homeowners in 32 states and Puerto Rico. The remaining 18 states and the District of Columbia are assisted by the U.S. Treasury's Innovation Fund for the Hardest Hit Housing Markets. EHLP will be administered through two delivery channels: (1) individual state agencies, if the state already administers a program deemed by HUD to be substantially similar to EHLP; or (2) through a network of intake/housing counseling agencies designated by NeighborWorks of America (NWA) – a national network with more than 230 community-based partners in all 50 states. All funds authorized by Dodd-Frank for EHLP must be obligated by September 30, 2011 though expenditures can continue until September 2013.

EHLP will provide as many as 30,000 distressed borrowers a zero interest forgivable bridge loan. EHLP assistance will first bring the homeowner current on their mortgage and then provide additional assistance to reduce the monthly payments (including principal, interest, taxes, and insurances) to an affordable 31 percent of current income. EHLP assistance terminates when the borrower's income is restored to pre-crisis levels, with assistance limited to a maximum duration of 24 months, or $50,000, whichever occurs first. Once EHLP assistance is complete, the assistance received by the borrower will be secured by a junior lien against the homeowner's principal residence. To avoid weighing the EHLP borrower down with burdensome debt, EHLP borrowers will be able to reduce their accumulated EHLP obligation by 20 percentage points for each year they continue to keep current on their first mortgage. In cases of foreclosure or voluntary sale of the mortgage property, HUD's recovery is limited to the net proceeds from the sale of the property.

IMPLEMENTATION TIMELINE

HUD is working diligently to implement the Emergency Homeowners Loan Program (EHLP) and hopes to begin accepting homeowner applications soon. It has taken longer to implement the program than earlier expectations due to challenges that are unique to this program.

- The EHLP rule and notice which reactivates the 1975 relief program have been sent to the *Federal Register* and is now publicly available on the HUD Website.
- HUD has drafted and is currently working to sign cooperative agreements with key program partners including NeighborWorks America and those states that have programs determined to be substantially similar to EHLP.

HUD will also provide information later this Spring as to when, where and how borrowers can apply for the NeighborWorks portion of the program. Since HUD anticipates that the program will be oversubscribed, a fair selection process will be devised in keeping with the Agency's commitment to promoting equal opportunity for accessing HUD assistance.

SUBSTANTIALLY SIMILAR STATE (SSS) PROGRAMS

The SSS portion of EHLP operates under specific authorities contained in Dodd-Frank and the implementation timeline differs from that of the HUD-administered portion. A Federal Register Notice was posted on Nov 12, 2010 defining the requirements for the SSS Program. Responding to that Notice, ten jurisdictions submitted information about programs they considered to be SSS HUD has completed its review of these submissions and is in the process of communicating with the states. These state directed programs may launch before the HUD-administered program because they build on existing program infrastructure. Applicants in those states will not apply through HUD, but instead will apply directly through these "substantially similar" programs. States determined to be substantially similar will announce when they will begin taking applications for assistance. Currently HUD anticipates that these state directed programs will begin taking applications later in March.

HUD-ADMINISTERED PROGRAM

On February 2, 2011, HUD submitted an interim rule for a 15 day Congressional review. The rule reinstates, with certain modifications, former HUD regulations to enable the provision of emergency relief to homeowners that do not live in substantially similar states. These regulations were originally promulgated following enactment of the Emergency Homeowners' Relief Act of 1975, the statute which was reauthorized, with certain amendments, in Dodd-Frank. The regulations were not utilized and HUD eventually removed the regulations from the Code of Federal Regulations in 1995. The Rule has completed the mandatory 15 day Hill review period, and now both the Rule and Notice await publication. Upon publication, HUD will have sufficient legal authority to obligate and spend funds to build capacity to implement the program.

In anticipation of publication, HUD has been working with NWA and several potential fiscal agents (FAs) to assist HUD in the administration of this program. Startup funding will enable NWA to assemble and train a network of counseling agencies and develop systems needed to operate the program. Once the needed mechanisms are in place, working with HUD, NWA will engage in a public outreach campaign and provide detailed information on when and how homeowners will be able to complete an initial pre-screening form. Each counseling agency (CA) participating in the program will host a two-week open enrollment period to accept the pre-assessment forms. Since the program is likely to be oversubscribed, NWA will use a randomized lottery process to determine which household submitting pre-assessment forms will be invited to submit the documentation required to complete an application package for the program.

Startup funding will also enable the selected FA to begin work with HUD and NWA to finalize program operations, train staff to provide a "second review" of application packages, establish best practices for effective engagements with servicers of delinquent mortgages, record ELHP Mortgages and complete technology build out. HUD will also use a share of the EHLP funds to adapt HUD systems to efficiently and effectively operate the program in a fiscally responsible manner.

HUD anticipates that EHLP in the HUD-administered program will be available to distressed homeowners later this Spring. In the meantime, unemployed households struggling to meet their mortgage payments should contact a HUD-approved Housing Counseling Agency to obtain information about other loss mitigation options that are currently available. They can find a housing counselor through the following HUD web page:
http://portal.hud.gov/portal/page/portal/HUD/ or by calling (800) 569-4287.

Conclusion

Obviously, Madam Chairwoman, these are only a few important tools in our toolbox as we fight to continue our nation's economic recovery. And they won't help every family struggling to keep their home.

Indeed, they recognize that we must balance the need to help responsible homeowners struggling to stay in their homes, with the reality that we cannot and should not help everyone. The President has said: "We can't stop every foreclosure." And in fact, we can't maintain this balance if we try to assist every borrower who bought more than they could afford, every investor and speculator who took a risky gamble that went bust or every or every millionaire who defaulted on their vacation home. Instead, the Administration must focus on providing responsible homeowners opportunities to obtain a modification or to refinance and prevent avoidable foreclosures and, when necessary, facilitate the transition to a more sustainable housing situation. The programs are tailored to accomplish these goals by helping a targeted group of borrowers.

Madam Chairwoman, thank you again for this opportunity to testify. I would be glad to respond to any questions.