LEGISLATIVE PROPOSALS TO END TAXPAYER FUNDING FOR INEFFECTIVE FORECLOSURE MITIGATION PROGRAMS

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING, AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MARCH 2, 2011

Printed for the use of the Committee on Financial Services

Serial No. 112–13

U.S. GOVERNMENT PRINTING OFFICE

65–670 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

SPENCER BACHUS, Alabama, *Chairman*

JEB HENSARLING, Texas, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
NAN A. S. HAYWORTH, New York
JAMES B. RENACCI, Ohio
ROBERT HURT, Virginia
ROBERT J. DOLD, Illinois
DAVID SCHWEIKERT, Arizona
MICHAEL G. GRIMM, New York
FRANCISCO "QUICO" CANSECO, Texas
STEVE STIVERS, Ohio

BARNEY FRANK, Massachusetts, *Ranking Member*
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
ANDRÉ CARSON, Indiana
JAMES A. HIMES, Connecticut
GARY C. PETERS, Michigan
JOHN C. CARNEY, JR., Delaware

LARRY C. LAVENDER, *Chief of Staff*

Subcommittee on Insurance, Housing, and Community Opportunity

JUDY BIGGERT, Illinois, *Chairman*

ROBERT HURT, Virginia, *Vice Chairman*
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
SCOTT GARRETT, New Jersey
PATRICK T. MCHENRY, North Carolina
LYNN A. WESTMORELAND, Georgia
SEAN P. DUFFY, Wisconsin
ROBERT J. DOLD, Illinois
STEVE STIVERS, Ohio

LUIS V. GUTIERREZ, Illinois, *Ranking Member*
MAXINE WATERS, California
NYDIA M. VELÁZQUEZ, New York
EMANUEL CLEAVER, Missouri
WM. LACY CLAY, Missouri
MELVIN L. WATT, North Carolina
BRAD SHERMAN, California
MICHAEL E. CAPUANO, Massachusetts

CONTENTS

	Page
Hearing held on:	
March 2, 2011	1
Appendix:	
March 2, 2011	29

WITNESSES

WEDNESDAY, MARCH 2, 2011

Barofsky, Hon. Neil, Special Inspector General, Troubled Asset Relief Program (SIGTARP)	2
Jones, Katie, Analyst in Housing Policy, Congressional Research Service (CRS)	9
Marquez, Hon. Mercedes M., Assistant Secretary, Community Planning and Development, U.S. Department of Housing and Urban Development (HUD)	6
Scire, Matthew J., Director, Financial Markets and Community Investment, U.S. Government Accountability Office (GAO)	7
Stevens, Hon. David H., Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, U.S. Department of Housing and Urban Development (HUD)	4

APPENDIX

Prepared statements:	
Barofsky, Hon. Neil	30
Jones, Katie	37
Marquez, Hon. Mercedes M.	46
Scire, Matthew J.	59
Stevens, Hon. David H.	78

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Biggert, Hon. Judy:	
Written statement of the American Alliance of Home Modification Professionals (AAHMP)	88
Written statement of Americans for Tax Reform	91
Written statement of Mark A. Calabria, Ph.D., Director, Financial Regulation Studies, Cato Institute	94
Written statement of Satya Thallam, Director, Financial Markets Working Group, and Anthony Sanders, Senior Scholar, the Mercatus Center at George Mason University	99
Written statment of the U.S. Department of the Treasury, with attachments	107
Article from The Wall Street Journal entitled, "Housing Market Masochism," dated March 2, 2011	121
Article from The Washington Times entitled, "Obama's helping hand hoodwinks homeowners," dated March 1, 2011	123

LEGISLATIVE PROPOSALS TO END TAXPAYER FUNDING FOR INEFFECTIVE FORECLOSURE MITIGATION PROGRAMS

Wednesday, March 2, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INSURANCE, HOUSING,
AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2220, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Miller of California, McHenry, Dold; Gutierrez, Waters, and Sherman.

Also present: Representative Green.

Chairwoman BIGGERT. The Subcommittee on Insurance, Housing, and Community Opportunity will come to order for a hearing entitled, "Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs."

Thank you all for being here in these tight quarters. Unfortunately, this hearing was put on the schedule rather late, so we are in the second hearing room. The reason that I am starting now, and the ranking member and I waived our opening statements, is because we are going to have votes. In fact, we expected them at quarter to one, and then we are expecting another series of votes, so the more that we can accomplish right now, the better.

So I am just going to start with the witnesses, and I would like to welcome them. And members will be always welcome to submit their statements for the official hearing record, but we will immediately proceed to our panel of witnesses.

Our first witness is the Special Inspector General for the Troubled Asset Relief Program, Neil Barofsky.

Inspector General, I understand you are retiring from your post, so I would like to thank you for your service and wish you the best in your future endeavors.

Mr. BAROFSKY. Thank you.

Chairwoman BIGGERT. And next, we will hear from HUD FHA Commissioner David Stevens. Welcome back. Also from HUD, our third witness is the Assistant Secretary for Community Planning and Development, Ms. Mercedes Marquez.

Our fourth witness is the U.S. Government Accountability Office Director of Financial Markets and Community Investment, Matthew Scire. And our final witness is Ms. Katie Jones, who is an Analyst in housing policy with the Congressional Research Service of the Library of Congress.

So welcome, all of you.

And, Inspector General, you are recognized for 5 minutes for your statement.

STATEMENT OF THE HONORABLE NEIL BAROFSKY, SPECIAL INSPECTOR GENERAL, TROUBLED ASSET RELIEF PROGRAM (SIGTARP)

Mr. BAROFSKY. Thank you, Madam Chairwoman.

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, it is a privilege to appear before you today to testify about the HAMP program. HAMP, of course, arose out of the Emergency Economic Stabilization Act.

Chairwoman BIGGERT. If you would suspend for a moment—

Please put those posters down; that is against the decorum in our hearings. Thank you.

I am sorry about that. Please continue, Inspector General.

Mr. BAROFSKY. Sure.

HAMP, of course, arose out of the Emergency Economic Stabilization Act's requirement that TARP be used not just to benefit the Wall Street banks, but also Main Street through a specific goal of preserving homeownership. Unfortunately, since HAMP's announcement 2 years ago that it would help up to 3 to 4 million struggling homeowners achieve sustainable permanent modifications, the numbers have been nowhere close, with fewer than 540,000 permanent modifications to date.

Five weeks ago, in testifying before the House Oversight Committee, I was asked the same question that is the subject of this hearing, whether given the disappointing results of HAMP, the program should be terminated. At that time, I thought this conversation was premature and that Treasury should be given an opportunity to respond to what had become bipartisan criticism and concern that the program was failing to do two things: one, set forth its plan on how to revamp the program so it could meet those important TARP goals of preserving homeownership; and two, finally answering the question that needs to be answered for there to be any true discussion about whether to continue this program or not, which is how many people Treasury expects to help through this program with sustainable permanent modifications.

Unfortunately, since that hearing Treasury has done little to address these concerns. On the one hand, Secretary Geithner has acknowledged that the program will come nowhere close to meeting its original expectations and that the program itself suffers from a major design flaw in that the incentives for the servicers are insufficient to overcome the conflicts of interest that are inherent in the program as Treasury designed it.

But rather than then build on this belated recognition of failure, Treasury continues to celebrate the status quo. Last week, to an applauding crowd of mortgage servicers, one Treasury official confirmed that there would be no meaningful change or changes in the HAMP program and that all that would be done is tweaks around the program's edges.

Since then, other Treasury officials, seemingly on a daily basis, have been issuing defenses of the program, saying that it has been successful, citing ever-changing goals and milestones that are meaningless and misguided.

Even more disturbing is Treasury's continued and inexplicable failure of transparency in identifying how many people it expects this program will help over the course of its life span. Steadfastly refusing to do so for more than a year, this past December, the Congressional Oversight Panel (COP) tried to fill the void by providing its own estimate of 700,000 to 800,000 modifications over the life of the program.

But since that past hearing, rather than issue its own numbers, its own estimate of the total number of people who would be helped, Treasury has done something astonishing. In a written report to Congress, it suggests both that the COP's estimate of 700,000 to 800,000 is accurate and also the number might be twice that amount. Another Treasury official testifying before the subcommittee only stated that the program would help as many people as it could. Treasury's refusal to be transparent about the number of people it expects to help does it no service, and merely fuels the concerns and suspicions of those seeking to terminate the program and providing for those who would otherwise seek to defend it, depriving them of the necessary tools to respond.

So here we are 2 years later with now basically universal and bipartisan agreement that the HAMP program is failing to meet TARP's goal of preserving homeownership, with Treasury standing alone as the defender of the status quo.

In fact, this past week, one senior Treasury official, in declaring the program a success, was citing to its otherwise disappointing rate of conversion from trial modifications to permanent—this, the conversation rate and tried to defend it by comparing it to a baseball player and said that if a baseball player hit for a 330 average, that would be successful, so therefore the HAMP program has been successful.

Now, to be sure, for those people, proportionately few, who do receive sustainable permanent modifications, they will receive a benefit under this program. But these type of flip statements and comparisons demean the real harm that is suffered by many of the more than 800,000 families who have seen their modifications terminated under the HAMP program and the up to 2.3 to 3.3 million families who might have been reached by this program if only it had been better designed, better managed, and better executed by the Treasury Department.

I thank you for this opportunity to testify, and I look forward to answering any questions you have.

[The prepared statement of Inspector General Barofsky can be found on page 30 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

I now recognize Commissioner Stevens for 5 minutes.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY FOR HOUSING AND COMMISSIONER OF THE FEDERAL HOUSING ADMINISTRATION, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Mr. STEVENS. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the opportunity to testify here today. I am pleased to discuss the Administration's programs designed to help families and the housing market recover from the economic crisis.

First, let me speak briefly about the progress of the recovery. As you know, when home prices were falling every month for 30 straight months when President Obama took office, the Administration had no choice but to take action.

The results are clear. Monthly foreclosure starts are down more than 30,000 a month from this time a year ago. More than 4.1 million distressed home borrowers have received mortgage assistance since April of 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. Still, the housing market remains fragile. Where the crisis was initially driven by defaults created by risky subprime loans, today unemployment and negative equity are the main drivers of foreclosures. To respond to these new challenges, the Administration has unveiled new tools, two of which I would like to talk about today.

The first is the FHA short refinance program to help some of the estimated 1.5 million borrowers who owe more on their mortgages than their homes are worth. Making matters worse, these borrowers often can't move to find a new job or refinance their loan into a lower payment, because their house is underwater.

Through the program, a targeted group of borrowers who are current on their mortgage payments, will have an opportunity to have their loans modified or refinanced into a sustainable FHA fixed-rate mortgage.

To qualify, the existing first lien holder must write down at least 10 percent of the unpaid principal balance. Then the borrowers are able to refinance an underwater, non-FHA insured mortgage into an FHA-insured mortgage at 97.75 percent of the home's value. As a result, the vast majority of the program's cost is borne not by the taxpayer, but by the investors and institutions which own these loans.

While we have faced some initial implementation challenges, with Wells Fargo, Citi Mortgage, and GMAC Ally having just announced they will soon begin short refinance pilots and several other major lenders indicating they will begin participating this year, we expect to see some progress in the months ahead.

What first started with the foreclosures from bad loans has now transitioned into issues with unemployment and negative equity. As we work to help homeowners who have watched the value of their homes plummet during this crisis, the Administration is working to help families who are facing foreclosure through no fault of their own, because they have lost their jobs.

In October, we announced the emergency homeowners loan program, a $1 billion initiative authorized by Congress to provide a zero interest, forgivable bridge loan of up to $50,000 to as many as 30,000 distressed borrowers in 32 States and Puerto Rico. This program is designed to bring the homeowner current on their mortgage and then provide additional assistance to reduce the monthly payments to affordable levels. Assistance terminates when the borrower's income is restored to 85 percent of their pre-crisis levels.

Once assistance is complete, the loan will be secured by a junior lien against the homeowner's principal residence. Created by the Dodd-Frank Wall Street Reform bill, this program complements the Treasury Department's hardest hit fund and will be administered through two delivery channels: individual State agencies for States with similar programs in place; and through a network of intake and housing counseling agencies designed by NeighborWorks America.

Madam Chairwoman, I would like to be the first to acknowledge that it is taking longer to implement the program than we had expected due to challenges that are unique to it. But I would note that the emergency home loan rule and notice have been sent to the Federal Register and are now publicly available on the HUD Web site.

HUD is currently working to sign cooperative agreements with key program partners including NeighborWorks and those substantially similar States. And this spring, we hope to provide information as to when, where, and how borrowers can apply for the NeighborWorks Program.

These initiatives supplement a variety of programs already in place to continue our Nation's economic recovery. Mark Zandi of Moody's Analytics said just recently that not only have the Administration's collective efforts to date helped to stem the vicious cycle of steadily declining home prices that was leading to escalating loan defaults when we took office, but also stated "any further price declines could be forestalled to an additional 500,000 solid modifications over the coming year" and that these kind of approaches, particularly principal write-downs represent a key to getting there.

Of course as President Obama has pointed out, we cannot prevent every foreclosure, nor would it be responsible to assist every borrower who bought more than they could afford. But those aren't the families these efforts assist. Rather, they are tailored to assist responsible borrowers who are at risk of foreclosures through no fault of their own, whether they have lost their jobs due to this recession or because they have seen their property values collapse.

That is why the Administration is opposed to all four bills that are the subject of this hearing, and it is why I urge Congress to instead support our efforts and help us improve them. Thank you for the opportunity to testify before you today.

[The prepared statement of Commissioner Stevens can be found on page 78 of the appendix.]

Chairwoman BIGGERT. Thank you. We have had a roll call, but we will try and do one more testimony before we run off like lemmings to the House Floor.

Next, we have the Honorable Mercedes Marquez.

STATEMENT OF THE HONORABLE MERCEDES M. MARQUEZ, ASSISTANT SECRETARY, COMMUNITY PLANNING AND DEVELOPMENT, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Ms. MARQUEZ. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you so much for the opportunity to testify today in support of the Neighborhood Stabilization Program.

Let me start by clarifying that the NSP Program is not a foreclosure prevention program, but rather a tool to help communities address and mitigate the negative effects that vacant, abandoned, and blighted properties have on neighborhoods and property values.

While monthly foreclosure starts are down more than 30,000 per month from the same time 1 year ago, the housing market remains fragile. Neighborhood stabilization investments are important because they prevent further decline. Since 2008, HUD, NSP grantees, and a range of private sector and nonprofit partners have worked together to craft distinctive, market-oriented responses that stabilize and improve neighborhoods while these dollars often turn foreclosed and abandoned properties into affordable rental housing that families need and shore up the equity of neighboring homeowners in these communities.

I am responsible for overseeing all three rounds of Neighborhood Stabilization Program funds, including: the initial $4 billion program established by HERA in 2008; $2 billion for NSP2 appropriated by the Recovery Act; and the $1 billion for NSP3 included in Dodd-Frank. All told, we expect the $7 billion in Neighborhood Stabilization Funds to impact 100,000 properties in the Nation's hardest-hit markets and with grantees reporting that more than 36,000 of these properties are under construction, we are more than a third of the way there.

While 100,000 properties may seem small by comparison to the millions of foreclosures we have seen in recent years, the targeted nature of these allocations, and the statutory requirement that grantees focus their funds on areas with the greatest need, has enabled NSP to not only impact those homes and neighborhoods where the funds are invested, but to produce a multiplier effect that impacts our local, regional, and even national housing markets.

I am pleased to report that the funds have been well-managed, both at the Federal and local levels. To date, HUD has obligated signed grant agreements with States, local governments, and nonprofits for 100 percent of NSP1 and NSP2 dollars and we expect the NSP3 funds by the end of this month.

Indeed, the 99.6 obligation rate for NSP1 grantees at the 18-month deadline speaks to the commitment and tenacity of communities across the country, even during a difficult budget environment and to CPD's NSP technical assistance effort, which ensured accountability of these funds by helping grantees assess their markets and retool their efforts to produce the biggest impact with the minimum taxpayer investment.

Most important of all, Madam Chairwoman, these efforts are producing results. To date, communities using NSP1 have produced more than 5,300 rehabilitated or newly constructed homes, more than 6,000 households have received direct homeownership assistance to acquire formerly foreclosed or abandoned properties, and more than 9,700 blighted properties have been demolished and cleared.

But statistics alone don't capture the impact this program is actually having. In Cleveland, Ohio, NSP funds have made a huge difference in helping reduce vacancy rates. Despite an estimated 18,000 vacant properties, NSP has helped Cleveland reduce the vacancies in one East Side neighborhood by nearly 40 percent in the last 2 years. At the same time, this helped responsible homeowners like Millie Davis, who recently earned her Master's Degree in Urban Planning from Cleveland State University, buy a home closer to where she works and invite her mom to live with her.

Or Lee County, Florida, one of the regions hardest hit by foreclosures with over 2,600 foreclosure filings per month at one point. Lee County not only used their NSP dollars to help its communities come back to life, they have also partnered with the sheriff's department there to create a weed-and-seed program to reduce crime in these areas.

One hardworking nurse, Priscilla Hardaway, was paying more than $1,000 in monthly rent when she learned about the NSP program. Because of NSP, she purchased a home, and now affords a mortgage of $528 per month, a dramatic savings.

Madam Chairwoman, I believe these two examples illustrate the impact this investment is having: helping stabilize hard-hit communities; creating sustainable homeownership opportunities for responsible homeowners; and stabilizing or raising property values for families who have lost so much over these past few years through no fault of their own.

These are the kinds of values we want our housing market to support in the years ahead: more affordability; more sustainability; and more transparency and accountability when it comes to taxpayer dollars. That is the difference this program is making and, with your partnership, will continue to make in the coming months. That is why I am here to support this program and to stand against the four bills.

Thank you again for this opportunity to testify, and I look forward to answering your questions.

[The prepared statement of Assistant Secretary Marquez can be found on page 46 of the appendix.]

Chairwoman BIGGERT. Thank you. I think we have time for one more, since we have 10 minutes.

Mr. Scire, please proceed for 5 minutes.

STATEMENT OF MATTHEW J. SCIRE, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Mr. SCIRE. Thank you. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to discuss GAOs assessments of Treasury's Making Home Affordable Program including its loan modification program called PAM.

It has been over 2 years since Treasury first announced the Home Affordable Modification Program with the promise of helping 3 to 4 million homeowners in danger of losing their homes. Since then, 1.7 million homeowners have been offered to file mortgage modifications, and in December there were 522,000 active, permanent modifications.

However, the number of homeowners who face foreclosure remains high. As of December, about 3.7 million mortgages were 90 or more days delinquent or in the process of foreclosure. That represents more than a fourfold increase over the number of such mortgages in 2005. Put another way, over 8 percent of all mortgages face the prospect of foreclosure.

We reported in July of 2009 and in June of 2010 on the challenges that Treasury and servicers faced in implementing the HAMP program, and the challenges that distressed homeowners faced using it. Later this month, we will report on the continuing challenges Treasury faces in its efforts to modify mortgages or otherwise help homeowners through its Making Home Affordable Program.

We also will report on the outcomes of borrowers who were either denied or fell out of Treasury loan modifications. At the outset, I think it is important to note that Treasury's HAMP program is part of an unprecedented response to a particularly difficult time in our Nation's mortgage market. The Emergency Economic Stabilization Act called for Treasury to, among other things, preserve homeownership and protect home values, and HAMP continues to be Treasury's cornerstone effort for doing this.

However, more than a year after Treasury's initial announcement of HAMP and the goal of bringing consistency to foreclosure mitigation, we reported last June that servicers continued to treat borrowers seeking to avoid foreclosure inconsistently, in part because of a lack of specific guidance from Treasury.

Servicers used different definitions for determining whether a homeowner was in imminent danger of default. Servicers also varied in their message for ensuring compliance with program requirements. We also found that Treasury had not specified consequences or remedies if servicers do not comply with program requirements and has yet to do so.

We recommended that Treasury take a number of steps to improve program transparency and accountability, but it has not fully implemented these measures. We also noted that as Treasury continued to design and implement new HAMP programs, including the Principal Reduction and Foreclosure Alternatives Program, it would be important to develop sufficient capacity to establish meaningful performance measures and make appropriate risk assessments.

In our ongoing work, we find that these newer efforts, along with the second lien program, have gotten off to a slow start with limited activity reported to date. The slow pace was due to several reasons and Treasury has taken steps to address many, but the potential effects of these changes remain to be seen. We believe there is more that Treasury could do. Treasury could do more to ensure that servicers have capacity to undertake these added responsibilities. Treasury could also do more to establish goals and effect the performance measures for these programs as we recommended last June.

Finally, to better understand the outcome for borrowers that HAMP was unable to help, we surveyed six large HAMP servicers. We found that borrowers denied HAMP modifications most often became current at the time of our survey. Those who fell out of modification most often were in the process of or had received a proprietary modification.

And those borrowers who defaulted on permanent modifications most often were in the process of foreclosure. Going forward, it will be important to understand what explains borrower outcomes from foreclosure mitigation efforts. And here again, we think there is more the Treasury can do to more clearly understand the final disposition of borrowers who fall out of the HAMP program.

In summary, Madam Chairwoman, the Treasury's HAMP program has not lived up to expectations. It has helped fewer persons than it had initially promised, and more announced programs have had limited activity. We continue to find that Treasury could do more to bolster program accountability and transparency.

Treasury can begin by understanding better the capacity of services to undertake, additional responsibilities for delivering recently implemented programs. It could specify what outcomes it expects of these programs. It could also do more to hold servicers accountable by establishing clear goals and performance benchmarks.

This concludes my opening remarks. Thank you again for the opportunity to appear before you today.

[The prepared statement of Mr. Scire can be found on page 59 of the appendix.]

Chairwoman BIGGERT. Yes. Thank you very much.

This committee will recess until we return immediately after Floor votes. I wouldn't give up your seats.

[recess]

Chairwoman BIGGERT. The hearing will come to order.

We have one more witness, Ms. Katie Jones, professional analyst. You are recognized for 5 minutes.

STATEMENT OF KATIE JONES, ANALYST IN HOUSING POLICY, CONGRESSIONAL RESEARCH SERVICE (CRS)

Ms. JONES. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, I am honored to be here today. My name is Katie Jones and I am an analyst at the Congressional Research Service. As requested by the subcommittee, my testimony will provide dot-com information and performance and funding metrics on the Home Affordable Modification Program, or HAMP, the FHA Short Refinance Program, the Interagency Homeowners Own Program, and the Neighborhood Stabilization Program.

Since CRS does not collect independently collect data, the numbers provided in my testimony come from data that are made publicly available by the administering agencies or other Federal entities.

My testimony today highlights information that is discussed in two CRS reports, written by myself and my colleagues, both of which I have included for the record. CRS has not performed additional analyses specifically for this hearing. As is our policy, CRS takes no position on these legislative proposals or on the initiatives themselves.

The first initiative that I will discuss is HAMP, which was established by the Administration using TARP funds. HAMP became active in March 2009 and currently has an end date for entering into new modifications of December 31, 2012. HAMP provides financial incentives to facilitate mortgage modifications that lower borrowers' monthly mortgage payments to no more than 31 percent of their monthly income. Borrowers first enter into a trial modification, which is supposed to become a permanent modification as borrowers make all of their trial period payments on time.

The incentive payments provided by the Federal Government are offered for permanent modifications. Treasury was designated nearly $30 billion in TARP funds for HAMP and its related initiatives. As of February 25, 2011, just over $1 billion has been dispersed. In addition to the TARP funds, Fannie Mae and Freddie Mac will provide up to $25 billion for the cost of modifying mortgages that they own or guarantee.

Under the HAMP incentive structure, some of the incentives are designed to be paid based on the future performance of the modifications. For this reason, Treasury may continue to have a contractual obligation to pay servicers for their past performance under, or reliance on, the HAMP program, even if the program were to be terminated before its currently scheduled end date.

In public announcements when HAMP began, Treasury estimated that HAMP could reach between 3 million and 4 million homeowners. As of Treasury's most recent report, which just came out today, there were almost 540,000 permanent active HAMP modifications, and about another 145,000 modifications were in the trial period, for a total of nearly 685,000 active modifications.

At the same time, over 800,000 modifications have been canceled since the start of the program. Most of these were trial modifications that never converted to permanent status. Nearly 54 percent of the active modifications are GSE loans, so the cost of modifying these loans come from the GSEs, rather than TARP funds.

The next initiative I will discuss is the FHA Short Refinance Program, which was also established by the Administration using TARP funds. It allows certain homeowners who are current on their mortgage payment, but owe more than their homes are worth, to refinance into new mortgages insured by FHA if the original mortgage lender agrees to write down the principal balance by a certain amount. The program was announced in March 2010 and became effective on September 7, 2010.

Currently, borrowers can refinance through the program until December 31, 2012. Treasury has designated up to $8 billion in TARP funds for the FHA Short Refinance Program to cover a portion of expected losses through the program. As of the January 2011 FHA report, 40 loans have refinanced through the program.

The next program that I will discuss, the Emergency Homeowners Loan Program, was established by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act. That legislation also provided up to $1 billion in mandatory funding to HUD to administer the program.

Through the program, HUD will provide short-term zero interest subordinate loans to some homeowners who meet certain eligibility criteria and who experienced a reduction in income due to unemployment or underemployment to help cover the cost of their mortgage payment. HUD will forgive the subordinate loan entirely after 5 years if the borrowers meet certain conditions.

HUD has allocated $1 billion in funding under this program to the 32 States and Puerto Rico that are not eligible to receive funding under Treasury's hardest-hit funds. The program is expected to begin taking applications this spring. Since the program is not yet taking applications, no funds have been dispersed to borrowers to date. By statute, no new loan agreements with borrowers can be entered into after September 30, 2011.

Finally, Congress established the Neighborhood Stabilization Program in the Housing and Economic Recovery Act of 2008 to provide funds to States and local communities to purchase and redevelop foreclosed or abandoned properties. Congress subsequently provided two additional rounds of funding for the programs. These components of NSP are identified as NSP1, NSP2, and NSP3, respectively. Unlike the other programs I have discussed, NSP is not designed to prevent foreclosures, but rather, to help communities deal with the aftermath of foreclosures.

NSP1 and NSP3 funds were awarded by formula, while NSP2 funds were awarded competitively. To date, HUD data show that NSP funds have principally been used for acquisition and residential rehabilitation activities. As of January 13, 2011, HUD reported that NSP1's grantees have completed nearly 20,000 units. HUD announced 283 NSP3 grantees on September 8, 2010. These grantees were required to submit their action plans to HUD by March 1, 2011, and HUD is expected to award these funds shortly.

Thank you.

[The prepared statement of Ms. Jones can be found on page 37 of the appendix.]

Chairwoman BIGGERT. Thank you very much. We will now proceed to questions. And members are limited to 5 minutes, as well.

So I will start the questioning, but first I would like to enter into the record, without objection, a number of written testimonies and letters: first, the testimony from Kelly William Cobb on behalf of Americans for Taxpayer Reform; second, testimony from Mark A. Calabria on behalf of the Cato Institute; third, the March 1, 2011, letter from the National Foreclosure Prevention and Neighborhood Stabilization Task Force; fourth, a March 1, 2011, Washington Times article entitled, "Obama's Helping Hand Hoodwinked Homeowners"; fifth, testimony from Satya Solomon and Anthony Sanders at the Mercatus Center at George Mason University; sixth, testimony from the U.S. Treasury Department; and seventh, a March 2, 2011, Wall Street Journal article entitled, "Housing Market Masochism."

My first question is to all the witnesses—the Administration has noted that 4.1 million distressed homeowners have received mortgage assistance since April 2009. However, according to the testimony that this subcommittee received on February 15th, around 3.5 million of these mortgage modifications were completed without any government program and no taxpayer assistance. Meanwhile, about 580,000 programs were completed through a government program.

So why is the Administration providing help to these programs when the majority of the modifications were made through efforts of the private sector?

Would anybody care to address that?

Ms. JONES. Chairwoman Biggert, while HAMP is not directly under my authority or HUD's authority, I would articulate it in a couple of fashions.

First of all, by previous testimony before the House Financial Services Committee, under the previous Congress, the two heads of the mortgage businesses were Bank of America and Wells Fargo, as an example, highlighted the fact that HAMP really created the blueprint for all other modification programs that have been implemented in this country, that they had seen, that they implemented in their institutions, being the largest institutions in the market.

So clearly, the tangible value of creating something in an environment that we had never experienced before started with HAMP and allowed the private sector to ultimately model after the HAMP program.

The interesting variable, however, and difference—and this comes from the OCC, who has stated that the HAMP program clearly is more effective than what they have seen in private modifications.

Just to give a couple of examples, the median savings on a monthly basis for borrowers from HAMP is $527 a month versus $337 to the OCC review of private modifications.

And also the other variable is, if you look at redefault rates, which I think reflects the sustainability of the HAMP program, the redefault rates for the OCC review is about 19 percent after a borrower is 60 days late after 6 months in the program.

And HAMP redefault rates are 10.7 percent after 6 months.

So, while the numbers have clearly been smaller and the total numbers are counted in the scorecard, there is absolutely unequivocal support, both from the private sector and in—and results that the HAMP program clearly was the model by which others followed, and that the HAMP performance of borrowers in the HAMP program exceeds those in the private sector.

Chairwoman BIGGERT. But besides the data that we have gotten from Federal oversight entities, this is something that my constituents have come in to see me about because they wrote seeking a mortgage modification under the HAMP program.

And so they were told, just while you are waiting, it is going to take us 3 months or so to go through this—pay the lower amount, starting now, and then you will continue when there is a loan modification.

What happened to them is that then some of them were told that they weren't qualified to do it. And so please pay us back, back to the rate that you were paying plus a penalty.

And I think the penalty is what really got these people, and particularly somebody who is in that place where they weren't able to make the payments, which is why they sought the modification.

And so it is—most of them went into foreclosure and lost their homes. And I think that is kind of a false hope to have people do that and then they are not able to fulfill—

Mr. SCIRE. If I could—

Chairwoman BIGGERT. Yes, Mr. Scire, I know that you have had some dealings with this. If you would comment on that, please.

Mr. SCIRE. For a borrower in that kind of situation, the servicer is required to first consider them for the HAMP program. So a servicer should not be telling a borrower and trying to move them into the proprietary without first full consideration for the HAMP program.

I would also point out that the proprietary modifications generally will have different terms, which I think the Commissioner was hinting at, than the HAMP program.

So you are not going to get as generous a modification on the proprietary program, generally.

Chairwoman BIGGERT. Okay.

Could you maybe—what are the characteristics of borrowers who have redefaulted or were canceled? What did you see as far as people who thought that they could do this and then couldn't make the mortgage payments?

Mr. SCIRE. For those who redefaulted, just like those who did not, they tended to have higher back-end DTI, for example. They tended to have lower FICO scores.

So they generally were more risky borrowers, if you will, those who got through HAMP and then redefaulted.

We did some other analysis where we are looking at what became of them. And there we also see those who redefault more often end up in foreclosure.

Chairwoman BIGGERT. Thank you. My time has expired.

I turn to the ranking member, Mr. Gutierrez—

Mr. GUTIERREZ. Thank you very much.

First of all, welcome to all of you. I want to express, first of all, my apologies, because I really feel that this room and this venue is really inadequate, especially for the seriousness of the issue.

There are people outside who can't get in. I have had difficulty listening to people as they have given testimony.

I hope that in the future we would use a venue that is appropriate to the importance and the substance of the issue that we are discussing here today.

And because I—just to be quick about something, I don't think, really gives value to the importance of people losing their homes and communities being destroyed and stripped apart across America.

Now as one who voted for TARP reluctantly, for over $700 billion in order to save the financial markets of the United States of America so that one day we could have some stability in our economy again, and it just seems to me, Madam Chairwoman, that in the last 2 years, the markets, the S&P is up 50 percent.

Pretty good if you are in the market. Goldman Sachs and the others are handing out bonuses once again to themselves. They are doing well and prospering.

We see that the money that we invested in our financial institutions that was largely due to their own greed, to their own mistakes, that we, the American public and American taxpayers put in to save them, they are doing well.

And what is the thank you we get? I think most of the American people, Madam Chairwoman, are saying, once again, they did well. And we get the short end of the stick because people aren't getting back into their homes.

Now, I want to thank—I can't say your name, I am sorry.

Mr. BAROFSKY. "Barofsky."

Mr. GUTIERREZ. Mr. Barofsky—I apologize.

Mr. BAROFSKY. I think I mispronounced your name at the beginning as well, so—

Mr. GUTIERREZ. But I want to thank you for your service. I want to thank you for your testimony. You will be missed in this process. And so I want to thank you for coming, and I just want to kind of part from where you are at. I agree.

They need to set standards and that is our responsibility and our obligation. I won't do that here in this—

I have other avenues and other opportunities in which to seek redress on that issue, and I will do that, at that appropriate—because I don't believe we should be discussing eliminating this program.

I think we should be discussing how we improve this program and how we expand the opportunity to Americans. And I say that on the basis of, God, the other side did really well.

We came at a moment of crisis and we saved them from themselves and their own mistakes.

And now those who are suffering the most, the homeowners, given the collapse of this bubble of our real estate, we should be there, 540,000 is not enough. We put $50 billion into this program.

It was a key cornerstone to getting Democrats or people on this side of the aisle to accept and to support a Republican President and a Republican Secretary of the Treasury. That is bipartisanship.

And what does a Democrat say and those who want it say?

We want some help for American men and women not to lose their most precious asset, the thing in which they have most of their equity and most of their savings and most of their future, their homes.

And now we are talking about stopping that from happening? I say shame on us if we give the Goldman Sachs of the world and we give all the investment bankers on Wall Street—and they are up 50 percent, ladies and gentlemen.

Some of them are up even more, billions of dollars in their pockets. And we are going to strip the ability of American homeowners to obtain and stay in their homes.

I don't think that is the America that I came to represent in the Congress of the United States, and that is why I will continue to oppose legislation that stops—

I say let's fix it, but let's not strip the program. It still has valuable goals, and I think we can reengineer and we can remodify the modifications so that people can stay in their homes.

That is certainly something that I am going to continue to attempt to champion here in the Congress of the United States. And I thank the chairwoman for the—

Chairwoman BIGGERT. And I thank the ranking member. This venue is very inadequate, as we see with everybody sitting here and standing here.

Be that as it may, we are here. And I would recognize the gentleman from Illinois, Mr. Dold, for 5 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

I appreciate it and I want to thank you all for taking the time to come. And I also want to apologize to those who are here. It is a little warm as well. So we appreciate that.

But I am delighted to know that it is getting picked up and hopefully many others will have the opportunity to see what we are talking about here today, because it is very important.

A couple things that I wanted to go over—and, really, the line of questioning I am going to focus on is going to be on the refinance program.

I know that, Secretary Marquez, you had talked about earlier, in your opening statement, that funds have been well-managed. And certainly, I would like to go into a little bit about the refinance, in terms of resources that have been spent on it, versus the number of refinances that have actually happened.

So would you say that, with regard to the FHA refinance program, the funds have been well-managed?

Ms. MARQUEZ. On that, I will have to defer to my colleague, Dave Stevens, the FHA Commissioner.

Mr. DOLD. Okay.

Ms. MARQUEZ. I run the NSP program.

Mr. DOLD. I understand, but I am just saying, if you—we are talking about several programs. I will direct it over to the Secretary in a second, but—so you are not really familiar with that specific—

Ms. MARQUEZ. That is not in my portfolio.

Mr. DOLD. Okay. I will then go over to Secretary Stevens. Can you tell me if you believe those funds have been well-managed?

Mr. STEVENS. Yes, no funds have been spent, Congressman. The funds were there for covering potential losses in the event of ultimate default, and no money has been spent out of those monies at this point.

Mr. DOLD. So is the information that I am receiving with regard to—I have been told that we have, through TARP, approximately $50 million that has been disbursed. Is that incorrect, out of the 8-plus billion?

Mr. STEVENS. That is incorrect. Not all of that was for the FHA short refinance program. But just—if I could clarify because I think—

Mr. DOLD. Please.

Mr. STEVENS. —it is an important question. The program, FHA short refi is part of kind of a mosaic of offerings that have been created by the Administration. And this was created later in the process to deal primarily with negative equity.

If you think about HAMP, for example, HAMP was an early creation to deal with borrowers who have been put into subprime loans and alternative products that they never should have been put in, in the first place, and that was meant to modify their payments downward.

As the recession moved forward over the last couple of years, those problems transgressed into areas that were specifically related to negative equity and unemployment.

The short refi program, which was only actually implemented in the late fall of last year, is still being operationalized by a number of institutions to get it into the market. In fact, this week alone it has been reported that Wells Fargo, GMAC/Ally, Citi, and other major institutions have stated publicly that they are just in the process of implementing pilots to roll out the short refinance program.

The monies that were allocated were designed to protect the fund going out past 2020, in the event of losses that might be incurred from FHA short refis that would be originated to protect the taxpayer—protect the fund itself from being at risk.

So, at this point, no funds have been expended whatsoever.

Mr. DOLD. If I can, do you have a response to that, in terms of funds from TARP that have been allocated?

Mr. BAROFSKY. There has been a significant obligation toward the short refi program, but because there have been only a small handful of actual refinances, none of which have defaulted yet, there has been no real expenditure of money. The expenditure will occur if the program is successful.

And if there are refinances and then there are problems with those refinances, that is when the TARP money kicks in, either as the guarantee, on one end, for failures, where TARP has the first loss position. And then secondly, there is an additional $2.5 billion that is allocated to help extinguish or modify second liens associated with this program. But to date, nothing has really happened, from a TARP perspective, on the short refi program.

Mr. DOLD. How long has the program been operational?

Mr. STEVENS. Again, Congressman, the program was—this was a later addition to deal with the economy. It was fully rolled out in November of last year.

Mr. DOLD. And how many—

Mr. STEVENS. And institutions were able to offer it from that, from November. And just to be clear, each of these institutions had to evaluate their portfolios. It was optional for investors to decide whether to write down. They had to create systems and we are just seeing those institutions begin to operationalize this now as we speak.

Mr. DOLD. I appreciate that. And one of the things that, at least, that—$50 million that has at least been put into the initial kitty. We have under 40 loans thus far, since September 2010, which may have been its inception, but maybe fully rolled out in November.

Still, we have seen 39. We have $50 million allocated if it goes well. And we have, I think—correct me if I am wrong—a little bit over $8 billion is what is totally allocated in there?

Mr. BAROFSKY. Well, yes. For this particular program, it is really almost a total of $10 billion of TARP funds that are allocated. The additional funds that you are referring to from that are dedicated to other TARP modification programs like the HAMP program.

Mr. DOLD. And since my time is really running out, just one last question. So homeowners can't participate unless the senior lender will reduce their principal by at least 10 percent?

Mr. BAROFSKY. That is correct.

Mr. DOLD. Is that correct? So principal lenders on performing loans will have to agree to reduce the principal by 10 percent in the private sector?

Mr. BAROFSKY. Absolutely, yes.

Mr. DOLD. Do you anticipate that there are going to be many who are going to flee to this program, that this was going to be a good idea?

Mr. STEVENS. We were always very clear from the beginning to understate the numbers. And while it started off slow, I will tell you that, in the first few months, we have 245 applications in process. It exceeds what HOPE for Homeowners did in 3 years.

By no means are we touting success, but these are complex programs to implement. If you read any of the news this week, three major national institutions announced that they are going to be doing pilots with the short refinance program.

I do not expect large numbers. And I think that is an absolute concern. Because it is voluntary on the part of these servicers to participate, with the investors that hold those mortgages.

Mr. DOLD. My time has expired. I would like, out of the 240 that you have in process, how many do you anticipate will actually make it through?

Mr. STEVENS. Two hundred and forty loans is a very low number.

Mr. DOLD. I understand.

Mr. STEVENS. And I can't estimate exactly what would go through. I will tell you this, that of the loans that have been financed already, the average write-down was $77,000. The average loan-to-value is 90 percent. And the average FICO score is 711.

So these are—I actually anticipate, if the sample were to keep like that, and as institutions implement the program, it will be seeing significant write-downs. And these loans will be very sustainable, exceeding what we expected from a risk factor, which would mean that the TARP allocation would be underutilized in that process.

But it is very early in the stage to be evaluating the program, since it was just literally implemented over the past few months.

Mr. DOLD. Thank you.

Chairwoman BIGGERT. The gentleman's time has expired. The gentleman from North Carolina, Mr. McHenry, is recognized.

Mr. MCHENRY. I thank the Chair. And thank you for your leadership on this.

And I am glad everyone is able to get into this little table together and share this space. But to you, Commissioner Stevens, thank you for coming back.

I wish that Treasury was here with you. However, we were informed by Treasury that they would prefer a 2-week notification. And so I am sorry this burden falls to you, and I would hope that you would encourage Mr. Massad to come forward, rather than let you answer these questions that are very pressing.

Under the HAMP program, under the status quo, how many permanent modifications do you foresee actually happening?

Mr. STEVENS. Congressman, I do apologize that I am not the HAMP expert here at the table. And I encourage you to communicate with that office. I think—let me give you some estimates that I have heard, and I would be glad to share those with you. So we have 540,000 permanent modifications now. We have 150,000 families who are in trial modifications. And we just announced, I think, another 27,000 new permanent modifications.

The numbers are definitely smaller than what was originally expected from the HAMP—

Mr. MCHENRY. Do you have an estimate?

Mr. STEVENS. The current expected population that, on a pro forma basis, looking forward at this point, looks to be about 1.4 million to 1.5 million families—

Mr. MCHENRY. On the HAMP Web site, it still says 3 million to 4 million.

Mr. STEVENS. And again, I can't answer for the HAMP Web site. I—

[laughter]

I apologize. That is managed by a different department, and—

Mr. MCHENRY. Sure, okay. But in your discussions in the Administration, you think 1.4 is—okay.

Now, how many permanent modifications do you foresee?

Mr. STEVENS. Okay, so the 3 million to 4 million on the Web site, if I could just clarify, is an estimate of all modifications that will occur. That includes the HAMP modifications, FHA's modifications, and the HOPE for Homeowners modifications.

Mr. MCHENRY. Wow. This is very different than what was said in March of 2009 when this program began.

Mr. Barofsky, is the 3 million to 4 million under the HAMP program—was that the original goal set forward, if you recall?

Mr. BAROFSKY. Three million to four million was what was originally intended and announced as the number of sustained permanent mortgage modifications that would come under that program, that would be funded by HAMP, provided by HAMP. And even Secretary Geithner now acknowledges that we are going to come absolutely nowhere close to that number.

Mr. MCHENRY. Okay. Do you foresee seeing a sustainable modification, basically what is also termed a permanent modification?

Mr. BAROFSKY. It is somewhat shameful that at this point, here we are in March 2011 and the Treasury Department will, in one breath, say that we know the number is not going to be anywhere close to what we originally said it would be, and then in the second breath, refuse—this is such a basic failure in transparency, to refuse to tell SIGTARP, to tell GAO, to tell the Congressional Oversight Panel, to tell you what their expectation is as to the total numbers that are going to receive permanent modification.

All we have is an estimate, the best estimate from the Congressional Oversight Panel, of $700,000 to $800,000, and Treasury, in its admission to Congress, saying, maybe that number is right or maybe it is going to be double that number.

And that is the exact opposite of transparency. It evades accountability. And it is trying to cover up a program that is clearly a failure.

Mr. MCHENRY. Failure?

Mr. BAROFSKY. Failure.

Mr. MCHENRY. Mr. Stevens, do you contend that is accurate or inaccurate?

Mr. STEVENS. Again, I am just going to—Congressman, I think it is an important question. I understand the debate. Without question, the HAMP numbers have not been what was originally forecast. Again, it is not—I am a member of the Housing and Urban Development. We are clearly very concerned about all the programs that are trying to be implemented.

I would say this, and I think it is important. I have been in this housing finance industry for 3 decades. We have never been through an environment like this in history. These programs were developed and created—

Mr. MCHENRY. Sure, but—

Mr. STEVENS. —in an environment that had never been created before.

Mr. MCHENRY. —we are 2 years in on this, and I realize—

Mr. STEVENS. So we are 2 years in, but I would just say, Congressman, that—and I refer back to testimony stated by Barbara Desoer of Bank of America, Mike Heid of Wells Fargo, the two—the presidents of each of those respective mortgage institutions. They would have no modification in their testimony that this program was the blueprint for it.

So while the numbers—

Mr. MCHENRY. So the blueprint for it—have they done more or less, in terms of permanent modifications, than HAMP?

Mr. STEVENS. They—

Mr. MCHENRY. More or less?

Mr. STEVENS. They have done more.

Mr. MCHENRY. More? So at lower—

Mr. STEVENS. But at lower payments and higher redefault rates?

Mr. MCHENRY. Right. But they have helped more people.

Mr. STEVENS. Lower payment reduction, excuse me.

Mr. MCHENRY. They have helped more people? Is that what you are testifying to?

Mr. STEVENS. I hope they—

Mr. MCHENRY. Because that is the number that I have, as well.

Mr. STEVENS. I would be hopeful that they helped vastly more people considering it is the servicers and originators in this country that originated the products that ultimately went in default. And if they can do it without taxpayer support, that would be all the better.

Mr. MCHENRY. What we get down to is this is about people and the harm that HAMP is giving—the harm that HAMP is doing to people. And it is their government with their tax dollars doing active harm, based on the analysis we have had, by stringing people out, putting them more upside down in their payment, taking every bit of savings that they can get out of these people, and still taking their homes.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from California, Mr. Miller. Oh, I am sorry, I am so sorry, the gentlelady from California.

Ms. WATERS. Oh, thank you very much, Madam Chairwoman. And I am sorry I was a little bit late coming in.

But let me just say from the onset that I have had a hand in helping to develop some of the programs that are being questioned here and are set for ending. I don't want to talk a lot about the HAMP program because I think we all agree that there were weaknesses in the HAMP program, that there are ways by which it could have been strengthened, and it did not do everything that it should do.

But I am not willing to talk about eliminating the opportunity for some people to get a loan modification by not replacing HAMP with something. And for those people who are talking about getting rid of all these programs and they come with no programs or proposals to help working people, to help Americans who are in trouble, to help many Americans who are in trouble having defaulted or in foreclosure or threatened to be in foreclosure, not because they are bad citizens.

And I will say it over and over again, millions of Americans didn't all of a sudden become bad citizens not paying their debts. Something went wrong.

And we know what went wrong. What went wrong was there were exotic products that were placed on the market, that were not regulated. There were products that were placed on the market such as no-doc loans, and these loans that are resetting, loans that—teaser loans that got people in for a little amount of money. So we owe it to the people to try and be of assistance because we didn't do what we should have done in order to do the kind of regulation that will protect them from all of these fraudulent practices that were out there.

Having said that, let us take a look at the NSP program. Now, to get rid of NSP is going backwards. NSP is the Neighborhood Stabilization Program that goes into these communities where you have all of these boarded-up properties that have been foreclosed on, driving down the value of homes that are being kept up in the neighborhood, increasing the cost to the cities for fire, fire departments and police departments, who now have to take care of the crime that is going on in these vacant properties, weeds growing up.

And not only is it a good program, to help stabilize the neighborhoods, and to make sure that we retain the value, it is a program that creates jobs. It is jobs intensive.

In order to rehab these houses and to put them back on the markets, we employ a lot of people. We employ the contractors. We get the Realtors involved. We get the title people involved. We get subcontractors involved. It goes on and on and on. It is job producing.

When there are estimates that talk about some of these cuts and how they are going to cause the loss of jobs, it is true. You can absolutely see it in something like NSP.

Many of the people who are talking about getting rid of NSP don't even know what NSP is. They are simply talking about slash and burn.

And so I helped to create NSP. I believe in it. Communities want it. It is being implemented well. The HUD took a look from the very beginning at how it is being implemented and moved quickly to strengthen it.

And now, cities and towns love it. They are doing a good job with it.

And I don't have any questions. I just have a lot to say.

Not only is this program good for the city, some people think, oh, this is just—this is for rural areas, this is for suburban areas, this is for everybody. So I don't want anybody to be mistaken to think, oh, this is just something for some of those cities that got in trouble. No, this is a good American program. It should not be cut.

And I don't know what else you can say to help educate all of the Members of Congress about the value of NSP, but ask them to go back to their cities and talk with their mayors and talk with people about NSP that they want to cut and see what kind of response they get.

With that, I yield back the balance of my time.

Chairwoman BIGGERT. The gentlelady yields back.

Mr. GUTIERREZ. Madam Chairwoman, may I ask unanimous consent that Congressman Green, a member of the full committee—when everyone on the subcommittee has been given an opportunity, be allowed to ask questions?

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. GUTIERREZ. And I ask unanimous consent that we insert a letter to both you, Madam Chairwoman, and me about the Neighborhood Stabilization Program from the National Association of Counties, National League of Cities, and U.S. Conference of Mayors in the record.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. GUTIERREZ. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. The gentleman from California, Mr. Miller.

Mr. MILLER OF CALIFORNIA. I have enjoyed a lot of the comments. I will go back in history to say Ms. Waters remembers me introducing language on predatory lending versus subprime probably 6 times. We got it to the Senate, and Senate Democrats filibustered it every time. We started in 2002. Had we done that, perhaps Countrywide and others would not have done what they did and ruined the marketplace.

Also, there were comments on the monies lent to banks in TARP I that was under a House and Senate controlled by Democrats. It was a bipartisan bill. The money lent to the banks was repaid. That also should be stated.

The problem I have today is Freddie and Fannie are in serious trouble and this Administration is charging them 10 percent interest for funds to keep them going. That is abhorrent. Ten percent interest.

So if we want to put the facts on the table here, let's put all the facts on the table.

My good friend Maxine talked about the Neighborhood Stabilization Program. The problem I have with it is the equitable allocation I think is absolutely questionable: Los Angeles County in NSP 1, 2, and 3 got $26.5 million; San Bernardino County got $33.2 million; and Orange County got $4.3 million.

Neighborhood Lending Partners, Inc., got $50 million. I don't know who they are. The Community Builders, Inc., got $78.6 million. Chicanos por la Causa, Inc., got $137 million, $137 million. I don't know who they are.

The Inspector General of HUD already identified numerous misuses of NSP money at the State level and the Government Accountability Office has questioned the information system in place that HUD used to track the money. There is very little hard evidence on whether the funds are being used by the recipients in a cost-efficient manner.

I guess the question I have is, the new proposed budget deficit is $1.6 trillion. This program is allocated for $7 billion. Is there any mechanism that requires repayment of these funds to the Federal Government? Can anybody answer that?

Ms. MARQUEZ. These are grant funds.

Mr. MILLER OF CALIFORNIA. They are grant funds to be repaid to the groups who buy the houses, rehab the houses, and sell the houses. So what we are saying is, we are giving $7 billion of taxpayers' money to groups and organizations out here and to cities and none of it comes back to the Federal Government?

Ms. MARQUEZ. The money is going to homeowners and to American citizens.

Mr. MILLER OF CALIFORNIA. There is a repayment of the funds to the group. So you are telling me if a group buys a foreclosed home and they rehab the home, they just give the house away?

Ms. MARQUEZ. I would be happy to discuss it.

Mr. MILLER OF CALIFORNIA. Yes.

Ms. MARQUEZ. The NSP program is in three phases. The formulas you speak about, formula program in NSP1 and in NSP3, as—spoke about, are done by formula. It takes into account—

Mr. MILLER OF CALIFORNIA. That is not the question. I have talked about that. Where does the money go when it is repaid? Is this just a gift?

Ms. MARQUEZ. When the money is repaid, it is calculated the way other community development programs are done. In fact, it mirrors the CDBG program, which uses it as program income. So, for instance—

Mr. MILLER OF CALIFORNIA. But wait a minute. We don't give CDBG program money to—we didn't give $50 million to Neighborhood Lending Partners, we did not give $78 million to Community Builders, we did not give $137 million Chicanos por la Causa, Inc.

Ms. MARQUEZ. In fact, sir, I guess I would say that we allocate money through communities, like NSP does with CDBG. CDBG does the same thing, we allocate to the grantees and the grantees have the discretion and the flexibility to then grant funds or lend funds to various sub-recipients.

It is probably true that if I were to check the records, I am pretty sure the Community Builders actually does receive money from CDBG from various States. And in fact, Chicanos por la Causa or these different groups run them through NSP2 and they are national groups. So they are doing work in multiple States.

So what they are doing is all throughout the country. Chicanos por la Causa—

Mr. MILLER OF CALIFORNIA. But there is a big difference between taking and making sure boarded-up houses are off the marketplace, rehabbed and sold, putting new people in there, then just giving $7 billion worth of government funds away.

And that is what we are doing, we are giving $7 billion worth of taxpayer dollars away to groups and organizations and there is no requirement for repayment. But in the bill, there is an opportunity for them to buy the property and sell the property. And the money goes back to them. It goes back to them. Mr. Stevens, do you have anything to add to that?

Mr. STEVENS. Congressman, I—under my authority, it is Assistant Secretary Marquez.

Mr. MILLER OF CALIFORNIA. I think it is a huge, enormous waste of taxpayer dollars to put $7 billion out there, giving some—they can say nonprofits, whatever you want to call it, the opportunity to receive the funds. I don't think there is adequate oversight over those funds, and if they sell the property to take the funds back and keep those funds.

A program like this should have been used for the purpose of making sure that foreclosed properties were taken off the market, if that was the intent, rehab them, sell them, then the money comes back to the Federal Government. But this government has to stop giving the taxpayers' monies away like we are today. We don't have $7 billion to keep throwing out there today. We just don't have it.

And if we are going to do something like this, it should be done in the form of a loan basis, not a grant, and especially when I don't think the grant was equitably distributed to the different groups out there.

I yield back.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from Virginia, Mr. Hurt, is recognized.

Mr. HURT. Thank you, Madam Chairwoman.

Welcome, to all of the witnesses.

Mr. Barofsky, are you familiar with an article that was written in The Washington Times this morning that talked about a survey that was conducted by a group called ProPublica?

Mr. BAROFSKY. I haven't read The Washington Times article. I am familiar with ProPublica's survey they did of HAMP recipients. Is that—

Mr. HURT. That is the one—that is the subject that I am talking about.

Mr. BAROFSKY. Oh, no, absolutely. We actually cited to it in our—one of our most recent quarterly reports.

Mr. HURT. Okay. And what was remarkable to me was their projection that during the progress of the HAMP program, that recipients were told to fall behind in order to qualify for the HAMP help.

Based on their calculations, they figured that 500,000 of those who received the HAMP program assistance actually were told that.

I wondered if you would comment on that and surmise as to whether or not you think that estimate is correct.

Mr. BAROFSKY. I can't speak on whether that estimate is correct or not. But it doesn't surprise me.

This has been one of the inherent problems of this program, is that the mortgage servicers entrusted with this program have done an abysmal job. There is universal agreement on this.

But Treasury has done nothing to punish or penalize these servicers.

So what you have is a program where these servicers routinely violate the rules, routinely violate the guidelines that—they are not supposed to ever tell a homeowner, oh, by the way, you should stop making payments. That is a direct violation of the rules.

But we hear anecdotally time after time that this has happened.

So what is the Treasury Department's role in this? They are enabling this behavior by not imposing financial penalties, by not trying to call back funds, by not denying servicer payments. But they do nothing—one of the reasons why I think—

Mr. HURT. You could argue that the person they are trying to help is the one who gets hurt the most because you could argue that certainly some of these folks might not have gotten into the modification program if they had not been told to miss a payment so they could qualify for assistance.

Mr. BAROFSKY. Which is, again, why, when Treasury cites as a success of this program the 1.4 or 1.5, now, million homeowners who have received trial, temporary modifications, and say that they have all received a benefit, why, that just is so dead wrong, because there are so many who have suffered as a result of this program and had the rug pulled out from under them.

Mr. HURT. Are there other examples of underhanded or wrong encouragement that was given by servicers, other than the—that the proposal that you fail to pay your mortgage so that you can qualify for the program?

Mr. BAROFSKY. We have heard and we have reported on, from our hotline, all sorts of different behavior. Losing documentation is one of the most common errors.

Whether intentional or not, we have had homeowners who can document that their paperwork has been lost, 1, 2, 3, 4, 5 times. And then they are pulled out of the program. They are kicked out of the program, even though they have made every payment on time.

They are hit, as the Chair said, they are hit not just with a bill for all of the difference between their trial payments and the amount original done, but late fees. Homeowners are being hit with late fees.

And Treasury permits this in their program, late fees, when they have never actually missed a payment. And all that—

Mr. HURT. But they are paying the reduced—paying the trial modification amount?

Mr. BAROFSKY. But so they—right, right. So they make all those payments, but not only do they get hit with the difference but with the late fees.

Mr. HURT. Right.

Mr. BAROFSKY. Which Treasury allows. And then the servicer tacks all of that onto the mortgage balance. And they get that money first when there is a foreclosure.

Or if it goes into one of these proprietary modifications, they are vastly inferior.

And I find it puzzling that Treasury continues to cite this as the success of the HAMP program when they cite these proprietary modifications so adoringly when they would never qualify.

They would be rejected—

Mr. HURT. My time is about to expire. But I would love it if either Ms. Marquez or Mr. Stevens would like to comment on what he has stated, in terms of the—what I would say fraudulent behavior.

Is there anything you want to add to that for those estimates?

Mr. STEVENS. Again, I would encourage you to work with the Department of the Treasury that manages the HAMP program. I am not well-versed enough in the details of those comments.

Mr. SCIRE. If I could add, we reported last year about concerns on equitable treatment of borrowers. And a borrower need not be delinquent to be considered for a HAMP modification.

They could be current, but as a servicer must then consider whether or not the borrower is in imminent danger of default, we recommended that Treasury establish criteria for making that determination.

And Treasury has not done so. We found, of the 10 servicers we visited, they had 7 different definitions for determining whether a borrower who was current should be considered for HAMP.

Mr. HURT. I thank the witnesses.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman.

I thank the witnesses as well.

I suppose I am the only person in the room who is not surprised that we have a program that is not perfect. Imperfect program. The question really is, who do you punish if the program isn't perfect?

Do you punish the people who can benefit from the program by eliminating it? Or do you try to find a means by which the imperfect can be perfected? Who do you punish?

Mr. Barofsky, you don't advocate punishing the homebuyers, do you?

Mr. BAROFSKY. We have advocated tirelessly that Treasury should fix the program.

Mr. GREEN. Fix the program. Thank you, sir. Please, I don't mean to be rude, crude, and unrefined, but I have much to say and little time to say it.

Fix the program. Does any one among you advocate punishing the homeowners by ending the program? Let the record reflect that not one person advocates ending the program and punishing the homeowners.

Ms. JONES. I do have to say that CRS doesn't advocate any position—

Mr. GREEN. Thank you, but for your edification, there are persons who will distort what has been said here today, but for what I am doing right now, I have to do my job. And my job is to make sure that those who want to be set free by knowing the truth will be free. If you know it, it will free you. And I want to free some souls.

The people who are damaged, who are to be helped by these programs, many of whom were pushed into subprime loans, who qualified for prime loans by the yield spread premium—for those who don't know, the yield spread premium said simply, you qualify a person for a 5 percent loan and if you can get them to take out an 8 percent loan, you will get a lawful kickback.

That was what took place at the time many of these loans were being made. And many people were pushed into subprime loans who qualified for prime loans, 3/27, 2/28, bearable rates.

Qualified for the bearable rate but didn't qualify for the adjusted rate. Teaser rates that coincided with prepayment penalties. If you try to get out of the loan, you have to pay this huge penalty that they could not afford.

So let's not kid ourselves.

We have a lot of people who were victims of a system that allowed these kinds of dastardly products to not only manifest themselves but to become a part of the broader market and be sold and securitized, credit default swaps, the list can go on and on of the things that were occurring at the time.

So we have to ask ourselves the question, who do we punish? Do we punish the people who can benefit from the programs by terminating them? Or do we do what we do when we have a problem with a military program, we fix it.

We fix the problem. When we sell $200 toilet seats, we fix it. When we sell $100 hammers, we fix it. Why not fix this?

When we have a problem in a police department, we don't say we are going to end the police department. We fix the problem and continue to have the police on the beat.

Who do we punish? Do we punish the people who can benefit by terminating the program? Name me one perfect bill that has ever been passed in Congress, other than the ones that I—of course.

The point is, my dear friends, let's assume for the record that all that you have said is true. You don't set the policy. That is our job. Does everybody agree with that?

If there is a person among you who thinks that you set policy, raise your hand so that you can be properly terminated. All right. You don't set policy.

We set policy. And in setting policy, we have to make tough decisions. The easy decision is to eliminate something that we don't like. The tough decision is to work together, bipartisanship, come up with a means by which that which is unacceptable can work for the American people. This is what the American people expect of us.

We have helped Wall Street. We have helped Main Street. Now it is time for us to help Home Street. These are dollars for homeowners. Let's help Home Street.

And my final question is this, my time has ended, but maybe I can get a quick answer.

Have any of you done any studies on the impact of this nationally, ending all of these programs at the same time, at the time of the crisis we are going through? Anybody? Anybody?

Ms. MARQUEZ. Not of all of them.

Mr. GREEN. Okay. All right. Thank you very much. I yield back the balance of my time that I do not have.

Chairwoman BIGGERT. Thank you very much.

I would like to ask unanimous consent to insert in the record written testimony of the American Alliance of Home Modification Professionals.

We have just been called for another vote—timing is perfect, I guess, here.

Let me note that some members may have—

Mr. GUTIERREZ. —if you have time, I would like to continue. I think it is important. And we are not coming back.

Chairwoman BIGGERT. Yes. We missed the last vote—we were able to get in—so I would prefer to adjourn. I would just note that members may have additional questions for these witnesses which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses and to place their responses in the record.

[Whereupon, at 3:47 p.m., the hearing was adjourned.]

A P P E N D I X

March 2, 2011

SIGTARP
OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM
ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

MARCH 2, 2011

Chairman Biggert, Ranking Member Gutierrez, and members of the Committee, I am honored to appear before you today to discuss the Department of the Treasury's Home Affordable Modification Program ("HAMP").

Since the President's announcement of the HAMP program in February 2009, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") has committed significant resources to provide oversight for the program and to take steps to limit its vulnerability to waste, fraud and abuse. To date, through one completed audit (with two more currently under way) and eight quarterly reports, SIGTARP has offered Treasury 18 recommendations to help maximize program effectiveness and protect the taxpayer from losses due to fraud. Of these, Treasury has fully implemented four recommendations, partially implemented five, not implemented seven, and has stated that it is in process of at least partially implementing the remaining two. SIGTARP's Investigations Division has also been busy policing the program, focusing primarily in its charged cases on those who have used HAMP as a tool to defraud struggling homeowners. Of the 47 individuals and 16 entities that to date have been the subject of criminal or civil actions[1] related to SIGTARP's investigations, HAMP-related frauds have resulted in criminal charges against eight people, civil actions against 23 people (3 of whom were also charged criminally), and civil actions against14 entities. Of the 15 defendants who have been convicted to date for fraud related to the Troubled Asset Relief Program ("TARP"), three have been convicted for participation in schemes relating to HAMP.

As for the program itself, HAMP began with much promise, intended to promote TARP's most specific Main Street goal of "preserv[ing] homeownership." But as SIGTARP and the other TARP oversight bodies – the Congressional Oversight Panel ("COP") and the Government Accountability Office ("GAO") – have detailed in audits and reports, HAMP has been beset by problems from the outset and, despite frequent retooling, continues to fall woefully short of meeting its original expectations. Today the program is under siege from all quarters, with near universal agreement that the program has failed to meet its goals, and the current debate centering mostly on whether the program should be terminated, replaced or revamped. Treasury, it seems, stands alone in defending the status quo.

The frustration expressed from both sides of the aisle is understandable. As SIGTARP described in its January 2011 Quarterly Report to Congress, the numbers as of the end of 2010 were remarkably discouraging. According to RealtyTrac data, a record 2.9 million homes received foreclosure filings in 2010, up from 2.8 million in 2009, and 2.3 million in 2008. RealtyTrac predicts that filings will be 20% higher in 2011, obliterating the 3 million threshold. The recently reported numbers for January 2011 support this prediction, with more than 260,000 foreclosure filings in that month alone. The firm's data further reveal that bank repossessions continue to increase, from just less than 820,000 in 2008 to more than 918,000 in 2009 to 1.05 million in 2010. Some estimate that as many as 13 million homes will be subject to foreclosure filings during the operative stage of HAMP.

In contrast, the number of permanent mortgage modifications under HAMP remains feeble—there were just under 522,000 ongoing permanent modifications as of December 31, 2010, with approximately 238,000 of those funded by and attributable to TARP. The remaining modifications were funded outside of TARP by the Government Sponsored Entities ("GSEs"). A combined total of more than 792,000 trial and permanent modifications had been cancelled,

[1] These numbers do not include multiple administrative actions, such as debarments and suspensions, or filings in bankruptcy cases.

with more than 152,000 trial modifications still in limbo. These permanent modification numbers pale in comparison not only to foreclosure filings, but also to Treasury's initial prediction that HAMP would "help up to 3 to 4 million at-risk homeowners avoid foreclosure" "by reducing monthly payments to sustainable levels." While as of the drafting of this testimony Treasury had not released numbers for January 2011, there is little reason to hope that things will get better.

Treasury, for its part, has at least begun to acknowledge the program's shortcomings, with Secretary Geithner recently conceding that HAMP "won't come close" to the initial estimate of helping 3 to 4 million at-risk homeowners avoid foreclosure. The Secretary also recently acknowledged what SIGTARP and the other oversight entities have been stating for some time, that loan servicers – which by design bear the central responsibility for implementing HAMP – "are still doing a terribly inadequate job." Further, the Secretary admitted that the program suffers from a design flaw that goes to its very heart, with the recognition that the incentives to servicers that were intended to serve as the engine of HAMP simply "have not been powerful enough." While these admissions about the fundamental flaws in HAMP represent a step forward, they come very late in the game and appear to be unaccompanied by any consequential changes to the program or meaningful statement of program goals. Indeed, it is apparent that Treasury has no intention of meaningfully responding to these failures in performance or design. Just last week a Treasury official reportedly declared at a Mortgage Bankers Association conference that the attendees would not "see any major new programs coming out," and that while Treasury "may tweak around the edges," its "primary objective in 2011 is excellence in the program we have."[2] As a result, supporters of HAMP have little reason to hope that it will be anything more than it is today – a program that benefits only a small portion of distressed homeowners, offers others little more than false hope, and in certain cases causes more harm than good.

HAMP's failure to meet its original expectations has many causes, starting with a rushed launch based on inadequate analysis, an insufficient incentive structure, and without fully developed rules, which has required frequent changes to program guidelines. The unnecessary confusion and delay that accompanied the hasty rollout were exacerbated by Treasury's initial decision (later corrected) to encourage servicers to accept homeowners into trial modifications without requiring adequate documentation of income, despite SIGTARP's warning of the hazards of doing so. And while Treasury now acknowledges that "when HAMP was launched in early 2009, servicers were totally unequipped to deal with a crisis," Treasury's design of HAMP as a program so entirely dependent on servicer competence, along with its decision to flood those same "unequipped" servicers with trial modifications based on unverified data, in no small part contributed to the well-documented servicer failures that followed.

Perhaps most fundamentally, despite consistent and repeated recommendations from SIGTARP and the other TARP oversight bodies, as well as members of Congress, Treasury has steadfastly refused to adopt meaningful goals and benchmarks for HAMP. Rather than develop such goals and metrics, which would allow more meaningful oversight, promote accountability, and provide guidance for useful change, Treasury instead has regularly changed its criteria for success, citing at different times the total number of trial modification offers extended to borrowers, regardless

[2] Jon Prior, *Treasury makes adjustments to give HAMP a chance*, HousingWire (Feb. 24, 2011) (online at www.housingwire.com/2011/02/24/treasury-makes-adjustments-to-give-hamp-a-chance).

of whether they were accepted, and then the total number of trial modifications, regardless of whether they became permanent, which far fewer than half have actually done.

Treasury's continued reliance on trial modifications as a measure of success – just last month it highlighted the "temporary relief" such modifications provide, reinforcing its prior declaration that "every person who is in a temporary modification is getting a significant benefit" – is particularly troubling in light of the harm and suffering that often accompany failed trial modifications. In SIGTARP's October 2010 Quarterly Report, SIGTARP provided examples of the damage that failed trial modifications have inflicted, including complaints received through SIGTARP's hotline. Since then, there have been countless published reports of HAMP participants who end up worse off for having engaged in a futile attempt to obtain the sustainable relief that the program promised. Failed trial modifications often leave borrowers with more principal outstanding on their loans, less home equity, depleted savings, and worse credit scores. And even in situations where they never missed a payment, such borrowers may face back payments, penalties, and even late fees that become due once their trial modification is cancelled. The impact of these added burdens becomes even greater when trial modifications are allowed to continue long past the three-month period called for by the program. While it may be true that some homeowners benefit from the "temporary relief" of a trial modification even though the modification ultimately fails, Treasury's repeated references to the benefits of failed modifications ignores the real and often debilitating harm that such modifications have inflicted on many families, and appears to be little more than an attempt to define specific failures as successes.

In recent months, Treasury's evolving defense of HAMP has featured the claim that HAMP has had a beneficial impact on private modifications that occur outside of the HAMP program. This too is a questionable measure of success. While Treasury may deserve credit for having had a positive, if inadvertent, impact on industry practice, according to a December 2010 COP report, "when pressed, Treasury acknowledges that there is no clear causal link between HAMP and proprietary modifications." Furthermore, while data suggests that proprietary modifications have generally improved from the homeowner's perspective since the launch of HAMP, the terms of such modifications are typically far less advantageous, often including more unfavorable terms for the borrower, higher rates of redefault, and broader imposition of servicer fees that are specifically prohibited in HAMP. In other words, it is odd for Treasury to celebrate modifications whose terms would largely be unacceptable from both the borrower's and Treasury's perspective in HAMP. Furthermore, touting such proprietary modifications as a HAMP "success" also undermines Treasury's defense of the need to continue HAMP. If it truly views these modifications in such an admiring light, it raises the very serious question as to why taxpayers should continue to fund HAMP.

Of course, any credible measure of HAMP's success would include a comparison of the original expectation of helping 3 to 4 million families with sustained permanent modifications with the number of families that will actually receive them over the course of the program. Remarkably, despite recommendations from oversight bodies and requests from Congress, Treasury still refuses to provide even the most basic estimate of the total number of permanent modifications it expects to complete and maintain under HAMP. Instead, in recent testimony to this Committee, a Treasury official merely promised "to reach out to as many eligible homeowners as possible to our program's expiration in 2012." In December 2010, COP attempted to fill the void left by Treasury by estimating that, if current trends hold, HAMP will result in only 700,000 to 800,000 effective permanent modifications. Unfortunately, COP's bleak projection appears all too reasonable, with participation trends getting worse with each passing quarter. For example, HAMP produced only a net increase of slightly more than 18,000 permanent modifications per month over the most recent quarter, down 35% from the quarter before that, and a far cry from the 20 to 25,000 trial modifications *per week* Treasury officials once predicted. Even of these, TARP is responsible for only approximately 10,000 modifications per month, with the GSEs providing the balance.

Rather than confirm or reject COP's estimate, or provide one of its own, Treasury does something astonishing: Albeit in the context of calculating HAMP's total cost, it suggests both that COP's estimate might be accurate, which would mean roughly an additional 180,000 to 280,000 ongoing permanent modifications by program's end, or that the total might be *twice* COP's estimate, which would mean roughly an additional 870,000 to 1,070,000 ongoing permanent modifications by program's end. Treasury's suggestion that the number of new ongoing permanent modifications might vary by a factor of close to 10 can hardly give comfort to those interested in saving HAMP. Nor does it provide the American people and their representatives in Congress with the kind of information that is absolutely necessary in evaluating whether the program should be shut down, significantly revamped, or permitted to stay on its current course. We were all led to believe when HAMP was launched that it would help 3 to 4 million families stay in their homes through permanent modifications to sustainable levels. Given Secretary Geithner's acknowledgement that Treasury will "not come close" to that number, any credible assessment of HAMP must start with Treasury's clear articulation of the number of sustained permanent modification it believes HAMP will deliver.

The foundation for Treasury's claim that HAMP is a success appears to be that at least the program is helping *some* families, even if nowhere near the number originally promised. While, as Treasury repeatedly points out, for the more than 520,000 families that benefit from ongoing permanent HAMP modifications the program has certainly been successful, this does not make the program itself successful. Instead, the program should be defined by its failure to reach, if COP's estimate is accurate, the 2.2 to 3.3 million families from Treasury's initial estimate that will never be reached but who would have benefited from a better designed, better executed, and better managed program. To be sure, if HAMP continues in the status quo, some incremental number of families will certainly benefit from new, ongoing permanent modifications. But without any estimate from Treasury about what that incremental number will be, it is nearly impossible to measure the incremental benefit against the additional costs of continuing at the current pace, including the additional administrative costs, the opportunity costs of not pursuing potentially more effective alternatives, the harm inflicted on those who will inevitably enter into modifications that later fail, and further harm to Government credibility.

One defense Treasury offers against terminating HAMP is its claim that the servicing industry "was not and still is not fully equipped to deal with this crisis. Ending HAMP now will mean that the fate of struggling homeowners will be solely up to the servicers." While Treasury's acknowledgement of the abysmal performance of servicers is important, its use of that observation to justify the continuation of HAMP ignores two critical realities: First, by its very design, HAMP puts the "fate of struggling homeowners" squarely in the hands of servicers. Under HAMP, servicers not only operate as the point of contact for distressed homeowners seeking to participate in the program but also administer the loans on behalf of investors. In short, Treasury has placed virtually all of HAMP's eggs in the servicer basket. Second, Treasury's implicit suggestion that it can and will control servicer behavior within HAMP is utterly belied by experience. Despite nearly daily accounts of servicer errors and more serious misconduct, Treasury reported to SIGTARP that as of December 31, 2010, it had yet to impose a financial penalty on, or withhold or claw back incentives from, a single servicer for any reason other than failure to provide data.

Anecdotal evidence of servicer failures, of course, has been well chronicled. From the repeated loss of borrower paperwork, to blatant failure to follow program standards, to unnecessary delays that severely harm borrowers while benefiting servicers themselves, stories of servicer negligence and misconduct are legion, and the servicers' conflicts of interest in administering HAMP — they too often have financial interests that don't align with those of either borrowers or investors — have been described by SIGTARP and others. Treasury's tepid reaction to date to servicer non-compliance with the requirements of HAMP and its related programs appears to be driven in part by the fear that forcing servicers to comply with their contractual obligations will drive them away from HAMP. Treasury recently told COP that since participation by the servicers is purely voluntary, "our abilities to enforce specific performance are extremely limited" and "aggressive enforcement [is] difficult." This same fear of servicer withdrawal was offered by Treasury in response to SIGTARP's recommendation that Treasury reconsider its decision to make its Principal Reduction Alternative program entirely voluntary, and Treasury continues to operate an appeals system that leaves the ultimate decision of whether to approve or deny a modification squarely with the servicer. TARP's oversight bodies — SIGTARP, COP, and GAO — have all called on Treasury to get tough on servicers. Without meaningful servicer accountability, the program will continue to flounder.

In recent testimony, Treasury has offered an additional justification for failing to get tough on servicers, stating that "Congress didn't give us the tools to impose fines, as Mr. Barofsky is suggesting. What we have is the ability to withhold payment when they enter a permanent modification." This statement appears to be a retreat from earlier Treasury press releases and statements warning that servicers would suffer consequences and face monetary penalties for failure to meet performance obligations. Indeed, a November 30, 2009, Treasury press release specifically stated that "servicers failing to meet performance obligations under the Servicer Participation Agreement will be subject to consequences which could include monetary penalties and sanctions." SIGTARP has asked Treasury to clarify its position on when it may impose penalties, claw back prior payments, or withhold payments to servicers for violations of program guidelines or other provisions of the Servicer Participation Agreement, as well as any legal authority it believes supports its position. And, of course, if Treasury believes that it needs additional tools from Congress to effectively manage HAMP, it should propose legislation that would give it the necessary authority it believes it lacks.

Another of Treasury's current defenses of the HAMP is its claim that SIGTARP "has explicitly stated that it does not support terminating the program." I can only assume that this is a reference to my testimony before the House Committee on Oversight and Government Reform in January of this year. At that hearing, which included overwhelmingly bi-partisan criticisms of HAMP, I suggested in response to a question as to whether HAMP should be terminated that while hope for the program was "slipping away," Treasury should be given the chance to respond swiftly to Congressional criticisms, articulate meaningful program goals, and implement changes to meet those goals before giving up entirely on the one TARP program that was specifically targeted to help Main Street, and fulfill the Emergency Economic Stabilization Act's goal of "preserv[ing] home ownership." What has happened since that hearing? Very little. While Treasury has acknowledged some of HAMP's shortcomings, it has offered no meaningful plan going forward, and no meaningful way to measure program success. Instead it continues to refuse to set forth its expectations for the program and reportedly promises a conference of mortgage servicers that it all it will do is possibly "tweak around the edges." As a result, those who argue for keeping HAMP alive have an increasingly daunting task, and absent meaningful action from Treasury, SIGTARP's "support" of HAMP's continued existence is all but exhausted.

Chairman Biggert, Ranking Member Gutierrez, and members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

Via Online: WWW.SIGTARP.GOV
Via Toll Free Phone: 877-SIG-2009
Via Fax: 202-622-4559

Via Mail: Hotline, Office of the SIGTARP
1801 L St., N.W.
Washington, D.C. 20220

Congressional
Research
Service

Subcommittee on Insurance, Housing, and Community Opportunity
of the House Financial Services Committee
Hearing on "Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs"
March 2, 2011

Testimony of Katie Jones
Analyst in Housing Policy
Congressional Research Service

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, my name is Katie Jones, and I am an analyst at the Congressional Research Service. I am honored to appear before the Subcommittee today. As requested by the Subcommittee, my testimony will provide background information on the four federal foreclosure mitigation initiatives that are the subject of the draft legislation that is the focus of this hearing. Those programs are the Home Affordable Modification Program (HAMP); the FHA Short Refinance Program; the Emergency Homeowners' Loan Program; and the Neighborhood Stabilization Program (NSP).

The Subcommittee specifically requested that I provide data on performance and funding metrics related to these foreclosure mitigation initiatives. Since CRS does not independently collect data, the numbers provided in my testimony come from data that are made publicly available by the Treasury Department, the Department of Housing and Urban Development, or other government entities. My testimony today highlights information that is discussed in my CRS Report R40210 entitled *Preserving Homeownership: Foreclosure Prevention Initiatives* and CRS Report RS22919 entitled *Community Development Block Grants: Neighborhood Stabilization Program; Assistance to Communities Affected by Foreclosures,* written by two of my colleagues. I have included both of these reports for the record. My testimony is limited to information contained in these reports and previous analyses that my colleagues or I have done in relation to these initiatives. CRS has not performed specific analyses of these programs for this hearing, and it has not performed any analyses of the draft legislation. As is its policy, CRS takes no position on these legislative proposals or on the initiatives themselves.

I have organized my testimony by first addressing the two foreclosure mitigation initiatives in question that are Obama Administration initiatives funded under the Troubled Asset Relief Program (TARP). I then address the two additional initiatives that were created by Congress. I will spend much of my time addressing HAMP and NSP, since these are the two initiatives that have been active for the longest periods of time.

HAMP

The first initiative that I will discuss is the Home Affordable Modification Program (HAMP), which was established by the Obama Administration using TARP funds. HAMP was first announced in February

2009, became active in March 2009, and currently has an end date for entering into new modifications of December 31, 2012. HAMP provides financial incentives to mortgage servicers, borrowers, and investors to facilitate mortgage modifications that lower borrowers' monthly mortgage payments to no more than 31% of their monthly income. Borrowers first enter into a trial modification, which is supposed to become a permanent modification if borrowers make all of their trial period payments on time and all other eligibility criteria are met. The financial incentive payments provided by the federal government are offered only for permanent modifications.

While HAMP is primarily geared to making monthly payments on first mortgages more affordable for borrowers, several additional components of HAMP that address related factors have been announced and implemented since HAMP first became active. These include the Second Lien Modification Program (2MP), which provides incentives for the modification of second liens when the first lien is modified through HAMP; the Home Affordable Foreclosure Alternatives Program (HAFA), which provides incentives to facilitate short sales and deeds-in-lieu of foreclosure as alternatives for borrowers who ultimately do not qualify for HAMP modifications; the Home Affordable Unemployment Program (UP), which provides for a three-month forbearance period for unemployed borrowers who meet the initial HAMP eligibility criteria; and the Principal Reduction Alternative (PRA), which requires servicers to consider reducing principal balances for certain homeowners who owe more than their homes are worth, although they are not required to do so. Additionally, mortgages insured by the Federal Housing Administration (FHA) can participate in a program known as FHA-HAMP, and mortgages insured by the Department of Agriculture's Rural Development agency can participate in a program called RD-HAMP. The start dates of HAMP and these related initiatives are included in **Table 1**.

Table 1. Start Dates of HAMP and Related Programs

Event	Date
HAMP Announced	February 18, 2009
HAMP Start Date	March 4, 2009
Start Date of 2MP	August 13, 2009
Start Date of FHA-HAMP	August 15, 2009
Start Date of HAFA	April 5, 2010
Start Date of UP	July 1, 2010
Start Date of RD-HAMP	September 24, 2010
Start Date of PRA	October 1, 2010
Anticipated Program End Date	December 31, 2012

Source: Table prepared by CRS on the basis of HAMP guidance.

In addition, Treasury has made several changes or updates to the program guidance for first-lien modifications since HAMP first became active. One such change was a requirement that servicers verify borrowers' income information before approving a trial modification, rather than approving trial modifications on the basis of stated income information and requiring documented income information before a trial converted to permanent status, as was allowed by the initial program guidance. This change went into effect for all servicers on June 1, 2010. Another program change was a requirement that servicers evaluate borrowers for HAMP eligibility before referring a borrower to foreclosure, which also went into effect for all servicers on June 1, 2010. There have also been a number of enhanced disclosure and outreach requirements that have gone into effect over the course of HAMP's existence. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act required certain changes to HAMP.

Namely, that law required that Treasury make a net present value (NPV) calculator available online, which Treasury has said it expects to be operational in Spring 2011; and that servicers provide borrowers with certain net present value test inputs upon denying a borrower for a modification, which went into effect for all servicers on February 1, 2011.

Program Funding

Treasury initially estimated that up to $75 billion would be spent on HAMP modifications. Of that amount, $50 billion was to come from TARP funds, and $25 billion was to be provided by Fannie Mae and Freddie Mac ("the GSEs") for the costs of modifying mortgages that they own or guarantee. The $50 billion in TARP funds has since been reduced to a total of $45.62 billion for HAMP and other housing programs. Treasury has reduced the amount of TARP funds that it has designated specifically for HAMP and its related programs to $29.91 billion, with the remainder of the funds designated for the FHA Short Refinance program ($8.12 billion) and the Hardest Hit Fund ($7.6 billion).

According to Treasury, as of February 25, 2011, $1.04 billion of the HAMP funding has been disbursed.[1] TARP funds spent on HAMP are used to pay incentive payments to mortgage servicers, borrowers, and investors in connection with first-lien modifications of non-GSE mortgages under HAMP. Some of the funding is also used for incentive payments under the related HAMP programs described earlier, as well as incentive payments related to modifying or extinguishing second liens under the FHA Short Refinance program.

Under the HAMP incentive structure, mortgage servicers receive an upfront incentive payment when a modification becomes permanent, and mortgage investors also receive a payment cost share incentive for successful permanent modifications. In addition, mortgage servicers can receive "pay-for-success" incentive payments of $1,000 per year for up to three years, and borrowers can receive pay-for-success incentive payments of $1,000 per year for up to five years in the form of principal reduction, if the borrower remains current on the modified mortgage payments. In other words, certain HAMP incentive payments are designed to be paid based on the *future* success of servicer actions in the *past*. For this reason, Treasury may continue to have a contractual obligation to pay servicers for their past performance under (or reliance on) the HAMP program, even if new legislation is enacted to terminate the program before its currently-scheduled end date.

While Treasury anticipates that the entire $45.62 billion currently designated for the three housing programs that use TARP funds (HAMP, FHA Short Refinance, and the Hardest Hit Fund) will be spent, a November report from the Congressional Budget Office (CBO) estimates that only $12 billion in TARP funds will ultimately be spent on these programs.[2]

Program Participation

In public announcements when HAMP began, the Treasury Department estimated that HAMP could reach between 3 million to 4 million homeowners.[3] As of December 2010, there were 521,630 permanent,

[1] U.S. Department of the Treasury, *Daily TARP Update (Figures as of 02/25/2011)*, February 25, 2011, http://www.treasury.gov/initiatives/financial-stability/briefing-room/reports/tarp-daily-summary-report/TARP%20Cash%20Summary/Daily%20TARP%20Update%20-%2002.25.2011.pdf.

[2] Congressional Budget Office, *Report on the Troubled Asset Relief Program – November 2010*, http://www.cbo.gov/ftpdocs/119xx/doc11980/11-29-TARP.pdf.

[3] U.S. Department of the Treasury, *Making Home Affordable: Summary of Guidelines*, March 4, 2009, (continued...)

active HAMP modifications. Another 152,289 modifications were currently active in the trial period that precedes a permanent HAMP modification, for a total of 673,919 currently-active modifications. At the same time, nearly 800,000 modifications have been canceled since the start of the program. Most of these were trial modifications that never converted to permanent status.[4] Note that these numbers include both GSE and non-GSE modifications; nearly 54% of all active HAMP modifications as of the December report were GSE loans.

Figure 1 shows the number of new HAMP trial modifications and new HAMP permanent modifications in each month in 2010. The number of new trial modifications decreased each month in the beginning of the year, but has somewhat leveled out in subsequent months. The number of new permanent modifications increased each month in the beginning of 2010, with a peak of over 68,000 new permanent modifications in April 2010. After that point, the number of new permanent modifications generally decreased over the next several months, although the numbers of new trial and permanent modifications both showed slight increases in the last months of 2010. In the last quarter of calendar year 2010, an average of 32,000 mortgages were entering a HAMP trial period each month, and an average of 28,000 modifications were transitioning to permanent status each month.

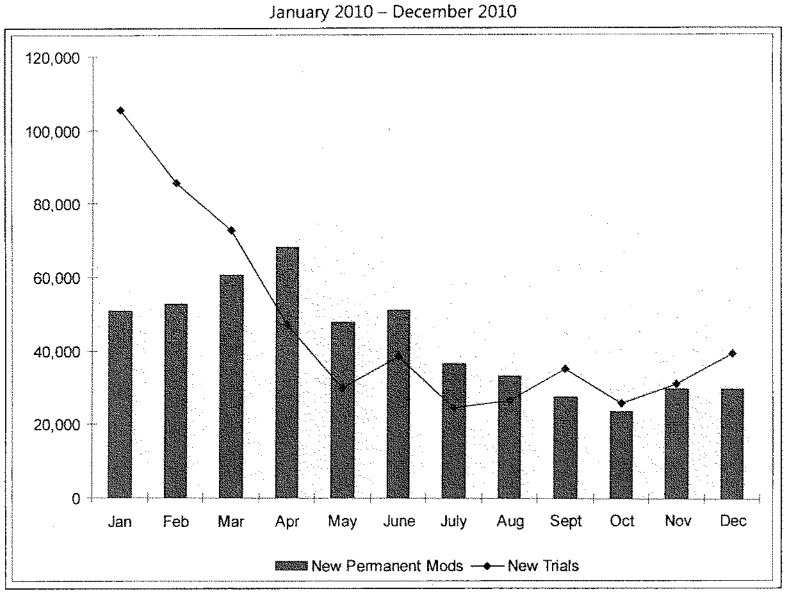
(...continued)

http://www.treasury.gov/press-center/press-releases/Documents/guidelines_summary.pdf.

4 U.S. Department of the Treasury, *Making Home Affordable Servicer Performance Report through December 2010*, January 31, 2011, http://www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Dec%202010%20MHA%20Report%20Final.pdf.

Figure 1. New Trial and Permanent HAMP Modifications by Month

January 2010 – December 2010

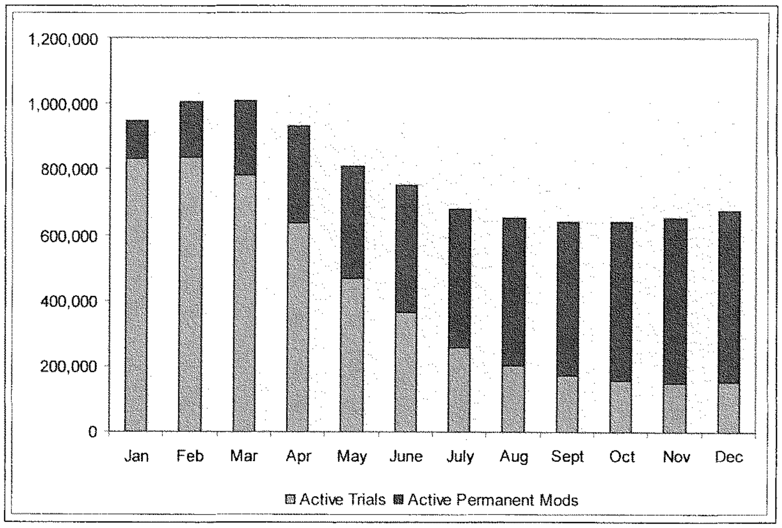


Source: Figure created by CRS based on data from Treasury's monthly Making Home Affordable Servicer Performance Reports.

Figure 2 illustrates the total number of active trial and permanent modifications, and their relative shares of the number of total active modifications, in each month between January and December 2010. The total number of active permanent modifications, and the proportion of active modifications that are permanent modifications, have both increased over the course of the year. This is to be expected as trial modifications convert to permanent status. The number of active trial modifications, and the total number of active modifications, has also decreased partly because a number of trial modifications have been canceled rather than converting to permanent status, and a smaller number of trial modifications have been beginning each month. While the total number of active modifications decreased for several months after a peak in March 2010, the number of total active modifications began to flatten out and then slightly increase in the last months of 2010.

Figure 2. Total Active Trial and Permanent Modifications by Month

January 2010 – December 2010



Source: Figure created by CRS based on data provided in Treasury's monthly Making Home Affordable Servicer Performance Reports.

In terms of redefault rates, the Treasury Department reports that about 20% of borrowers who receive permanent HAMP modifications are 60 or more days behind on their mortgages again twelve months after the modification became permanent.[5] The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS), which put out a quarterly Mortgage Metrics Report, report similar numbers. For example, the OCC/OTS Mortgage Metrics Report for the Fourth Quarter 2010 reports that 14.4% of HAMP modifications completed in the fourth quarter of 2009 are 60 or more days delinquent nine months after the modification. This compares to a redefault rate of 30.3% for modifications performed during the same time period that took place outside of HAMP. [6]

FHA Short Refinance

The FHA Short Refinance program was established by the Obama Administration using TARP funds. It allows certain homeowners who are current on their mortgage payments, but owe more than their homes are worth, to refinance into new mortgages insured by the Federal Housing Administration (FHA), if the original mortgage lender agrees to write down the principal balance by certain amounts. The program was

[5] Treasury's *Making Home Affordable Servicer Performance Report through December 2010*, p. 4.

[6] Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, Third Quarter 2010*, December 2010, p. 37, http://occ.gov/publications/publications-by-type/other-publications/mortgage-metrics-q3-2010/mortgage-metrics-q3-2010.pdf.

announced in March 2010; detailed guidance on the program was released on August 6, 2010; and the program became effective on September 7, 2010. Currently, borrowers can refinance through the program until December 31, 2012.

Program Funding

Treasury has designated up to $8.12 billion in TARP funds for the FHA Short Refinance program to cover a portion of any losses that FHA experiences on defaulted loans through this program. Also, as noted earlier, a portion of the TARP funds set aside for HAMP will be used by Treasury to pay the costs of incentive payments to second lienholders to reduce second mortgage balances or extinguish their liens through this program.

Program Participation

The FHA Short Refinance program became active in September 2010. As of a January 2011 FHA report, 40 loans had refinanced through the program.[7]

A HUD economic impact analysis of the FHA Short Refinance Program notes that HUD cannot make a "definitive estimate" of the number of households that could utilize the program due to the voluntary nature of the program and the number of external factors that could impact program participation. However, the same analysis states that Treasury expects that 1 million households could refinance through the program, and HUD has established a range of between 500,000 and 1.5 million households to evaluate the program. HUD also states that it anticipates that most of these expected participants (60%) would sign up in the program's first year (FY2011).[8]

Emergency Homeowners' Loan Program

Congress established the Emergency Homeowners' Loan Program (EHLP) in the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), which was enacted on July 21, 2010. The Dodd-Frank Act reauthorized and made changes to the Emergency Mortgage Relief Program, which was initially established by the Emergency Housing Act of 1975. The legislation also provided funding to HUD to administer the program, effective October 1, 2010. Through the Emergency Homeowners' Loan Program, HUD will provide short-term, zero-interest, subordinate loans to some homeowners who meet certain eligibility criteria, and who have experienced a reduction in income due to unemployment or underemployment to help cover the cost of their mortgage payments. No payment on the subordinate loan will be due during the following five-year period as long as borrowers remain current on their first mortgage payments and continue to live in the home as their primary residence. HUD will forgive the subordinate loan entirely after five years if these criteria continue to be met.

The program is expected to begin taking applications in Spring 2011. By statute, no new loan agreements with borrowers can be entered into after September 30, 2011.

---

[7] U.S. Department of Housing and Urban Development, *FHA Single-Family Outlook, January 2011*, p. 4, http://www.hud.gov/offices/hsg/rmra/oe/rpts/ooe/olcurr.pdf.

[8] U.S. Department of Housing and Urban Development, "Economic Impact Analysis of the FHA Refinance Program for Borrowers in Negative Equity Positions," http://www.hud.gov/offices/adm/hudclips/ia/ia-refinancenegativeequity.pdf.

Program Funding

Congress provided up to $1 billion in mandatory funding for the Emergency Homeowners' Loan Program in the Dodd-Frank Act. HUD has allocated this funding to the 32 states (and Puerto Rico) that are not eligible to receive funding under Treasury's Hardest Hit Fund Program; the funding was allocated according to each state's relative share of unemployed homeowners with a mortgage.

States that already have programs that are deemed to be "substantially similar" to the Emergency Homeowners' Loan Program can receive allocations of their share of funds for the cost of making loans under their existing programs. In states that do not have substantially similar programs, HUD has contracted with NeighborWorks America to perform administrative and outreach functions, including accepting applications from homeowners. Since the program is not yet taking applications, no funds have been dispersed to borrowers to date.

Program Participation

The Emergency Homeowners' Loan Program has not yet begun taking applications, but is expected to begin doing so imminently. The Conference Report that accompanied the Dodd-Frank Act did not provide an estimate of the number of borrowers that Congress expected could be assisted through this program. HUD also does not appear to have publicly announced an estimate of the number of borrowers it expects to receive loans through this program.

Neighborhood Stabilization Program

Congress established the Neighborhood Stabilization Program in the Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted on July 30, 2008, to allow states and local communities to purchase and redevelop foreclosed or abandoned properties. Congress subsequently provided additional funding for the program in the American Recovery and Reinvestment Act (P.L. 111-5), enacted on February 17 , 2009, and in the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), enacted on July 21, 2010. These components of NSP are identified as NSP-1, NSP-2, and NSP-3 respectively.

Program Funding

The Housing and Economic Recovery Act of 2008 provided $3.9 billion for NSP-1. HUD awarded the funds to states and local governments based on a formula that focused on the number and percentage of residential foreclosures and subprime loans. Each state was granted a minimum allocation of 0.5% of the amount appropriated. Only local governments who received a minimum allocation of $2 million were granted direct administrative control of NSP-1 funds. In total, 309 states and local governments met the minimum requirements to directly administer NSP funds.

The American Recovery and Reinvestment Act provided $2 billion for NSP-2. These funds were awarded competitively to states, local governments, or non-profit entities. For-profit entities could participate as direct recipients of funds when teamed with a state or local government or a non-profit entity. Funds were awarded based not only on need, as measured by highest number and percentages of foreclosed homes, but also on additional factors intended to measure project quality, such as a project's potential leveraging of other public and private sector funds. The program's Notice of Funding Availability (NOFA) required that the amount requested was to be of "sufficient size to contribute toward significant and measurable neighborhood stabilization." The minimum grant request could be not less than $5 million, and was required to return at least 100 abandoned or foreclosed homes back to the housing stock. On January 14, 2010, HUD announced the selection of 56 grantees. Most were consortia of local governments and nonprofit housing organizations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act provided $1 billion for NSP-3, to be obligated using the same formula as NSP-1. Each state receives a minimum grant amount of $5 million. The minimum grant threshold for communities is $1 million based on the results of the formula used by HUD. Cities whose fund allocation is less than $1 million are rolled into its county's allocation. If the county's allocation falls below $1 million, its allocation is rolled into the state allocation. HUD announced 283 grantees on September 8, 2010. Grantees were required to submit their action plans to HUD by March 1, 2011.

Each of the rounds has specific deadlines that must be met with respect to the obligation and expenditure of funds.

- Under NSP-1, grantees had 18 months from the date HUD signed their grant agreements to obligate these funds and four years to expend allocations. According to HUD, 99.7% of NSP-1 funds had been obligated by grantees by September 30, 2010, and 55.4% of NSP-1 funds had been disbursed as of February 7, 2011.
- Under NSP-2, recipients are required to spend at least half of the funds within two years of their allocation date (February 2012), and 100% within three years of the date funds are allocated (February 2013). As of February 7, 2010, HUD reports that 9% of NSP-2 funds had been disbursed. All NSP-2 funds were obligated to grantees by the February 17, 2010 deadline established by ARRA.
- Under NSP-3, no obligation deadline was established in legislation; however, 50% of NSP-3 funds must be expended within two years, and 100% within three years.

Program Participation

According to data available to date, NSP-1 grantees are using funds principally for two types of activities: acquisition accounted for 33% of obligated funds, and residential rehabilitation accounts for 27%. As of January 13, 2011, HUD reported that NSP-1 grantees have completed 19,189 units, which may include rehabilitation activities, clearance and demolition, and new housing construction.[9]

[9] U.S. Department of Housing and Urban Development, FY2012 Congressional Budget Justification, http://portal.hud.gov/hudportal/documents/huddoc?id=Neighborhood_Stab_2012.pdf.

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

Written Testimony of Mercedes M. Márquez
Assistant Secretary of Community Planning and Development
U.S. Department of Housing and Urban Development

"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, I am Mercedes Márquez, Assistant Secretary for Community Planning and Development (CPD) at the U.S. Department of Housing and Urban Development. Thank you for the opportunity to testify today on status of the Neighborhood Stabilization Program (NSP) and the continued need for all NSP funding appropriated to date.

In less than three years since its authorization, NSP has progressed through three rounds and is delivering on its intent by assisting states and local governments to stabilize neighborhoods impacted by foreclosures. To be clear, NSP is not a foreclosure prevention program but rather a tool to help communities across our nation address and mitigate the negative effects that vacant, abandoned and blighted properties have upon neighborhoods and property values.

The problems presented by foreclosed and abandoned properties across the nation remain a significant challenge for the country – and certain markets in particular.

Foreclosed homes have a debilitating effect on neighborhoods and often lead to blight, neighborhood decay and reduced property values, feeding a vicious cycle. Back in 2008, the Center for Responsible Lending estimated that homeowners living near foreclosed properties would see their property values decrease $5,000 on average. And while the freefall in home prices was stopped in early 2009 and monthly foreclosure starts are down more than 30,000 per month from this same time one year ago (partially attributed to servicer process reviews in light of foreclosure processing deficiencies), the housing market remains fragile.

While recent increases in foreclosure activity are due in large part to poor lending practices and general economic conditions such as increases in unemployment, the impact of foreclosed homes on surrounding property values creates a negative effect in our neighborhoods. NSP serves as a buffer against further decline by shoring up the equity of homeowners that live on the block where an NSP investment is made. CPD, NSP grantees, and a range of private sector and non-profit partners have worked together since August 2008 to craft distinctive, market-oriented responses that help stabilize and improve target neighborhoods with NSP investments.

Background

As Assistant Secretary for Community Planning and Development, I am responsible for the administration of the three rounds of NSP, known respectively as NSP1, NSP2, and NSP3, as well as the NSP technical assistance effort. NSP1 refers to the initial $3.92 billion program established by the Housing and Economic Recovery Act of 2008 (HERA), which was signed into law on July 30, 2008. NSP2 refers to the $2 billion appropriated in the American Recovery and Reinvestment Act of 2009 (Recovery Act) and the NSP technical assistance effort is a $50 million initiative funded out of the Recovery Act appropriation. NSP3 refers to the $1 billion appropriated by the Dodd-Frank Consumer Protection and Wall Street Reform Act of 2010 (Dodd-Frank Act). Of the NSP3 funds, $20 million will be reserved to supplement the NSP technical assistance effort. The following table provides details with regard to the NSP funds.

	NSP1	NSP2	NSP3
Legislative Basis	Housing and Economic Recovery Act of 2008 (HERA)	American Recovery and Reinvestment Act of 2009 (ARRA)	Dodd-Frank Consumer Protection and Wall Street Reform Act of 2010
Appropriation	$3,920,000,000	$2,000,000,000	$1,000,000,000
Program Format	Formula allocation	Competitive	Formula Allocation
Number of Grantees	307	56	283[1]
Technical Assistance Funds	N/A	$50,000,000[2]	$20,000,000[3]
Administrative Funds	$6,500,000[4]	$20,000,000[5]	$10,000,000[6]

[1] Projected based on allocations.
[2] Recovery Act permitted up to 10% of NSP2 appropriation ($200 million) to be used for technical assistance and capacity building for NSP1 and NSP2 but HUD opted for only $50 million.
[3] Dodd-Frank Act permits up to 2% of appropriation for technical assistance purposes.
[4] P.L. 110-329, Continuing Resolution Act, 2009, provided funds to support 2008 CDBG disaster recovery appropriation and NSP1.
[5] Recovery Act permitted 1% of NSP2 to be used for HUD's administrative purposes.

Funds Use Deadline	March 2013	50% by February 2012 and 100% by February 2013	50% by March 2013 and March 2014

HERA

NSP1 funding was provided to states and local governments by formula as specified in HERA. Each of the 50 states and Puerto Rico received a minimum award of $19.6 million. Insular areas and the District of Columbia also received direct awards. Ultimately, NSP1 funds were allocated to 309 grantees (North Las Vegas joined with Clark County, NV and Colorado Springs, CO joined with the State of Colorado for a total of 307 grants), all of which applied for their funds by early December of 2008 and received approvals and grant agreements by mid-March 2009.

Because HERA directs that NSP funds be treated largely like Community Development Block Grant (CDBG) funds, CPD was able to quickly establish the NSP1 program requirements on a framework familiar to grantees. Unlike CDBG, NSP funds are restricted to a range of housing activities that affect vacant and foreclosed properties. Grantees may use NSP1 funds to establish financing mechanisms for the acquisition of foreclosed property, acquire and rehabilitate abandoned or foreclosed property, establish and operate land banks for foreclosed residential property, demolish blighted properties and redevelop vacant or demolished properties. All NSP1 funds received by a grantee must be used to benefit individuals at or below 120 percent of area median income (AMI). Further, all NSP appropriations require that at least 25 percent of the funds be expended for housing activities that benefit households at or below 50 percent AMI.

HERA established an 18 month obligation period for NSP1 funds once the funds were available to grantees. Through tremendous efforts by grantees, CPD staff and technical assistance providers, NSP1 grantees achieved an obligation rate of 99.6 percent by September 30, 2010, the point at which NSP1 grantees completed their 18 month obligation period. Grantees were motivated to obligate funds by the announcement in May 2010 that CPD would aggressively move to recapture and reallocate unobligated funds at the close of grantee obligation periods. As of February 28, 2011, NSP1 grantees have expended 57.2 percent of their grant funds.

ARRA

NSP2 was funded at a level of $2 billion by the Recovery Act. The Recovery Act directed HUD to award these funds competitively to states, local governments, non-profit organizations or consortia of these eligible applicants. The Department conducted the necessary competition in the second half of 2009 and announced 56 awards for $1.93 billion on January 14,

[6] Based on applicability of Recovery Act provision for 1% of NSP appropriation for HUD administrative costs.

2010. These awards ranged in size from $5 million to the city of Reading, Pennsylvania, to $223 million to the state of Michigan. These funds were obligated to grantees on February 11, 2010.

Of the remaining $70 million from the Recovery Act appropriation, $20 million was reserved for CPD's administrative cost in managing NSP and, pursuant to a Recovery Act provision; $50 million was reserved for a separate competition for NSP technical assistance purposes to support both NSP1 and NSP2. The Department conducted this competition in the summer of 2009, announced awards on August 26, 2009, and obligated all funds in October 2009. I will discuss the impact of the NSP technical assistance in the Technical Assistance section of this testimony.

In the risk analysis for the NSP appropriations, HUD determined that additional field staff hires were necessary to mitigate the program launch and ongoing management risks, through 2013. With the administrative funds, in 2009 HUD hired 34 temporary NSP staff and stationed them in field offices to support management of NSP grantees. They joined 8 temporary staff hired in an earlier round in 2009, and were supplemented later by two additional term employees as a coverage gap was noted. To increase field support as grantees have ramped up production and to replace staff lost to attrition, HUD advertised 22 temporary positions in early 2011. HUD is currently reviewing applications for these positions, all but two of which will be stationed in field offices.

Dodd-Frank

The Dodd-Frank Act, enacted July 21, 2010, provided an additional $1 billion for the third round of NSP. The language of the Dodd-Frank Act places NSP3 in the context of the Recovery Act provisions but directed the program be allocated on a formula basis to states and local governments. The Department announced $970 million in allocations to 283 jurisdictions on September 8, 2010, and, in subsequent guidance, established March 1, 2011, as the deadline for submission of action plans describing the uses of funds. The Department is in the process of reviewing and accepting these action plans at this time, and expects to obligate these funds by March 31, 2011. The remaining $30 million is allocated for technical assistance ($20 million) and administrative support ($10 million) consistent with provision of the Recovery Act.

Program Status

The total appropriation for NSP has been $7 billion, a relatively small amount in the context of the problems that have arisen in the housing markets over the past four years. There were 1.7 million foreclosures completions between April 2009 and December 2010 and we expect NSP will impact 100,000 properties in the nation's hardest-hit markets.

Already, grantees report that more than 36,000 of these properties are either under construction or rehab – better than a third of the way there.

Because this makes up almost 20 percent of the REO over the last 18 months in NSP-targeted areas, we believe these efforts will have "a multiplier effect" that could have a profound impact on our local, regional and national housing markets alike. By investing NSP dollars the other units in the neighborhood will be more likely to be acquired by the private sector because the area is stabilizing.

Indeed, the targeted nature of allocations and awards in conjunction with the statutory requirement that grantees focus their funds on areas having the greatest need has enabled NSP to have a positive effect in those neighborhoods where the funds have been put to work. Grantees have had to make critical decisions on the selection of target neighborhoods to assist and the activities to implement in order to make the best use of their limited NSP resources.

NSP grantees continue to make great strides in production. The fact that most communities started their NSP programs in the midst of the mounting fiscal distress facing local governments over the past three years cannot be ignored when evaluating their resources (or lack thereof) to quickly implement a new program, especially one that requires expertise they may not have had in-house. To ensure that grantees have sufficient resources to implement NSP, HUD permits up to 10 percent of the grant to be for administrative costs. In most cases, NSP grantees have responded to this challenge in a positive and creative manner, are producing units, housing families and reducing vacancy rates to stabilize neighborhoods. In weak markets such as Michigan and Ohio, many weighted their program mix toward land banking and demolition and clearance of blighted, vacant units that depreciated neighborhood property values. In California and Florida, direct homeownership and purchase/rehabilitation projects are more common.

NSP is singular among grant programs in CPD in that the income of the beneficiaries ranges up to 120 percent of area median income, or middle class. Grantees for NSP1 and 2 are projecting, conservatively, treatment of over 100,000 units or properties; this figure includes significant demolition of blighted property, particularly in Michigan and Ohio. Currently, NSP1 and 2 communities are projecting direct benefit to more than 86,000 households, meaning those households will be able to live in housing affordable to them. With NSP3, the total projected households benefiting from NSP would rise to 100,000. The data projecting the number of persons to benefit from stabilized neighborhoods is not as refined as the production projections, but it is clear from grantee estimates that several million persons live in the neighborhoods in which NSP is active.

The 99.6 percent obligation rate for NSP1 grantees at the 18-month deadline speaks to the commitment and tenacity of communities across the country, and to CPD's NSP technical assistance effort, which helped many grantees to assess their markets, re-design their programs, and successfully meet their obligation deadline.

As of February 28, 2011, NSP1 grantees have obligated $4.01billion or 103% of the original formula allocation amount, an amount of funds that exceeds the original grant amounts because of the program income beginning to return to the program as treated units and properties return to the markets. To date, including program income, NSP1 grantees have expended $2.24 billion, or 57.2 percent of the original grant allocations. As of the last quarterly performance reports, for the quarter ending December 31, 2010, communities using NSP1 have produced more than 5,300 households in rehabilitated or newly constructed units, more than 6,000 households have received direct homeownership assistance to acquire formerly foreclosed or abandoned properties, and more than 9,700 blighted properties have been demolished and cleared.

Communities are making good progress in meeting the statutory requirement to use 25 percent of each NSP grant to produce housing affordable to households with incomes at or less than 50 percent of area median income (AMI). In NSP1, grantees report committing more than $1.3 billion for such activities, over 33% of the total; more than $680 million has been drawn. So far in NSP2, grantees have set up activities in the online reporting system totaling $494 million to meet this requirement and of this amount have drawn down about $48 million.

For NSP1 and 2, grantees report that, as of December 31, 2010, 2101 low-income (50% of AMI or below) rental households occupied completed units. As of February 2011, grantees were projecting that a total of 14,515 low-income households, 5,224 moderate-income (51-80% AMI) households, and 4,435 middle-income (81-120% of AMI) households will occupy rental units assisted with NSP1 and 2.

And in some places, data is emerging to show all this effort is working to stabilize neighborhoods. Our data shows that concentrated targeted investment by grantees arrests decline and reduces vacancy rates. Witness the dramatic reductions in long-term vacant properties in target neighborhoods in Youngstown and Cleveland, Ohio. In

Case Study: Cleveland, Ohio

Tools like NSP aren't just critical to our economic recovery -- they're essential to reimagining the future of our communities...and our economy. We've seen how true that is in Cleveland, where despite an estimated 18,000 vacant properties, tools like NSP have helped local leaders like Mayor Jackson reduce the vacancy rate in one East Side neighborhood by nearly 40 percent in the last two years. Having recently earned her Master's Degree in Urban Planning from Cleveland State University, Millie Davis was living in a small apartment outside of town, paying exorbitant monthly utility bills where, as she put it, she "had to drive to do anything."

Millie had her eye on a home not far from here in the Detroit Shoreway neighborhood. The home had been long-vacant and fire-damaged, an eyesore on this block for more than three years -- but was being rehabilitated to green standards by the Cleveland Housing Network using NSP funds as part of a cross-sector partnership called Opportunity Homes. Opportunity Homes not only rehabbed the home itself -- it provided Millie with the financial counseling and assistance she needed to purchase it last November, closer to where she worked.

North Reno, a neighborhood with fast rising vacancies saw them fall quickly with NSP investments.

Not only was NSP2 competitive, HUD tightened the targeting requirements and enhanced the data support for the program, providing more detailed foreclosure and vacancy data via an online mapping tool (which was again enhanced for NSP3). The only neighborhoods eligible for NSP2 were among the hardest hit in the nation – applicants had to select neighborhoods that scored an average of at least 18 on a 1-20 scale, with 1 the fewest vacancies and foreclosures and 20 the most, to be eligible to participate in NSP2. All NSP2 grantees received their grant agreements in February 2010.

Starting about one year behind NSP1 with about half the funds, as of February 28, 2011, NSP2 grantees have obligated about $475 million. NSP2 grantees have expended $200 million, or 10.4 percent. NSP2 grantees project serving 11,000 households through rehabilitation and new construction and more than 5,200 households through direct homeownership support, and about 3,800 blighted properties cleared.

NSP 3

For NSP3, HUD enhanced the NSP mapping tool to support the requirement (the first of its kind for a CPD formula program) that NSP3 grantees should only target neighborhoods that met a certain standard of need. The tool was enhanced to allow a grantee to draw online the shape of a proposed target neighborhood. The tool calculated the stabilization need in the neighborhood, providing the grantee not only the need score, but also other data about the area including an estimate of how many properties would have to be treated to achieve neighborhood stabilization and, where the data were clear, recommendations for the most appropriate NSP activities for the area. Grantees were not required to accept HUD's recommendation. They were however, required to include the data with their proposed plan for public comment. Moreover, as grantees have already launched and designed NSP1 and/or NSP2, they will be move quickly to implement their NSP3 plans.

Given the projections for NSP2 and the actual production for NSP1, CPD estimates that at least 6,000 households will benefit from NSP3 through purchase/rehabilitation of foreclosed or abandoned residential property or new construction on redeveloped lots. About 3,000 households will benefit from direct homeownership assistance.

Estimated Total NSP3 Households Served for Selected Activities

Activity Type	Projected NSP1 and 2	Projected NSP3 (program total)
Acquisition – general	17,775	2,666
Clearance and Demolition	3,568	535

Construction of new housing	8,384	1,258
Disposition	1,403	210
Homeownership Assistance	19,933	2,990
Housing Counseling	2,928	439
Rehabilitation/reconstruction	31,766	4,765
Estimated Total	**85,757**	**12,863**

NSP also contributes to a community's overall well-being by providing employment opportunities across the nation. Based on NSP1 activity budgets, the Department estimates that NSP will support more than 93,000 jobs nationwide.

Management of NSP

The Department began implementation of NSP1 immediately and met the legislative deadline of 60 days to issue implementing regulations. These took effect on Sept. 29, 2008. Grantees immediately received training in the form of regional briefings on the program. The 309 potential grantees developed their applications and all submitted them on or before the December 1, 2008 deadline. Two grantees joined with nearby communities in joint programs, resulting in a total of 307 grantees. CPD provided support in the form of an e-mail Hotline and a website with Frequently Asked Questions and other supporting information. The initial assistance was limited by the existing staff capacity in the Department, yet all applicants were able to develop programs that met the requirements.

Technical Assistance (NSP TA)

The technical assistance effort is proving to be a tremendous support to NSP grantees. As I noted earlier, HUD used $50 million in Recovery Act funding to create NSP TA. This competitive program distributed $50 million to regional and national technical assistance providers. With NSP TA, we are making CPD's TA, not only about program compliance, but about capacity building. For many years, technical assistance at the Department primarily focused on compliance – filling out the right forms and checking off the right boxes. Now, we are moving to provide technical assistance in a more holistic manner to truly meet the needs of grantees. The overall $7 billion NSP effort is targeted at communities that have suffered the most through the foreclosure crisis.

Through NSP technical assistance (NSP TA), we are assisting these communities by conducting individual needs assessments, particularly for grantees who are struggling to meet the goals of the program, and following up with customized direct practitioner assistance plans. In addition, all HUD OIG findings are reviewed and considered as CPD deploys the NSP TA resources. We plan to continue this effort with NSP3 to help create and increase the capacity of whole communities across the country to address this crisis responsibly. From the resource exchange where CPD, communities, and nonprofits share tools for effectively implementing neighborhood stabilization projects, the NSP TA resources are creating affordable housing expertise at the local level that will last after the NSP1, NSP2, and NSP3 programs are closed out. Problem solving clinics, NSP term employees – who were hired from their communities using Recovery Act funds– weekly technical webinars, and frequent feedback in the form of data snapshots increase the likelihood that the practitioner skills formed in carrying out the NSP programs will translate into new or enhanced community ability to use other resources.

As the term employees came on board and technical assistance firms were engaged, the range of available services expanded substantially. By early 2010, CPD and its team were developing needs assessments in 102 of the 307 grantee communities which were deemed vulnerable because of weak administrative capacity, difficult market conditions, prior audit or monitoring findings and similar indicators. CPD also launched a very popular series of sixteen Problem-Solving Clinics across the country, where grantees could receive face-to-face assistance, ask questions, and attend workshops.

The NSP group also created a much-expanded website (www.hud.gov/nspta) where grantees can find resources, ask questions, and request technical assistance. The technical assistance providers have developed nine toolkits for different program types (e.g. acquisition-rehab, lease-purchase, land banking) which enable grantees to easily adapt procedures manuals and document templates. The Department also produced training for new grantees and is offering on-site direct technical assistance through the providers.

NSP First Look

The Department has actively sought non-profit and private sector partners in its effort to make NSP successful. The *National First Look Program* is a first-ever public-private partnership agreement between HUD and the National Community Stabilization Trust (Stabilization Trust). In collaboration with national servicers, Fannie Mae, Freddie Mac and our FHA colleagues, the First Look program is intended to give communities participating in NSP a brief exclusive opportunity to purchase bank-owned properties in NSP target neighborhoods so these homes can either be rehabilitated, rented, resold or demolished.

Case Study: Montgomery County, Ohio

Montgomery County in Ohio is an example the effectiveness of NSP resources and the First Look program. In the Huber Heights, a suburb outside of Dayton, property values have declined by 30 percent. These are middle-income neighborhoods with one or two vacant, foreclosed homes on virtually every block.

The County has targeted 2,000 homes in this community -- about 200 of which were vacant when NSP dollars first hit the ground. The County has purchased 35 homes – over a third of the total it expects to purchase in the next three years with NSP funds-- rehabilitating these homes to green and energy efficient standards. Instead of working with a dozen mortgage servicers to purchase these properties, the County purchased these through First Look's REO Match -- a fully automated, free mapping and property management tool which allows grantees to know what properties are available and who owns them.

Based on a pilot forged by the National Community Stabilization Trust and the nation's leading financial institutions, First Look gives NSP grantees an exclusive 12-to-14 day period to evaluate and bid on properties before others can do so.

It's based on a simple idea: that instead of the "retail" strategy so many communities resort to when it comes to neighborhood stabilization--establishing individual relationships with financial institutions, negotiating the best price one house at a time--we should be creating a wholesale strategy -- and market power. Since the program was announced in early September, NSP grantees have had the opportunity to view over 20,000 properties through the first look program and purchased 553. On average, these properties were purchased at an average discount of 13% below fair market value.

With the country's leading financial institutions participating in First Look, accounting for more than 75 percent of the REO inventory, we expect First Look will cut the traditional 75-to-85 day REO process in half. Moreover, grantees selectively pick the most strategically important properties, whether they are REO, short sale or deed-in-lieu. In addition, the system is extremely cost-effective because instead of using a staff intensive, one-off property acquisition approach, our partners have access to automated, state of the art mapping and property management tools -- so communities can spend more time targeting their efforts and optimizing their limited NSP resources.

Interagency Partnerships

An interagency effort at the Federal level should be noted as well. The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision recently published a joint final rule (Final Rule) expanding the category of community development activities that qualify for Community Reinvestment Act (CRA) credit to include loans, investments and services to support NSP activities in communities with HUD-NSP plans. These investments must be in NSP target areas and mirror the NSP program requirements, which allow assistance to household up to 120% of AM. The final rule, published on December 19, 2010, and effective January 19, 2011, further supports the soundness of the NSP strategy.

Program Monitoring

Complementing the added capacity and program support, CPD continues to monitor and communities for progress, performance and compliance. CPD field offices monitored 146 NSP1 grantees in the first year and have undertaken reviews of NSP2 grantees. Relatively few significant problems emerged, although numerous communities still struggled. CPD continues to build capacity in those locations with on-site and other technical assistance.

The HUD Office of Inspector General (OIG) instituted an aggressive audit program focused on NSP shortly after its enactment in 2008. To date, the OIG has completed 42 NSP audits nationwide and 10 more are currently in progress. I would like to note two evaluations completed by HUD's OIG that speak to the effectiveness of CPD's implementation of NSP2. The first evaluation, issued in September 2009 (Memorandum NO. 2009-AT-0801), addressed the front end risk assessment that CPD prepared for NSP2. A front end risk assessment (FERA) is a management tool required by OMB Circular A-123 and is used to minimize the Department's exposure to fraud, waste and abuse in the administration of its programs and is required for new program such as NSP. In its report, the OIG made no recommendations with regard to the NSP2 FERA and provided a positive review, stating:

- "Our review determined that the factors of general control environment, risk assessment, control activities, information/communication, and monitoring were adequately addressed and the major program objectives of timeliness, clear and measurable objectives, transparency, monitoring, and reporting were adequately emphasized in the assessment. "(p. 3-4)

The second OIG evaluation to note is one that assessed CPD's competitive review and award process for $1.93 billion in NSP2 funding (Audit Report 2010-AT-0001). This competition was administered by CPD's Office of Block Grant Assistance, which traditionally manages formula grants under the CDBG program. Nonetheless, HUD carried out the evaluation and selection process in accordance with all applicable requirements by reviewing 482 applications requesting more than $15 billion in funding. After performing its due diligence, the OIG did not issue any recommendations because there were no reportable deficiencies with the NSP2 evaluation and selection process. The following excerpts from the OIG report clearly make that point:

- "What we found: HUD followed the applicable requirements during the evaluation and selection process and included special conditions in the grant agreements as required." (p. 2)
- "HUD properly evaluated and selected the applications for the NSP2 funding. It followed the requirements and procedures in the notice and employed quality control procedures to help ensure that its decisions were correct and supportable. In addition, it properly included special conditions in grant agreements for high risk grantees." (p. 8)
- "Our audit did not identify any reportable deficiencies, and, therefore, there are no recommendations." (p. 8)

The results of these two reviews well characterize CPD's efforts to implement and manage NSP. Overall, CPD continues to work with the OIG on audits of NSP, most of which focus on program implementation and oversight at the state and local grantee levels. In the cases where these audits have identified program deficiencies, we have used these as opportunities to target technical assistance funding and to improve local capacity.

In December 2010, the Government Accountability Office completed a report on NSP1 (GAO-11-48). The report examined CPD and NSP1 grantee performance in the following areas: (1) meeting HERA obligation time frames and income-targeting criteria; (2) actions HUD has taken to mitigate program risks and ensure grantee's compliance with key NSP1 requirements; and (3) HUD's efforts to collect program data and to assess the reliability of the data. As part of this effort, GAO analyzed data, interviewed selected grantees and HUD staff in Washington, DC and at 15 sites across the United States. It was noted that data on program outputs could be improved and we at HUD are actively working to make those improvements. In the end, GAO concluded that HUD and NSP1 grantees are taking actions to comply with program requirements as reflected by the following comment:

- "NSP 1 provided a mechanism for state and local governments to mitigate the destabilizing effects of mortgage foreclosures, but HUD and grantees faced a number of implementation challenges, including the program's tight time frames and the limited capacity of some grantees to undertake real estate activities. HUD took actions to help grantees meet these challenges though guidance, training, and technical assistance. Additionally, HUD established internal control procedures to mitigate risks and promote compliance with program requirements. Our work suggests that these efforts helped grantees obligate funds in a timely manner, adopt strategies appropriate to their communities, and follow program rules." (p. 41)

The Recovery Act enabled CPD to use 1 percent of the NSP2 appropriation for administrative purposes and this resource enabled the hiring of more than 30 temporary NSP Specialists, to visit grantees and monitor their programs, and it also funded improvements to the Disaster Recovery Grant Reporting (DRGR) system, which is used by grantees to budget, draw funds and report NSP program outputs to HUD. Many of these temporary hires were displaced real estate professionals who were impacted by the housing crisis so they were capable of "hitting the ground running," supporting grantees with program compliance and program implementation issues. Today, these temporary hires serve as the first line of support in CPD field offices responding to grantee needs, alerting HUD Headquarters when problems arise and track grantee performance in DRGR. ARRA Administrative funds make it possible for them to visit grantees and monitor their programs on a regular basis. These visits help CPD establish relationships with our grantees and identify problems before they become serious hindrances to program implementation.

While DRGR was built to serve CDBG disaster recovery grants, it did not have all of the metrics needed to track NSP program outputs. The Recovery Act administrative funds made it possible to improve the DRGR platform and it is those improvements that enable me to share NSP program accomplishments with you today. Additional DRGR improvements are proposed to be funded with Recovery Act dollars to assist NSP grantees in deploying more complex program techniques and CPD track their program outputs and accomplishments.

In closing, the Neighborhood Stabilization Program is being effectively implemented by HUD's Office of Community Planning and Development consistent with the purpose of assisting state and local governments in addressing the negative effects of abandoned and foreclosed properties. NSP grantees are gaining traction at the local level as they build capacity and expend funds, thereby helping to stabilize still fragile housing markets. While $7 billion is a substantial sum to invest in this purpose, it pales in comparison to the overall size of the problem. But a program targeted to areas of high need coupled with a flexible programmatic approach, extensive technical assistance, and aggressive management on the part of CPD, has yielded some remarkable progress in the 30 months that NSP has been in existence. To rescind the final $1 billion in NSP funding at this time would stall that progress and remove critically needed investments from the hardest hit housing markets in the country. For these reasons, Secretary Donovan and I urge the Committee not to move any legislation that would rescind the NSP3 funding.

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Insurance, Housing, and Community Opportunity, Committee on Financial Services, House of Representatives

For Release on Delivery
Expected at 2:00 pm. EST
Wednesday, March 2, 2011

TROUBLED ASSET RELIEF PROGRAM

Actions Needed by Treasury to Address Challenges in Implementing Making Home Affordable Programs

Statement of Mathew J. Scirè, Director
Financial Markets and Community Investment

GAO
Accountability * Integrity * Reliability

GAO-11-338T

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee:

I am pleased to be here today to discuss our work on the Making Home Affordable (MHA) program, including the Home Affordable Modification Program (HAMP). Since the Department of the Treasury (Treasury) first announced the framework for its MHA program over 2 years ago, the number of homeowners facing potential foreclosure has remained at historically high levels. HAMP, the key component of MHA, provides financial incentives to servicers and mortgage holders/investors to offer modifications on first-lien mortgages. The modifications are intended to reduce borrowers' monthly mortgage payments to affordable levels to help these homeowners avoid foreclosure and keep their homes.

Since HAMP's inception, concerns have been raised that the program is not reaching the expected number of homeowners. In two prior reports, we looked at the implementation of the HAMP first-lien modification program, noted that Treasury faced challenges in implementing it, and made several recommendations intended to address these challenges.[1] In addition, our ongoing work examines the extent to which additional MHA programs have been successful at reaching struggling homeowners, the characteristics of homeowners who have been assisted by the HAMP first-lien modification program, and the outcomes for borrowers who do not complete HAMP trial or permanent modifications. These programs include the Second-Lien Modification Program (2MP) for those whose first liens have been modified under HAMP, the Home Affordable Foreclosure Alternatives (HAFA) program for those who are not successful in HAMP modifications, and the Principal Reduction Alternatives (PRA) program for borrowers who owe more on their mortgages than the value of their homes.

[1]GAO is required to report at least every 60 days on findings resulting from, among other things, oversight of the Troubled Asset Relief Program's (TARP) performance in meeting the purposes of the Act, the financial condition and internal controls of TARP, the characteristics of both asset purchases and the disposition of assets acquired, the efficiency of TARP's operations in using appropriated funds, and TARP's compliance with applicable laws and regulations (12 U.S.C. § 5226(a)). Under this statutory mandate, we have reported on Treasury's use of TARP funds to preserve homeownership and protect home values. See GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, GAO-09-837 (Washington, D.C: July 2009) and GAO, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitable Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C: June 2010).

My statement is based on the report on HAMP that we issued in June 2010, as well as on preliminary observations from our ongoing work.[2] Specifically, this statement focuses on (1) the extent to which HAMP servicers have treated borrowers consistently and the actions that Treasury and its financial agents have taken to ensure consistent treatment; (2) the status of Treasury's second-lien modification, foreclosure alternatives, and principal reduction programs; (3) the characteristics of borrowers who received HAMP modifications; and (4) outcomes for borrowers who are denied or fall out of HAMP trial or permanent first-lien modifications.

To examine these questions, we spoke with and obtained information from 10 HAMP servicers of various sizes who collectively had been designated 71 percent of the TARP funds allocated to participating servicers. We visited 6 of them for our June 2010 report. In addition, for our ongoing work, we spoke with and obtained data from 6 large MHA-participating servicers. We reviewed HAMP program documentation issued by Treasury, including supplemental directives for the first-lien program and announcements of new TARP-funded homeowner assistance programs. To determine the key elements needed to ensure program stability and adequate program management, we compared documents obtained from Treasury regarding HAMP program governance and internal controls to the Government Performance and Results Act of 1993 (GPRA) and the Standards for Internal Control in the Federal Government.[3] We also analyzed loan-level data from Treasury's HAMP database, which included data reported by servicers on borrowers evaluated for HAMP participation through September 30, 2010, to analyze the characteristics of borrowers who received HAMP modifications, were canceled from HAMP trial modifications, or redefaulted from permanent HAMP modifications. We coordinated our work with other TARP oversight entities, including the Congressional Oversight Panel, the Office of the Special Inspector General for TARP (SIGTARP), and the Financial Stability Oversight Board.

The work on which this testimony is based was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate

[2]GAO-10-634.

[3]Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285, codified at 5 U.S.C. § 306 (1993), and GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

In June 2010, we reported on several inconsistencies in the way servicers treated borrowers under HAMP that could lead to inequitable treatment of similarly situated borrowers. These inconsistencies involved how servicers solicited borrowers for the program, how they evaluated borrowers who were not yet 60 days delinquent on their mortgage payments, and how they handled borrower complaints.[4] In addition, we noted that while Treasury had taken some steps to ensure servicer compliance with program guidance, it had not yet finalized consequences for servicer noncompliance. We made eight recommendations to improve the transparency and accountability of HAMP in June 2010. Treasury stated that it intended to implement some of the recommendations, but little action has been taken to date.

Further, as part of our ongoing work, we identified several implementation challenges that had slowed implementation of newer MHA programs, specifically 2MP, HAFA, and the Principal Reduction Alternative (PRA). For example, we found that servicers experienced difficulties in using a required database to identify borrowers who might be eligible for 2MP, contributing to a slow start for this program. We found that borrowers who were in HAMP trial or permanent modifications tended to share certain characteristics, such as reduced income and having high debt levels, and that those who were canceled from trial modifications or redefaulted from permanent modifications tended to be further into delinquency at the time of their modifications. Lastly, we found that many borrowers who were denied or fell out of HAMP modifications had been able to avoid foreclosure to date. But weaknesses in how Treasury reports the disposition paths, or outcomes, for these borrowers make it difficult to understand exactly what has happened to these homeowners.

Background

In March 2009, Treasury issued the first HAMP guidelines for modifying first-lien mortgages in an effort to help homeowners avoid foreclosure. The goal of the first-lien mortgage modification program is to reduce

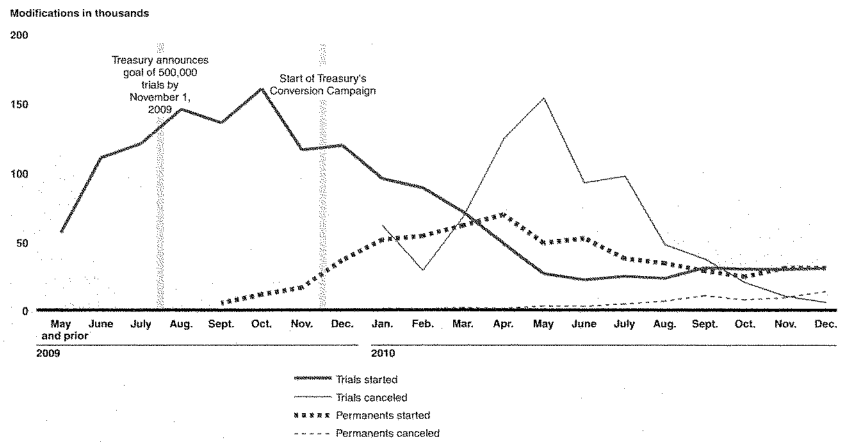
[4]GAO-10-634.

struggling homeowners' mortgage payments to more affordable levels—specifically to 31 percent of the borrower's income. To reduce mortgage payments, servicers may modify the loan by lowering the interest rate, extending the amortization period, or forbearing principal. According to Treasury officials, the program was intended to offer reduced monthly payments to up to 3 to 4 million homeowners.

Through December 2010, there were a total of 143 active servicers under the TARP-funded portion of HAMP. Through December 2010, over 1.7 million HAMP trial modifications had been offered to borrowers, nearly 1.5 million of which had begun HAMP trial modifications.[5] Of the trial modifications begun, approximately 152,000 were active trial modifications, and roughly 522,000 were active permanent modifications. Approximately 735,000 trial modifications and around 58,000 permanent modifications had been canceled (fig. 1). As of December 31, 2010, $1 billion in TARP funds had been disbursed for TARP-funded housing programs, of which roughly $840 million was disbursed to servicers for HAMP-related activity. Most of the disbursements to date have been made for the first-lien modification program.

[5]The government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac have directed all of their approximately 2,000 servicers to implement parallel HAMP programs on first-lien mortgages owned or guaranteed by the GSEs. Roughly 46 percent of borrowers who were in trial or permanent modifications as of September 30, 2010, had non-GSE loans and, therefore, fell under the TARP-funded portion of HAMP.

Figure 1: GSE and Non-GSE HAMP Trial and Permanent Modifications Made and Canceled Each Month, through December 2010



Source: GAO analysis of Treasury data.

In addition to first-lien modifications, Treasury has announced a number of TARP-funded housing programs, including those for modifying second liens held by borrowers with first-lien modifications under HAMP, reducing principal, offering temporary forbearance for unemployed borrowers, and providing alternatives to foreclosure (see table 1). At the current time, with the exception of the Housing Finance Agency (HFA) Hardest-Hit Fund, the cutoff date for borrowers to be accepted into TARP-funded programs is December 31, 2012, and disbursements of TARP funds may continue until December 2017.

Table 1: Status of TARP-Funded Housing Programs as of December 2010

Program	Program description	Program status
HAMP First-Lien Modification	First-lien loan modifications	• Announced in March 2009 • Implemented in April 2009 • 143 active non-GSE servicers • More than 1.5 million trials started—522,000 active permanent modifications, 152,000 active trials, and 735,000 cancellations • Over $827 million disbursed in incentive payments
2MP	Second-lien loan modifications for HAMP first-lien borrowers	• Announced in March 2009 • Implemented in March 2010 • 17 servicers have signed agreements • $2.9 million in incentive payments made
HAFA	Incentives for short sales or deeds-in-lieu of foreclosure	• Announced in March 2009 • Implemented in April 2010 • $9.5 million in incentive payments made
HFA Hardest-Hit Fund	Funding for state housing finance agencies in the 18 states and Washington, D.C., hardest hit by the foreclosure crisis	• Announced in February and March 2010 • Implementation varies by state • $7.6 billion designated for 19 HFAs
PRA	Principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	• Announced in March 2010 • Implemented October 2010
HAMP Unemployed Borrowers	Temporary principal forbearance for unemployed borrowers	• Announced in March 2010 • Implemented July 2010 • No expected TARP funds
FHA Refinance	Principal reduction and loan refinancing into an FHA loan	• Announced in March 2010 • Implemented September 2010 • $11 billion designated

Source: Treasury.

Servicers Have Been Inconsistent in Soliciting and Evaluating HAMP Borrowers and More Treasury Action Is Needed to Ensure Equitable Treatment of Borrowers with Similar Circumstances

Although one of Treasury's stated goals for HAMP is to standardize the loan modification process across the servicing industry, in our June 2010 report, we identified several inconsistencies in the way servicers treated borrowers under HAMP that could lead to inequitable treatment of similarly situated borrowers.[6] First, because Treasury did not issue guidelines for soliciting borrowers for HAMP until a year after announcing the program, the servicers we contacted solicited borrowers differently. A few solicited those who were 31 days delinquent on their payments, but other servicers waited until borrowers were at least 60 days delinquent. We also noted that many borrowers had complained they did not receive timely responses to their HAMP applications and had difficulty obtaining information about the program. In March 2010, Treasury issued guidelines to address some of the issues related to communicating with borrowers about the program, and said it planned to monitor servicers' compliance with the guidelines.

Second, Treasury's lack of specific guidelines for determining HAMP eligibility for borrowers current or less than 60 days delinquent, but in imminent danger of defaulting has led to inconsistencies in how servicers evaluate them. The 10 servicers who GAO contacted reported seven different sets of criteria for determining imminent default. Two servicers considered borrowers in imminent default if they met basic HAMP eligibility requirements, but other servicers had additional criteria, such as requiring that a hardship situation has existed for more than 1 year. Treasury's goal was to create uniform, clear, and consistent guidance for loan modifications across the servicing industry, but these differences may result in one borrower's being approved for HAMP and another borrower with the same financial situation and loan terms being denied by a different servicer. We recommended that Treasury establish clear, specific criteria for determining whether a borrower was in imminent default to ensure greater consistency across servicers. However, Treasury believes the impact of these variations on borrowers is inconsequential and has declined to implement this recommendation. We continue to believe that further actions are warranted.

In addition, Treasury has not clearly informed borrowers that they can use the HOPE Hotline to raise concerns about servicers' handling of HAMP loan modifications and to challenge potentially incorrect denials, likely limiting the number of borrowers who have used the hotline for these

[6] GAO-10-634.

purposes.[7] The HOPE Hotline also has procedures for referring borrowers who need additional assistance to the Making Home Affordable Escalation Team. However, it is unclear whether borrowers are aware of and using the HOPE Hotline to raise concerns about their servicers and challenge potentially incorrect denials. We recommended that Treasury (1) more clearly inform borrowers that the HOPE Hotline may also be used for these purposes and (2) monitor the effectiveness of the HOPE Hotline as a process for handling borrower concerns.

Finally, Treasury has taken some steps to ensure that servicers comply with HAMP program requirements, but has yet to establish specific remedies for noncompliance with HAMP guidelines. For instance, the HAMP servicer participation agreement describes actions that could be taken in response to noncompliance and the HAMP Compliance Committee monitors servicers' performance and activities. But without standardized remedies for noncompliance, Treasury risks treating servicer noncompliance inconsistently and its methods of responding to incidents of noncompliance lack transparency. In our June 2010 report, we recommended that Treasury finalize and expeditiously issue consequences for servicers who do not comply with HAMP requirements. We made eight recommendations to improve the transparency and accountability of HAMP in June 2010. Treasury stated that it intended to implement some of the recommendations, but little action has been taken to date.

Implementation Challenges Have Affected the Progress of Treasury's Newer Housing Programs

The implementation of Treasury's 2MP, HAFA, and PRA programs has been slow, and limited activity has been reported to date. This slow pace is attributed in part to several implementation challenges, including the following.

- *Difficulty matching first and second liens for 2MP.* Because eligibility for 2MP required a first-lien HAMP modification, Treasury contracted with a database vendor to provide data on existing second liens that corresponded with these modifications. However, the servicers we contacted noted that even differences in the spelling of addresses—for

[7]Fannie Mae, in its role as the MHA program administrator, has contracted with the Homeownership Preservation Foundation to offer its HOPE Hotline for incoming borrower calls about HAMP and Treasury's other MHA programs. Through the HOPE Hotline, borrowers may obtain information about the programs, assess their potential eligibility, or discuss their individual situations, including complaints about their servicer or about potentially incorrect HAMP denials.

example, in abbreviations or spacing—could prevent an accurate identification. Initial 2MP guidelines stated that servicers could not offer a second-lien modification without confirming a match with the database vendor, even if they had serviced both first and second liens on the same property. In November 2010, Treasury provided updated program guidance that allowed servicers to offer a 2MP modification if they could identify a first- and second-lien match within their own portfolio or had evidence that a corresponding first lien existed, even if the database had not identified it.

- *Extensive program requirements for HAFA.* All six of the large MHA servicers we spoke with identified extensive program requirements as reasons for the slow implementation of HAFA, including the initial requirement that applicants first be evaluated for a HAMP first-lien modification. Because of this requirement, potential HAFA borrowers had to submit extensive income and other documentation required for a modification, even if they simply wanted to sell. In cases where a borrower had already identified a potential buyer before executing a short-sale agreement with the servicer, the additional time required for a HAMP first-lien evaluation may have dissuaded the buyer from purchasing the property. Restrictive short-sale requirements and a requirement that mortgage insurers waive certain rights may have also contributed to the limited activity under HAFA. Servicers said that given these requirements, they did not expect HAFA to increase their overall number of short sales and deeds-in-lieu. In response to this concern, Treasury released updated HAFA guidance on December 28, 2010, to no longer require servicers to document and verify a borrower's financial information to be eligible for HAFA.

- *Voluntary nature of the PRA program.* Treasury officials told us that 13 of the 20 largest MHA servicers were planning to offer principal reduction to some extent, but some servicers we spoke with said they would limit the conditions under which they would offer principal forgiveness under PRA. Treasury's PRA guidelines require all servicers participating in HAMP to consider principal forgiveness for HAMP-eligible borrowers with mark-to-market loan-to-value ratios (LTV) greater than 115 percent.[8] But servicers are not required to offer principal reduction, even if the net present value (NPV) is higher when principal is forgiven.[9] For example, one servicer had

[8]Mark-to-market LTV is the unpaid principal balance divided by the property value at the time of modification.

[9]The NPV model compares expected cash flows from a modified loan to the same loan with no modification, using certain assumptions.

developed a "second look" process that used internal estimates of default rates to determine NPV and did not forgive principal unless these estimates—not those calculated using program guidelines—indicated a higher NPV with forgiveness. As a result, only 15 to 25 percent of those who otherwise would have received principal forgiveness received it, according to this servicer. We recommended in June 2010 that Treasury report activity under PRA, including the extent to which servicers determined that principal reduction was beneficial to mortgage investors but did not offer it, to ensure transparency in the implementation of this program. Treasury officials told us they would report PRA activity at the servicer level once the data were available. We plan to continue to monitor Treasury's reporting of PRA and other TARP-funded housing programs.

In addition, we found that Treasury could do more to build on the lessons learned from its first-lien modification program. For example, we previously reported that Treasury had not sufficiently assessed the capacity of servicers to implement the first-lien program. More recently, we observed that Treasury has not obtained all required documentation to demonstrate that servicers have the capacity to successfully implement the newer programs. According to Treasury, Fannie Mae has conducted program-specific readiness reviews for the top-20 large servicers for 2MP, HAFA, and PRA, including all 17 servicers participating in 2MP. These reviews assess servicers' operational readiness, including the development of key controls to support new programs, technology readiness, training readiness, staffing resources, and program processes and documentation. According to Treasury's summary of these reviews, of those that had completed reviews, 4 had provided all required documents for HAFA, and 3 had provided all required documents for PRA. None of the servicers provided all required documents for 2MP. As a result, servicers' ability to effectively offer troubled homeowners second-lien modifications, foreclosure alternatives, and principal reductions is unclear. Further, Treasury has not implemented our June 2010 recommendation that it establish goals and effective performance measures for these programs, nor has it said how it will use any assessments to hold servicers accountable for their performance. Treasury also has not established actions it will take in cases where individual servicers are not performing as expected in these programs. As we noted in June 2010, without performance measures and goals, Treasury will not be able to effectively assess the outcomes of these programs.

HAMP Borrowers Shared Several Characteristics, Including Reduced Income; Early Data Indicate that Borrowers Who Redefaulted from Permanent Modifications Were Further Into Delinquency

Our analysis of HAMP data for borrowers in trial and permanent modifications indicated that over half of borrowers cited curtailed income, such as reduced pay, as the primary reason for needing to lower their mortgage payments (56 percent of borrowers in active modifications and 53 percent in trial modifications). However, only 5 percent of borrowers in each of these groups cited unemployment as their primary reason for financial hardship. Borrowers also had high levels of debt prior to modification with monthly mortgage payments that were 45 and 46 percent of gross monthly income, respectively, and total debt levels of 72 and 76 percent of gross monthly income, respectively. Even after modification, these borrowers continued to have high debt levels (median back-end DTI ratios of 55 and 57 percent for those in trial and permanent modifications, respectively). In addition, borrowers in trial and permanent modifications tended to be "underwater," with median mark-to-market LTV ratios of 123 percent and 128 percent, respectively.

Borrowers who were either canceled from a trial modification or redefaulted from a permanent one shared several of these characteristics, including having high debt levels and being "underwater" on their mortgages. However, some characteristics appeared to increase the likelihood that a borrower would be canceled from a trial modification. For example, borrowers who received a trial modification based on stated income were 52 percent more likely to be canceled from trial modifications than those who started a trial modification based on documented income. In some cases, borrowers who received trial modifications based on stated income were not able to or failed to provide proof of their income or other information for conversion to permanent modification.[10] In other cases, borrowers may have submitted the required documentation but the servicer lost the documents. In addition, borrowers who were 60 or 90 days or more delinquent at the time of their trial modifications were 6 and 9 percent more likely to have trial modifications canceled, respectively, compared with borrowers who were not yet delinquent at the time of their trial modifications. Treasury has acknowledged the importance of reaching borrowers before they are seriously delinquent by requiring servicers to evaluate borrowers still current on their mortgages for imminent default. But, as we noted in June

[10]Treasury has recognized challenges with documentation as a reason for the low conversion rate to permanent modifications, and as of June 2010, began requiring that servicers verify borrowers' income before placing borrowers into trial modifications.

2010, this group of borrowers may be defined differently by different servicers.[11]

Borrowers who had high mark-to-market LTV ratios (from 120 to 140 percent) were 7 percent less likely to be canceled from trial modifications than those with mark-to-market LTV ratios at or below 80 percent, and those with a mark-to-market LTV ratio of more than 140 percent were 8 percent less likely to be canceled. Borrowers who received principal forgiveness of between 1 and 50 percent of their total loan balance were less likely to be canceled from trial modifications compared with those who did not receive principal forgiveness. In addition, larger monthly payment reductions lowered the likelihood that a trial modification would be canceled. For example, borrowers who received a principal and interest payment reduction of least 10 percent were less likely to be canceled from their trial modifications than other borrowers.

Our initial observations of over 15,000 non-GSE borrowers who had redefaulted from permanent HAMP modifications through September 2010 indicated these borrowers differed from those in active permanent modifications in several respects. Specifically, non-GSE borrowers who redefaulted on their HAMP permanent modifications tended to have higher levels of delinquency at the time they were evaluated for a trial modification (median delinquency of 8 months compared to 5 months for those still in active permanent modifications), lower credit scores, and lower median percentage of payment reduction compared with those who were still current in their permanent modifications (24 percent compared with 33 percent). These borrowers may have received smaller reductions in their payments because they had lower debt levels before modification than borrowers who did not redefault.

[11] GAO-10-634.

Most Borrowers Denied or Canceled from Trial Modifications Have Avoided Foreclosure to Date, but Limits to Treasury's Data Make Understanding Their Outcomes Difficult

We requested data from six servicers on the outcomes of borrowers who (1) were denied a HAMP trial modification, (2) had their trial modification canceled, or (3) redefaulted from a HAMP permanent modification. According to the data we received, of the about 1.9 million GSE and non-GSE borrowers who were evaluated for a HAMP modification by these servicers as of August 31, 2010, 38 percent had been denied a HAMP trial modification, 27 percent had seen their HAMP trial modifications canceled, and 1 percent had redefaulted from a HAMP permanent modification.[12]

According to these servicers' data, borrowers who were denied HAMP trial modifications were more likely to become current on their mortgages without any additional help from the servicer (39 percent) than to have any other outcome. Of those borrowers who were canceled from a HAMP trial modification, servicers often initiated actions that could result in the borrower retaining the home. Specifically, 41 percent of these borrowers had received or were in the process of receiving a permanent proprietary modification, and 16 percent had received or were in the process of receiving a payment plan. However, servicers started foreclosure proceedings on 27 percent of borrowers at some point after the HAMP trial modification was canceled, but only 4 percent of these borrowers completed foreclosure. Compared with borrowers who were denied, borrowers who had a HAMP trial modification canceled were less likely to become current on their mortgages (15 percent) or to pay off their loan (4 percent).

Finally, though data are limited, of the borrowers who redefaulted from a HAMP permanent modification, almost half were reflected in categories other than proprietary modification, payment plan, becoming current, foreclosure alternative, foreclosure, or loan payoff. Twenty-eight percent of borrowers who redefaulted from permanent modifications were referred for foreclosure at some point after redefaulting, but, like borrowers denied or canceled from a HAMP trial modification, the percentage of borrowers who completed foreclosure remained low relative to other outcomes (less than 1 percent). Unlike borrowers who were denied or canceled, borrowers who redefaulted were less likely to

[12]The remaining borrowers included those in active trial and permanent modifications, those who were still being evaluated for trial modifications, and those who were offered but declined trial modifications. Two servicers provided the data as of their closing date for reporting August 2010 data to Treasury, September 6, 2010, and September 8, 2010, respectively.

receive or be in the process for receiving a permanent proprietary modification or payment plan after redefaulting, with 27 percent of borrowers receiving or in the process for receiving one of the outcomes. In addition, less than 1 percent of borrowers who redefaulted had become current as of August 31, 2010.[13]

We also looked at data that Treasury had begun reporting on the disposition paths of borrowers who were denied or canceled from HAMP trial modifications. However, weaknesses in how Treasury requires servicers to report data make it difficult to understand the current status of these borrowers. First, Treasury's system for reporting the disposition of borrowers requires servicers to place borrowers in only one category, even when borrowers are being evaluated for several possible dispositions, with non-HAMP (proprietary) modifications reported first. As a result, the proportion of borrowers reported as receiving proprietary modifications is likely to be overstated relative to other possible dispositions, such as foreclosure starts. Further, Treasury does not require servicers to distinguish between completed and pending actions, so some reported outcomes may not be clear. For example, we asked six large servicers to separate borrowers who had a HAMP trial modification canceled into two groups: those who were being evaluated for permanent proprietary modifications and those who had actually received them. The servicers' data indicated that 23 percent of these borrowers were in the process of being approved for proprietary modifications, and 18 percent had received one. At the same time, Treasury reported that 43 percent of borrowers canceled from a HAMP trial modification through August 2010 were in the process of obtaining a proprietary modification.[14]

Servicers told us they had been able to offer more proprietary modifications than HAMP permanent modifications because proprietary

[13]Because borrowers who redefault on a HAMP modification would still retain the terms of their HAMP modification, we would not expect many borrowers who redefaulted to receive a proprietary modification. One servicer, however, reported that 95 percent of those borrowers who redefaulted from a HAMP permanent modification had an action pending for a proprietary modification. The servicer explained that it evaluates the majority of these borrowers for another modification program after they redefault.

[14]We requested that servicers provide the data as of August 31, 2010, but servicers could report borrowers with a canceled HAMP trial modification to Treasury until early September 2010 for August 2010 reporting. In addition, servicers may have included loans in our data request that have not yet been reported to Treasury and, therefore, would not be reflected in the number of borrowers that Treasury reports. Lastly, one servicer reported borrowers to Treasury for a business division not included in our data.

modifications offered greater flexibility. For example, several servicers told us that their proprietary modification programs had fewer documentation requirements. Several servicers told us they were able to offer more proprietary modifications than HAMP modifications or help borrowers when HAMP could not because their proprietary modifications had fewer eligibility requirements, such as restrictions on occupancy type. In addition, while HAMP guidelines require borrowers to have a mortgage payment exceeding 31 percent of their income, all of the servicers we spoke with indicated their proprietary modification programs also served borrowers who had lower payment ratios. While the number of proprietary modifications has outpaced the number of HAMP modifications, the sustainability of both types of modifications is still unclear. For example, proprietary modifications may not reduce monthly mortgage payments as much as HAMP modifications, potentially affecting the ability of borrowers to maintain their modified payments.

In summary, we reported in June 2010 that it would be important for Treasury to expeditiously implement a prudent design for the remaining TARP-funded housing programs. Our current work shows there is more Treasury can do to ensure the effective implementation of these programs, including ensuring that servicers have sufficient capacity to implement them, and that borrowers are notified about potential eligibility for second-lien modifications. We also believe it will be important for Treasury to have clear and accurate information on the dispositions of borrowers who are denied or fall out from HAMP modifications. Without accurate reporting of borrower outcomes, Treasury cannot know the actual extent to which borrowers who are denied, canceled, or redefaulted from HAMP are helped by other programs or evaluate the need for further action to assist this group of homeowners. We provided a copy of our current draft report to Treasury for its review and comment. Treasury acknowledged the report's description of servicers' challenges and appreciated our assessment of Treasury's housing programs. Treasury indicated that the draft report raised certain criticisms of the design and implementation of MHA that were unwarranted. We continue to believe there are opportunities to improve the transparency, accountability, and effectiveness of MHA and anticipating the report this month, in March 2011. We will continue to monitor Treasury's implementation and management of TARP-funded housing programs as part of our ongoing oversight of the performance of TARP in meeting its legislative goals. We are also conducting a broad-based study of the federal government's efforts to mitigate the impact of foreclosures, which will include an assessment of how federal foreclosure mitigation efforts or alternatives might better preserve homeownership, prevent avoidable foreclosures, and otherwise help resolve troubled mortgages.

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, I appreciate this opportunity to discuss this important program and would be happy to answer any questions that you may have. Thank you.

GAO Contact and Staff Acknowledgments

For information on this testimony, please contact me at (202) 512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made major contributions to this statement include Lynda Downing, Harry Medina, John Karikari (Lead Assistant Directors); Tania Calhoun; Emily Chalmers; William Chatlos; Grace Cho; Rachel DeMarcus; Marc Molino; Mary Osorno; Jared Sippel; Winnie Tsen; Jim Vitarello; and Heneng Yu.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, http://www.gao.gov/ordering.htm.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

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

Written Testimony of David H. Stevens
Assistant Secretary of Housing – Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development

"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.

American Alliance of Home Modification Professionals

•AAHMP•

"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, I am Steven Gillan Executive Director of American Alliance of the Home Modification Professionals. Thank you for the opportunity to submit testimony in support of HAMP.

"HAMP Fatal Flaw"

Twenty months into HAMP and the Obama Administrations efforts to slow foreclosures with its many troubles still exist. This is evident from all the processing problems we still see and hear about on a daily basis, from lost documents, improper calculation of income, poor knowledge and implementation of the underwriting guidelines, 4, 6, 12, 20 months for approval and now the Robo signing situation. The list goes on and on but yet after all this time we do not see improvement. Now we find a "Fatal Flaw" in HAMP that could be our last chance to fix the problems.

What we do see is a level of frustration from all interested parties; we have the investor who hired the servicer under a Master Servicing Agreement (MSA) who can not get their servicer provider to even respond to their inquires. These investors are losing money and are being charged a continuous stream of fee's to deal with the foreclosure process. We have the Homeowner who is making ever effort to comply with the servicers' continuous request for more and more documentation even though they where sent ten times. Than there are our government representatives from the State level to Congress wondering what is going on. Hearings are held in the House and Senate with all witnesses, excluding the Bank/Servicing Industry, all testifying to where the problem lies.

The plan in the beginning was to create MHA/HAMP where Treasury would provide an over all strategy, guidelines, policy directives and alterations as required to try and meet the overall objectives of stabilizing real estate values nationwide. Treasury hired Fannie Mae and Freddie Mac to run the programs, Freddie as its compliance team and Fannie as the agency responsible for implementation. After all this time it is evident the program is failing for reasons as mentioned earlier.

To Treasury's credit they have tried to work with the servicing industry to make the plan workable. They have implemented directive after directive to deal with the challenges and shortfalls of the original program. The frustration is evident at Treasury and in Congress with the failure of the servicer to follow guidelines as designed. The servicer claim they are doing everything possible giving a host of reasons, excuses, why after all this time they can not get their programs, manpower or technology working.

Now we have the Robo signing issue which they (servicers') have admitted to being part of. Employees signing documents where the signers' attests to having full knowledge that the information with in the documents is true, to the best of their knowledge, and a notary stamp certifying the same.

Lets review; twenty four (24) of improper implementation by the servicer, millions of people out of their homes, millions of below market REO's on the market and now Robo signing. If the servicer has willingly taken part in Robo signing in the hundreds of thousands why is anyone to believe they did not cut corners in the underwriting process. Based on all the evidence delivered by witness after witness, with report after report, from many different entities both in and outside of the government is a forgone conclusion why HAMP is failing.

Treasury could implement a component in HAMP that deals with compliance. It is a tool that has been built into the guidelines for compliance of policy by the servicer. This job is contractually the responsibility of Freddie Mac. It is a tool that allows Freddie Mac to review the servicer operation and procedures to assure that all applications for HAMP are given the same treatment. This compliance operation is part of the Participating Servicing Agreement (PSA) that over one hundred servicers have signed with Treasury. Part of this guideline is the "Escalation" process where a homeowner that has been denied a modification has the ability to have their case reviewed by Treasury. Treasury has hired Homeownership Preservation Foundation (HPF) to handle those calls. According to Treasury it is the job of HPF to work with the homeowner and servicer to try and iron out differences, to act as an advocate of the homeowner with the servicer.

In the past week Treasury has announce a program for greater use of this "Escalation" process. The troubling part of the above process is this; during that escalation process no one checks the servicer work product. When this homeowner was denied a HAMP modification or the process is taking ten to twenty months no one checks if the servicer underwriting was correct to start with, no one request to see the files to determine if that homeowner does or does not actually meet the guidelines. Again are we just to believe the servicer did the job correctly or that the file is not being dragged on for financial gain.

This is the "Fatal Flaw" in HAMP which has doomed it to failure because no one is checking on the servicer. How can Treasury assure that homeowner or the American Taxpayer that the particular file did not "in fact" qualify for a HAMP modification if no one determines that it was underwritten properly? The servicer can do and say what ever they want and Treasury or the homeowner has not recourse but t accepts their conclusion.

A strong "Escalation" process performed by a neutral third party can either affirm or dispute those finding. With cases that the decline is valid based on HAMP underwriting guidelines everyone knows where they stand and they all move on. In a case where the servicer did "in fact" make a mistake - a completed modification application, fully underwritten by a HUD Direct Endorsed Underwriter, would be given to the servicer for them to review and completion of the process. This Escalation process would also give Treasury the information they need to verify if the servicer is doing the right job and take action on those they are not. It would let the servicing industry know that they can not continue to perform they job poorly because no one will check on them. The hope would be to get the servicer, due to competition that they no longer have a monopoly on the process to act properly.

Unfortunately at this time Treasury has stated clearly on two separate occasions they have no intention of performing this function even though it is mandated by HAMP, makes sense to actually "review" a file for accuracy and they have been presented with a plan to implement a program immediately by our organization. With out this what recourse is left to the investor and homeowner, the answer is possible the Courts but that takes a long time which will continue to just slow the process. This does not benefit anyone but the servicer. This "Fatal Flaw" needs to be corrected and can be.

We do not support the cancelation of HAMP rather that Treasury use tools available to them to insure compliance by the servicing industry. To cancel HAMP would be to return the process back to the servicers. Millions of American Families, investors, our housing market and over all economic recovery can ill afford to let this happen.

AMERICANS for TAX REFORM

Statement of Kelly William Cobb
Government Affairs Manager, Americans for Tax Reform

Hearing on

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

Subcommittee on Insurance, Housing, & Community Opportunity
U.S. House of Representatives Committee on Financial Services

March 2, 2011

Chairwoman Biggert and Members of the Subcommittee, thank you for the opportunity to submit testimony for the record in support of rescinding money for well-intentioned, but costly and unsuccessful, housing programs.

Americans for Tax Reform fully supports legislation that would rescind unused funds from the Troubled Asset Relief Program (TARP), so-called "stimulus" American Recovery and Reinvestment Act of 2009, and the Dodd-Frank Act. Faced with an impending vote to raise the debt ceiling beyond an astounding $14.29 trillion, repurposing this money from failed housing programs presents an opportunity to save taxpayers billions of dollars.

Over the past two years, the federal government has used taxpayer dollars to help prop up lenders and borrowers mired in a foreclosure crisis. While the administration's intentions are certainly noble given high mortgage defaults during the economic downturn, such profligate spending has resulted in greater harm to all American taxpayers than benefits to homeowners.

Combined, the Home Affordable Modification Program (HAMP), the Neighborhood Stabilization Program, the Emergency Homeowner Relief Fund, and the Federal Housing Administration's Refinance Program will cost taxpayers well over $30 billion. Yet, these programs have helped dramatically fewer mortgage holders than anticipated.

Given the programs' failed outcome, the manner in which taxpayer dollars are being redistributed, and the need to bring down our nation's growing debt, Americans for Tax Reform urges all monies appropriated be returned to the U.S. Treasury from the following federal programs:

Home Affordable Modification Program (HAMP)

The Home Affordable Modification Program (HAMP) was established in February 2009 with the goal of lowering mortgage payments and interest rates. The Making Home Affordable program was originally estimated to cost $75 billion, funded with $45.6 billion from TARP and another $25 billion from Fannie Mae and Freddie Mac – all of which is paid for or guaranteed by American taxpayers.[i] Given the program's failure, HAMP has now been ratcheted down and is expected to cost $29.9 billion.[ii]

HAMP has been the U.S. Treasury and Department of Housing and Urban Development's primary spending program for combating foreclosures, and the program has been a costly failure. When the program was announced in February 2009, it was estimated to assist three to four million homeowners.[iii] According to the GAO, by the end of November 2010, less than 550,000 loan modifications had been processed.[iv] In contrast, over 792,000 modifications have been canceled under the program – far more than have been granted.[v]

Even if one assumes massive federal spending programs can combat the mortgage crisis, the prospects for the HAMP program improving are slim to none. Loan modifications under HAMP hit their peak in April 2010 and have since dropped significantly to roughly 30,000 at the end of 2010.[vi] In other words, there is little demand for the program and what demand exists is shrinking.

At the end of 2010, HAMP and related TARP programs have spent $1 billion (or 2.2 percent) of obligated funds.[vii] With little taxpayer money expended, there is an opportunity to rescind most HAMP funds and return this taxpayer money. HAMP's failure is perhaps for the betterment of taxpayers, who were expecting the federal government to spend significantly larger sums of taxpayer dollars. This money can now be returned to the U.S. Treasury's coffers.

FHA Refinance Program

The Federal Housing Administration's Short Refinancing Program is poised to utilize $8.2 billion from unused HAMP funds to refinance and turn underwater mortgages into FHA-insured mortgages.[viii]

In the first three months of its inception, the program has refinanced only 15 loans.[ix] While these few loans have not defaulted, the program places more loans on the balance sheet of the Federal Housing Administration, subjecting taxpayers to greater risk should any of these loans default. Assuming this risk comes on top of using billions of taxpayer dollars for incentive payments to refinance loans.

Neighborhood Stabilization Program (NSP)

Established under the "stimulus" American Recovery and Reinvestment Act of 2009, the Neighborhood Stabilization Program (NSP) provides billions in block grants to states and localities in areas with a high number of foreclosures.[x]

In three separate appropriations, the program has been authorized to spend upwards of $7 billion through the Department of Housing and Urban Development. The $1 billion in unobligated funds that remains should be immediately rescinded.

Emergency Homeowner Relief Fund

The Dodd-Frank Act contained $1 billion to resuscitate the Emergency Homeowner Relief Fund, which authorizes the Department of Housing and Urban Development to provide loans and other payments to underwater borrowers. However, handing low-interest loans subsidized by taxpayers to underwater borrowers only furthers their indebtedness and exposes taxpayers to any risk should these loans default.

---

[i] Office of the Special Inspector General for the Troubled Asset Relief Program, "Quarterly Report to Congress." January 26, 2011. Pg 64.

[ii] Ibid. Pg. 66.

[iii] Ibid. 64

[iv] United States Government Accountability Office, "Troubled Asset Relief Program: Status of Programs and Implementation of GAO Recommendations." January 2011. Pg. 35.

[v] Office of the Special Inspector General for the Troubled Asset Relief Program, Pg. 11.

[vi] U.S. Government Accountability Office, Pg. 36.

[vii] Office of the Special Inspector General for the Troubled Asset Relief Program, Pg 66.

[viii] Ibid. Pg. 90.

[ix] Ibid.

[x] United States Government Accountability Office, "Neighborhood Stabilization Program: HUD and Grantees Are Taking Actions to Ensure Program Compliance but Data on Program Outputs Could be Improved." December 2010.

Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, Cato Institute
Submitted to the
Subcommittee on Insurance, Housing, & Community Opportunity
House Committee on Financial Services
On "Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs"
March 2, 2011

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent seven years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance. Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. He has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He holds a doctorate in economics from George Mason University. http://www.cato.org/people/mark-calabria

Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, Cato Institute
Submitted to the
Subcommittee on Insurance, Housing, & Community Opportunity
House Committee on Financial Services
On "Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs"
March 2, 2011

Chairman Biggert, Ranking Member Gutierrez, and distinguished members of the Subcommittee, I thank you for the invitation to submit testimony for today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen, homeowner and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

Deficits as far as the eye can see

The fiscal deficits facing our nation are simply without precedent. The Congressional Budget Office (CBO) projects a 2011 deficit of $1.48 trillion, almost 10 percent of GDP. While of course a considerable portion of this deficit is due to short term factors related to the recession and financial crisis, much is structural. Under current policy, CBO estimates that in 10 years, in 2021, our annual fiscal budget deficit will still be $763 billion. The 2021 projected deficit is also not from a lack of revenues, as revenues are projected to be 20.8 percent of GDP, above the historical average of around 18 percent and near what many economists consider the maximum amount that can be borne by the economy without substantially shrinking the economy (and hence actually lowering total dollar revenues).

Federal spending currently hovers around 20 percent of GDP, but is projected by CBO to reach 24 percent by 2010, a 20 percent increase in the size of government relative to GDP in just 10 years. This is likely an underestimate, as the CBO baseline assumes several policy outcomes, like sharp reductions in Medicare's payment rates for physicians' services, which may not come to pass. The drivers of this spending are Social Security, Medicare, Medicaid and other health entitlement programs. We cannot address our long term fiscal imbalances without reform of these programs. As defense spending also remains a considerable portion of the budget going forward, cuts to defense spending should be high on the list of any deficit reduction package.

Recognizing that the primary drivers of our long term fiscal deficits are outside the jurisdiction of the Financial Services Committee, I commend the Committee for examining programs within its jurisdiction that can be eliminated or cut. I also commend the Committee for not waiting for these larger issues to be resolved. Although the current deficit is projected to decline as the economy strengthens, before rising again, efforts should be made to reduce the current size of the deficit, as such questions the credibility of political efforts to restrain future spending.

Where to Cut?

Spending cuts must start somewhere. Given concerns, which I believe are misplaced, that spending cuts could adversely slow the economy, a way to address such concerns is to target first those programs that are actually doing harm to the economy and slowing the pace of recovery. While well-intended, the various programs designed to keep delinquent borrowers in their current residence; I believe are slowing the needed, and inevitable, re-balancing of our housing and labor markets.

Jobs, Jobs, Jobs

There is perhaps no more important economic indicator than unemployment. The adverse impacts of long-term unemployment are well known, and need not be repeated here. Although there is considerable, if not complete, agreement among economists as to the adverse consequences of jobless; there is far less agreement as to the causes of the currently high level of unemployment. To simplify, the differing explanations, and resulting policy prescriptions, regarding the current level of unemployment fall into two categories: 1) unemployment as a result of lack of aggregate demand, and 2) unemployment as the result of structural factors, such as skills mismatch or perverse incentives facing the unemployed. As will be discussed below, I believe the current foreclosures mitigation programs have contributed to the elevated unemployment rate by reducing labor mobility. The current foreclosures mitigation programs have also helped keep housing prices above market-clearing levels, delaying a full correction in the housing market.

First we must recognize something unusual is taking place in our labor market. If the cause of unemployment was solely driven by a lack of demand, then the unemployment rate would be considerably lower. Both GDP and consumption, as measured by personal expenditures, have returned to and now exceed their pre-crisis levels. But employment has not. Quite simply, the "collapse" in demand is behind us and has been so for quite some time. What has occurred is that the historical relationship between GDP and employment (which economists call "Okun's Law) has broken down, questioning the ability of further increases in spending to reduce the unemployment rate. Also indicative of structural changes in the labor market is the breakdown in the "Beveridge curve" – that is the relationship between unemployment and job vacancies. Contrary to popular perception, job postings have been steadily increasing over the last year, but with little impact on the unemployment rate.

Historically many job openings have been filled by workers moving from areas of the country with little job creation to areas with greater job creation. American history has often seen large migrations during times of economic distress. And while these moves have been painful and difficult for the families involved, these same moves have been essential for helping the economy recover. One of the more interesting facets of the recent recession has been a decline in mobility, particular among homeowners, rather than an increase. Between 2008 and 2009, the most recent Census data available, 12.5 percent of households moved, with only 1.6 moving across state lines. Corresponding figures for homeowners is 5.2 percent and 0.8 percent moving across state lines. This is considerably below interstate mobility trends witnessed during the housing boom. For instance from 2004 to 2005, 1.5% of homeowners moved across state lines, almost double the current percentage. Interestingly enough the overall mobility of renters has barely changed from the peak of the housing bubble to today. This trend is a reversal from that witnessed after the previous housing boom of the late 1980s burst. From the peak of the bubble in 1989 to the bottom of the market in 1994, the percentage of homeowners moving across state lines actually increased.

The preceding is not meant to suggest that all of the declines in labor mobility, or increase in unemployment, is due to the foreclosure mitigation programs. Far from it. Given the many factors at work, including the unsustainable rate of homeownership, going into the crisis, it is difficult, if not impossible, to estimate the exact contribution of the varying factors. We should, however, reject policies that encourage homeowners to remain in stagnant or declining labor markets. This is particularly important given the fact that unemployment is the primary driver of mortgage delinquency.

Ending the TARP

While there is widespread agreement that the TARP, as authorized under the Emergency Economic Stabilization Act of 2008, is one of the most controversial pieces of legislation passed in modern times; there remains considerable disagreement over its effectiveness. For those of us who believe the TARP was a mistake, it is time to finally put an end to the program. Fortunately many of the components of the TARP have already ended, and at less cost than may have originally been feared (although many at the time predicted "profits"). There remains approximately $60 billion in obligated but not expended TARP funds. The vast majority, $44.6 billion as of December 31, 2010, of unexpended TARP obligations are in the TARP housing programs. All of this funding should be rescinded.

Although the success of a government program should not be determined solely on whether or not it turns a "profit", the ultimately costs of the TARP will be almost exclusively the result of the auto bailouts and the housing programs. If Congress were to rescind the obligated, but not expended, housing funds remaining under the TARP, then the ultimately program costs are likely to be under $20 billion.

Banker bailout by another name

Over 60 percent of expenditures under the TARP housing programs have taken the form of "incentive payments". For instance loan servicers receive a one-time payment of $1,000 for each permanent modification under HAMP. Servicers also receive an additional compensation amount of $500 if the borrower was current but at imminent risk of default before enrolling in the trial plan. Servicers can also receive payments of up to $1,000 annually for three years if the borrower remains current.

Borrowers also receive incentives of annual principal reductions of up to $1,000 annually for a maximum of five years. Interestingly enough, this "borrower" incentive is actually paid to the servicer. Investors, who are often the banks themselves, can also receive incentive payments in exchange for the lowering of monthly mortgage payments.

Almost $600 million has been paid to lenders and investors to modify loans. If these were indeed loans that would have otherwise defaulted, then lenders and investors stood to suffer significant losses. Repeated throughout the recession was the assertion that foreclosure was not in the lender's interest. One cannot help but wonder why the American taxpayer has had to pay lenders and investors $600 million, so far, to do what was apparently already in their interest. The truth is that the TARP housing programs have largely been a transfer from the taxpayer to the very mortgage lenders that contributed to the financial crisis. If we are ever to reduce irresponsible lender behavior, then the place to start is to have the lenders bear the costs of their own mistakes, rather than the taxpayer.

Conclusion

The foreclosure mitigation efforts of both the Obama and Bush Administrations have largely been failures. Their one saving grace has been that such programs have been much smaller than originally projected. These programs have delayed the needed corrections in both our housing and labor markets, effectively prolonging weaknesses in the economy. The TARP housing programs have also represented the largest source of expected losses in the TARP. Ending these programs would immediately protect the taxpayer from future loss. Contrary to concerns about broader cuts to the federal government, eliminating the TARP housing programs would accelerate the recovery of our economy. Lastly, ending the TARP housing programs would put an end to what can only be characterized as back-door bank bailouts, for lenders have been the largest beneficiaries of these programs.

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

Hearing before the House Committee on Financial Services
Subcommittee on Insurance, Housing, & Community
Opportunity

March 2, 2011, 2:00PM, 2220 Rayburn HOB

by

Satya Thallam
Director, Financial Markets Working Group
Mercatus Center at George Mason University

and

Anthony Sanders
Senior Scholar
Mercatus Center at George Mason University

I. Introduction

There are a variety of Federal government programs and initiatives for attempting to create more sustainable mortgage payments for borrowers in imminent risk of default on their home loans. We focus here on the Obama Administration's "Home Affordable Modification Program" (HAMP).

According to the HAMP reporting, 1.71 million trial modification plans have been offered to borrowers and there have been 1.47 million trial modifications made.[1] Given the "fall off the cliff" of housing prices in many states, the surge of unemployment and the evaporation of liquidity for banks and related institutions in the second half of 2007, we are surprised that the servicing industry has moved so quickly to make loan modifications in such large numbers.

This is especially true when one considers how the very nature of the residential servicing industry has changed since 2007 in terms of number of problem loans to be serviced so dramatically. With 12.85 percent of borrowers in foreclosure or delinquent on their mortgages (as of 4th quarter 2010),[2] this creates an incredible challenge to the servicing industry. It is a real challenge to servicers to make loan modifications succeed when 70 percent of modifications that have only interest rate cuts have gone into re-default after 12 months. If the loan modification affordability calculation, as done under HAMP, only uses the first lien position, taxes and insurance and fails to include home equity loans, car leases, credit card debt and other debt burdens, the failure of a large proportion of loan modifications should be anticipated. The negative equity problem in the "sand states" of California, Arizona, Nevada and Florida is going to be considerably challenging for the servicing industry; loan modifications must take into consideration the negative equity position of households to determine their likelihood of success for making mortgage payments. The problem will be exacerbated once short term rates begin to rise.

But it is unclear how many trial modifications will become permanent modifications. The most recent "conversion" rate of trial to active permanent modifications is less than 36 percent, although the total number of permanent modifications started has been increasing steadily.[3] And the re-default rate on those trial loans that survive the challenge of making three months of consecutive mortgage payments during the trial period will likely be about 50 to 60 percent or even higher.[4] Say that only 25 percent of borrowers convert from trial to permanent modifications and then 50 percent of those go into re-default, that translates into 12.5 percent of eligible borrowers actually receiving permanent loan modifications and keeping them current. And it is entirely possible that the "success" rate could even fall below 10 percent of eligible loans.

[1] "December 2010 Making Home Affordable Program Report," Making Home Affordable Program, January 31, 2011.

[2] "Economic and Mortgage Finance Commentary – February 2011," Mortgage Bankers Association, February 18, 2011.

[3] *Supra note 1.*

[4] Lender Processing Services in late May 2009 reported that nationwide modification efforts as of April achieved a re-default rate of nearly 50% six months after modification (with the Office of the Comptroller of the Currency showing a 55% re-default rate within six months).

II. A Critique of the HAMP Approach

There are several reasons why so few loans will make the transition from temporary modification to successful permanent modification.

1. The first reason for the projected failure rate is the degree to which many residential loans in the United States are in a negative equity situation. According to a Deutsche Bank research report, 25 million homes or 48 percent are expected to be in negative equity position by the first quarter of 2011.[5] A less pessimistic estimate is by First American CoreLogic of 10.7 million households (23 percent) having negative equity as of third quarter 2009.[6] These estimates may not be inconsistent since home prices are not expected to hit bottom until the end of 2011 (J.P. Morgan Chase, November 23, 2009). Although negative equity in small amounts is not a problem, larger negative equity positions such as 125-150 percent LTV are difficult to modify (even if the HAMP allowed such large modifications). Therefore, permanent loan modifications in areas with large house price declines will be extremely difficult. Realistically, without significant principal write-downs, modifications are unlikely to be successful. But the write-down approach entails its own problems.[7]

2. The second reason behind the poor prediction for successful permanent loan modifications is the increasing unemployment or declining employment. While a 9 percent reported unemployment rate nationally is bad enough, the true unemployment rate (including wage and salary curtailment) is much higher. This is a challenging obstacle to overcome for the servicing industry. When high unemployment rates and declining employment are combined with a severe negative equity position, a "perfect storm" is brewing of bad conditions, placing enormous burdens on the mortgage servicing and banking industries.

3. The third reason for only minimal success is the documentation problem. To qualify for a trial loan modification, the HAMP program is following the borrower "stated" income approach that does not require documentation.[8] Like stated income loans, stated income qualification for temporary loan modification is a fertile ground for moral hazard problems where borrowers/applicants who are insulated from risk may behave differently from the way they would behave if fully exposed to the risk. In this case, borrowers may

[5] *Bloomberg*, http://www.bloomberg.com/apps/news?pid=20603037&sid=adBYDzUMt68k

[6] Ruth Simon and James R. Hagerty, "1 in 4 Borrowers Under Water," *Wall Street* Journal, November 24, 2009, p. A1.

[7] Megan McArdle, "Principal Write-Downs Still Popular with Wonks," *The Atlantic Online*, February 28, 2011, http://www.theatlantic.com/business/archive/2011/02/principal-write-downs-still-popular-with-wonks/71820/.

[8] See Gerald Hanweck (2007), "Subprime Mortgage Delinquency Rates by Metropolitan Area: An Analysis by Origination Vintages and Projections for 2007," working paper, for estimates of the effect of low or no documentation had on the rate of delinquency by vintage of subprime and Alt-A mortgages within metropolitan.

not want to submit the required documentation since they may be denied a permanent modification. While there have been stories of servicers making it "difficult" for borrowers to submit the necessary documentation, one has to consider the flip side of the argument. Borrowers may claim that the servicers are making it difficult to obtain documentation when, in fact, they may just simply be hoping that the permanent modification will be approved without full documentation. In fact, a recent article discusses how willing the servicers were to make loan modifications, only to find that borrowers were not completing the submission of the required paperwork.[9] This is not to say that some borrowers have not experienced "true" documentation problems, which would be consistent with the dramatic growth in demand for loan modifications through HAMP as servicing entities ramp-up their servicing efforts to meet the demand.

4. The fourth reason is that many borrowers are having trouble making their three consecutive mortgage payments during the trial modification period.[10] In addition, borrowers may not qualify for the temporary modification by having 1) too much income, 2) not enough income, or 3) have a house that has fallen too much in value.

III. Servicer Performance

The Making Home Affordable Program provides a "Servicer Performance Report" that rank orders servicers in terms of "Active Trial Modifications as a Share of Estimated Eligible 60+ Day Delinquencies." The higher the ranking, the more active trial modifications the servicer is making. The problem with this accounting method for "success" is that it does not control for servicers with loans in particularly hard hit areas such as "bubble" states like California, Arizona, Nevada and Florida. Servicers in states where house prices have collapsed, sometimes by as much as over 50 percent, are going to be **heavily** challenged to perform these loan modifications. When you add in the already high unemployment rate in these states, these are indeed challenging areas to perform loan modifications.

In addition, the highest unemployment rates by large metropolitan area (as of December 2010) are Las Vegas, NV (14.9), Riverside-San Bernadino, CA (13.9), Sacramento, CA (12.5), and Tampa-St. Petersburg (12.0).[11] While Arizona has "only" a 9.6 percent unemployment rate, the difficulty of loan modifications must be considered when combined with the crash of housing prices that occurred there.[12] The states and metropolitan areas with the highest unemployment

[9] Floyd Norris, "Why Many Home Loan Modifications Fail," *The New York Times*, December 3, 2009, http://www.nytimes.com/2009/12/04/business/economy/04norris.html?_r=1.
[10] *Ibid*
[11] Local Area Unemployment Statistics, U.S. Department of Labor.
[12] Anthony B. Sanders, "The Subprime Crisis and its Role in the Financial Crisis," *Journal of Housing Economics*, Volume 17, Issue 4, December 2008.

rates should be taken into consideration by Treasury when determining loan modification trial success rates.

Our recommendation for reporting servicer performance is to adjust the service performance by percentage of loans in 1) bubble states and 2) Midwest "economic malaise" states such as Ohio and Michigan. In short, modifying loans in Nebraska is likely to be far easier than modifying loans in Arizona, Nevada or the Inland Empire of California or various condo-laden areas in Florida. Therefore, servicers should be given additional credit for attempting to modify loans in these challenging areas.

IV. Lack of Principal Write-downs

When financial institutions and other holders of mortgages (investors) accept loan modifications that reduce principal, short sales and short payoffs, they take an immediate hit, causing them to reduce earnings and receive pressure from regulators to raise additional capital.[13] To provide an incentive for financial institutions/investors to sell their distressed mortgage loans to the private markets, government regulators, including the SEC, should allow financial institutions/investors to amortize the losses for up to 5 years, with greater proportions in the early years, so as to spread the accounting consequence of a loss over time. This would enable the financial institutions/investors to sell distressed assets from their books and free up funds to be invested elsewhere such as loans to small businesses that will increase employment.

While programs like HAMP are meant to keep people in their houses, an incentive needs to be provided to financial institution to avoid becoming "zombie banks" as has occurred in Japan. While the HAMP program might keep some people in their homes, the program maintains the loan with the lender and does not free funds for uses other than housing until the loan is paid off or refinanced. And with a 40-year extension of loan maturity for some modifications, this would mean that these loans would be on the balance sheets of the lenders/investors for almost a half century.

V. Critique of Mortgage Modification as a Solution the Mortgage Crisis and Use of Taxpayer Resources to Subsidize House Buyers In Default

Policies by our Federal government to encourage banks/servicers to modify mortgages to as low as two percent interest rate and up to 40 years to maturity have the potential to load up the already fragile U.S. banking industry with billions of dollars and possibly up to $5 trillion of

[13] There are other reasons for difficulties in loan modifications and principal write-downs such as HELOCs held by other entities and mortgage insurance companies where there third party has the right to prevent the servicer from modifying the first lien.

these mortgages. It is known that many of these mortgages carry considerable default risk because of the nature of borrower loan modification history. From this perspective it is a dangerous program for the survival of the banking industry and the GSEs. Based on their latest 10Q filings with the SEC, Fannie Mae currently has $700 billion of mortgage loans and MBS in portfolios. In addition, Fannie Mae has approximately $3 trillion of mortgage guarantees on their books.[14] Unfortunately, the problem extends beyond the banks and the GSEs, but to the Fed as well. It is sitting on nearly $1 trillion of MBS at the present time from open market purchases and portfolios taken over from Bear Stearns now called the Maiden Lane funds.[15] The problem comes from potential increases in inflation and interest rates.

Considering the current fragile state of the banking system and the GSEs, taking on more mortgage assets with very large durations opens them up to increased interest rate, market and liquidity risks. Macaulay's duration of a 40-year mortgage when mortgage market rates are 5 percent or less is 8 years or more (a 30-year mortgage has a duration of 7.9 years), regardless of the stated coupon rate (the rate actually paid by the borrower). What this level of duration means is that if market rates rise by 2 percentage points (200 basis points), the fair value and market value of the mortgage asset declines by 15 percent—very meaningful change.

Using duration as an indicator of interest rate risk exposure for a mortgage instrument, the duration of a portfolio of mortgages is equal to the remaining balance-weighted average of each mortgage's duration. For the GSEs they have virtually their entire portfolios in mortgages so that the duration of their asset portfolio is about 7 to 7.5 years (including MBS). They state that the companies' interest rate exposure as a whole is controlled by borrowing callable bonds and matching liability duration with asset duration. The problem with this strategy is that historically mortgages were prepaid as market mortgage interest rates fell, decreasing the effective duration of their assets. The current situation is that the possibility of prepayments of any magnitude is slim since current rates at historic lows with the much greater likelihood that they will rise, not fall. The implication of this expectation is that loan prepayments from current loans will be slow in the future and much slower for loans modified in the HAMP program. Thus, GSE financing mortgages with say 5-year callable bonds with a Macaulay's duration of about 3 years will cause a considerable mismatch with mortgage assets and substantially increase the interest rate risk exposure of the GSEs. Not only will interest risk exposure increase, but as rates rise, market values fall and the ability to trade mortgages decreases. Thus, market liquidity of the mortgage portfolio will also be impaired.

The banking system faces an even more serious interest rate risk exposure problem in taking on a meaningful amount of modified mortgages. As of the September 30, 2009 Call Reports, banks

[14] SEC Filing, Form 10-Q for Federal National Mortgage Association, Table 37. Freddie Mac also carries a similar total value of mortgages as well as guarantees also in the trillions.

[15] "Federal Reserve System Report of Assets, Liabilities, and Capital of the Federal Reserve System as of November 25, 2009"

and thrifts hold $4.5 trillion in mortgage loans and MBS. These represent 37.0 percent of total domestic assets at these institutions. If $1 trillion of HAMP modified mortgages were added to bank portfolios, the interest rate risk exposure of depository institutions would rise considerably. Not only would the composition of the mortgage portfolio would change, but the size of the mortgage portfolio would increase to perhaps $5.5 trillion. Unlike GSEs, banks finance asset positions with deposit liabilities with very short durations - usually 1year or less. Thus, by adding 8-year duration assets to the mortgage portfolio would increase the asset and liability duration mismatch and expose banks to greater interest and market risk of their portfolios.

However, the good news is that this increase will not be as severe as for the GSEs since the banking system has portfolios that are much less concentrated in mortgages and carry durations that are more like 3 years – 37 percent for banks and nearly 100 percent for the GSEs. An increase in interest rates will have a deleterious effect on the value of banking portfolios and reduce the liquidity of them with more mortgage lending. Furthermore, additions of HAMP modified mortgages to GSE or banking system portfolios exposes each to considerably greater default risk. Perhaps most important, each are left with extremely illiquid loans that will be a burden on their portfolios for years perpetuating the same over-investment in housing that caused the crisis in the first place. This will force these institutions, particularly the banks, to retard growth of lending to small businesses (which are responsible for much of job creation) as a consequence.

VI. Bringing More Equity into the Market

Once the financial institutions/investors can dispose of distressed loans from their portfolios, private market groups can acquire these loans and enact private market loan modifications.[16] In fact, allowing financial institutions/investors to sell their distressed assets without immediate devastating consequences would enable them to pursue loan modifications through their services more aggressively, if economically appropriate.

Another advantage of allowing financial institutions/investors to sell the assets without immediate adverse consequences is that it opens the door for broader approaches to dealing with the foreclosure crisis such as 1) short payoffs, 2) short sales, 3) foreclosure, 4) conversion to leases and 5) broader loan modifications if they make economic sense. Particularly given the vacancy rates in many states in the housing market, conversion to leases makes sense given the comparatively low rental rates relative to mortgage payments. Private funds have offered interesting loan modification examples as converting the loan to a rental agreement with an

---

[16] For example, Selene Residential Mortgage Opportunity Fund ("SRMOF") is a private fund that is actively purchasing, servicing and restructuring loans. See also Fortune Magazine, December 21, 2009, p.88.

option for the former borrower to purchase the house, a shared appreciation approach where the borrower shares part of the upside with the lender in return for a principal write-down on the loan. Essentially, the market-based approach brings sorely needed equity into the mortgage market while the HAMP approach retains nearly 100 percent debt financing of its modified mortgages.

Accounting changes to permit financial institutions, investors and servicers to ignore fair value accounting and retain book values of their distressed assets that clearly dominate alternatives such as "cramdowns" or other judicial interventions into the mortgage market. Helping financial institutions and servicers dispose of their distressed assets was one of the original purposes of TARP and we should now consider the wisdom of cleaning-up financial institution balance sheets rather than judicial interventions or Federal government debt financed mortgage modification programs.

VII. Conclusion

The HAMP program is designed to modify mortgages by reducing the monthly payment of the borrower to no more than 31 percent of state gross income and extend the maturity of the mortgage. Once the borrower qualifies by meeting an initial NPV test and a 3-month trial period at the modified monthly payments, they become eligible for a permanent modification once all documentation requirements are met. Essentially HAMP creates a modified mortgage with the same unpaid balance as the original mortgage, except at a much lower interest rate (as low as 2 percent) and up to a 40-year maturity. However, HAMP still leaves borrowers whose mortgages were upside down before modification, upside down after modification. In addition, HAMP leaves banks and GSEs with mortgages on their books with considerable default and interest rate risk with a need to continue financing.

Helping financial institutions and servicers dispose of their distressed assets was one of the original purposes of TARP and we should now consider the wisdom of cleaning-up financial institution balance sheets rather than judicial interventions or Federal government debt financed mortgage modification programs.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

March 2, 2011

The Honorable Judy Biggert
Chairman
House Financial Services Subcommittee on Insurance, Housing and Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Biggert:

Thank you for the opportunity to provide a statement for the record for today's hearing on "Legislative Proposals to End Taxpayer Funding for Ineffective Foreclosure Mitigation Programs."

I write to express the Administration's strong opposition to these four proposals aimed at eliminating the Neighborhood Stabilization Program, the Federal Housing Administration Short Refinance Program, the Emergency Homeowner Relief Fund, and the Home Affordable Modification Program ("HAMP").

The Department of Housing and Urban Development has principal responsibility for the first three programs, and I understand that Assistant Secretary for Housing and Commissioner of the Federal Housing Administration David Stevens and Assistant Secretary for Community Planning and Development Mercedes Marquez will be testifying at today's hearing to discuss these programs in more detail. The Department of the Treasury administers HAMP. Therefore, I am writing to explain why it is important to continue this critical program and to urge you to oppose the "HAMP Termination Act of 2011."

Terminating HAMP before the end of 2012 would be a mistake. HAMP continues to help tens of thousands of additional families every month with mortgage modifications that provide the typical borrower with a $500 reduction in monthly mortgage payments. Put simply, ending HAMP now, without a meaningful alternative in place, would mean that struggling homeowners would have far fewer ways of coping with the worst housing crisis in generations. Instead, their fate would be left solely in the hands of the same mortgage servicers whose standards are widely recognized to be in need of reform.

HAMP's impact on the housing market goes far beyond the number of permanent modifications achieved. By setting affordability standards and developing a framework for how mortgage servicers should provide assistance to struggling homeowners, HAMP provides critical protections for homeowners and has catalyzed improvements in modifications across the board.

It is also important to note that HAMP utilizes a pay-for-success model in most of its programs. Taxpayer funds are used *only* for homeowners in permanent modifications and only so long as those homeowners continue to make payments. As required by statute, any unused funds at the expiration of the program will be used to pay down the national debt. *In short, the program only uses taxpayer funds to the degree it succeeds.*

For your further information, attached are: 1) a document entitled *Home Affordable Modification Program (HAMP) Fact vs. Fiction*, and 2) the testimony of Ms. Phyllis Caldwell, Chief, Homeownership Preservation Office, before your Subcommittee on February 16, 2011.

I strongly urge you and your colleagues to oppose the early termination of HAMP, and to work with the Administration to ensure that struggling homeowners continue to have meaningful tools to avoid foreclosure and to keep their homes.

Sincerely,

Timothy G. Massad
Acting Assistant Secretary
Office of Financial Stability

cc: Subcommittee on Insurance, Housing and Community Opportunity Ranking Member Luis Gutierrez
Members, House Financial Services Committee

Attachments

MAKING HOME AFFORDABLE.GOV

Home Affordable Modification Program (HAMP) – Fact vs. Fiction

In early 2009, the Obama Administration launched the Home Affordable Modification Program (HAMP) to help middle-class American families weather the worst economic downturn since the Great Depression. This program to date has helped more than 600,000 families stay in their homes while helping neighborhoods avoid the associated blight that comes with vacant and foreclosed homes. However, some have suggested eliminating this program. This would be a mistake, as HAMP continues to help tens of thousands of additional families every month. Put simply, ending HAMP now would mean that struggling families will have far fewer ways of coping with the worst housing crisis in generations. Some have suggested eliminating the program based on incorrect assertions or myths about the program. Here are the facts:

1. **Assertion: HAMP has failed because it hasn't helped 3-4 million homeowners.**

Facts: The primary reason we will not achieve 3-4 million *permanent* modifications of mortgages is that there are not that many people who meet the eligibility criteria—criteria which ensure that taxpayer funds are used wisely.

HAMP is not available for:

- mortgages in excess of $729,750;
- mortgages on second homes or investor-owned properties;
- mortgages on vacant homes;
- homeowners who can afford to pay their mortgage without government assistance; and
- homeowners with mortgages that are unsustainable even with government assistance.

Today, there are roughly 5 million delinquent mortgages. Currently, about 1.4 million homeowners are eligible for HAMP. Approximately 600,000 homeowners have had their mortgages permanently modified under HAMP, and an average of 30,000 more are being added each month. These homeowners have a median payment reduction of $527 a month, with aggregate savings to date totaling approximately $5 billion.

Nearly 1.5 million American homeowners have received a trial modification providing temporary relief, and most of those homeowners then received some form of additional assistance, whether within or outside of HAMP.

HAMP has also helped millions of people indirectly, because HAMP's standards have been adopted across the industry to standardize loan modifications. Fitch's most recent report states that:

"Fitch believes that the HAMP program, while not meeting its volume projections, did help to bring a needed standard to varied programs offered prior to its introduction and to focus attention on the use of mods. Establishing a priority in steps, target interest rate and payment allowances, and a net present value calculation resulted in a more consistent application of efforts."

The fact that the program has not achieved 3-4 million permanent modifications is no reason to end it, particularly when the number of Americans that HAMP helps continues to grow each month.

2. **Assertion: HAMP will cost $75 billion, which is far too much money to spend on a program that won't help that many people.**

Facts: The amount of TARP funds allocated to the Making Home Affordable Program, including HAMP, is $29 billion. Treasury makes payments only for homeowners in permanent HAMP modifications and only so long as those homeowners continue to make their payments. In short, HAMP only pays for success.

We want to be sure that we have the funds available to help all those who need assistance and we will continue to reach new families through the end of 2012. Whatever is not spent will go to pay down the national debt; it will not be used for any other purpose.

3. **Assertion: There have been more trial modifications cancelled –over 700,000—than there are current permanent modifications.**

Facts: The fact that many trial modifications were cancelled or did not become permanent is not evidence of failure; it is evidence of HAMP's strict and sensible conditions for using federal funds. Most of those trial modifications did not satisfy the eligibility criteria noted above. In other cases, homeowners could not document their income, or could not make their payments during the three-month trial period.

The reason the conversion rate from trial modifications to permanent modifications was initially low—about one-third—was that at the beginning of the program, homeowners were accepted into trial modifications without first providing written documentation of their income or financial hardship. We felt this policy was necessary because the gravity of the crisis required quick action. As of DATE, all homeowners began entering trial modifications with full documentation. Going forward, the only reason a homeowner will not convert from a trial modification to a permanent modification is if they are unable to sustain their trial payments on time.

4. **Assertion: HAMP is a failure because Treasury has spent $1 billion of the $29 billion allocated for the program.**

Facts: HAMP was designed so that money is spent only for permanent modifications and only gradually, over a five-year period. If a homeowner defaults on their payments, Treasury stops paying. So the fact that payments are staged is further evidence of the prudent design of the program.

5. **Assertion: HAMP is not needed because the industry will enter into modifications anyway.**

Facts: The servicing industry was not and still is not fully equipped to deal with this crisis. Ending HAMP now would mean that the fate of struggling homeowners will be solely up to the servicers—the same servicers whose bad mortgage lending practices contributed to the crisis, whose poor implementation of HAMP has been widely criticized, and who have recently acknowledged failures to follow the law in pursuing foreclosures.

The industry has improved since HAMP was launched and is offering modifications today, but that is largely because HAMP set standards that the industry needed and subsequently adopted. These include the universal affordability standard—a 31 percent debt-to-income ratio which helps ensure that homeowners can sustain payments. And HAMP created a "net present value" tool to enable servicers to evaluate whether a HAMP modification provides a better financial outcome to the investor relative to a foreclosure. Servicers are required to follow investor guidelines when modifying loans, including demonstrating that actions taken are in the investor's best interest. Before HAMP was launched, very few modifications were made, and very few of those were sustainable.

Moreover, the process HAMP created for evaluating borrowers is what has enabled servicers to then offer their own modifications to homeowners that do not meet HAMP eligibility requirements.

HAMP modifications thus far appear to be more sustainable than other modifications. The Office of the Comptroller of the Currency (OCC) recently stated that, "HAMP modifications were performing better than other modifications implemented during the same periods at the end of the third quarter of 2010. These lower post-modification delinquency rates reflect HAMP's emphasis on the affordability of monthly payments relative to the borrower's income, verification of income, and completion of a successful trial payment period." In Treasury's own latest monthly report, we show that at 12 months, more than 80 percent of homeowners remain in a permanent modification.

And even proprietary modifications are showing improved redefault rates, a development that Fitch's most recent report attributes to "more standardized qualification criteria for mods, coupled with a focus on lowering monthly payments" – a direct result of HAMP's influence on the industry.

HAMP continues to set standards that the industry needs. These include standards for borrower protection, which ensure that a borrower that is being evaluated for a modification is not foreclosed upon. HAMP also provides monitoring of servicer performance, requires enhanced reporting for greater transparency and openness, and holds servicers accountable to ensure all eligible homeowners are fairly evaluated under the program. The compliance oversight provided by HAMP is critical to sustaining these improvements in the servicing industry. Terminating HAMP would eliminate these critical levers for holding servicers accountable to basic customer service and modification standards.

6. **Assertion: SIGTARP has said HAMP has failed to realize the TARP goal of "preserving homeownership".**

Facts: SIGTARP has made a variety of recommendations regarding HAMP, most of which Treasury has implemented. Its principal criticism today is that Treasury has not set "realistic and meaningful goals" for the program by which it can be evaluated.

Treasury publishes a monthly report that contains detailed program statistics, which enables the public to evaluate the performance of both the program and its participating servicers. We have also released a data file which includes characteristics of program participants to date, including financial information, mortgage loan information before and after entering HAMP, performance in a HAMP modification, and race/ethnicity data. This data shows that HAMP is helping its intended audience – homeowners in active permanent modifications have a median annual income of approximately $46,000; a median credit score of 570 when they enter the trial period; a median post-modification loan balance of just over $232,000; and a median mark-to-market loan-to-value ratio of 118 percent.

Finally, HAMP is not the only action being taken by Treasury and the Obama Administration to address the housing crisis. Treasury has allocated $7.6 billion of TARP funds to the states hit hardest by unemployment and falling house prices through the Hardest Hit Fund. And Treasury is working with the Federal Housing Administration (FHA) to implement the FHA Short Refinance program, which will help people who are suffering from declines in the value of their homes to refinance into a more affordable mortgage. Treasury has also expanded Making Home Affordable to address the problem of second liens, to provide incentives for other alternatives to foreclosure such as short sales, to provide additional help to the unemployed, and to encourage principal reduction. In addition, an interagency task force chaired by Treasury and HUD has been investigating the issues of robo-signing, foreclosure documentation mistakes and related problems.

****

The question raised by legislation put forward in the House is whether the Obama Administration should continue to help struggling homeowners. HAMP provides a model to allow families to remain in their homes through affordable, sustainable loan modifications. It continues to serve as a benchmark for the mortgage servicing industry through its focus on reduced payments, borrower protections, compliance and innovative approaches to new challenges in the housing market. To end HAMP now would inject uncertainty and unnecessary risk into a fragile housing market that has only recently begun to regain its footing.

Embargoed until delivery

Written Testimony of Phyllis Caldwell,
Chief of Homeownership Preservation Office,
U.S. Department of the Treasury
Hearing before the House Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
on
"Are There Government Barriers to the Housing Market Recovery?"

February 16, 2011

Chairwoman Biggert, Ranking Member Gutierrez and Members of the Subcommittee, thank you for the opportunity to testify today. I appreciate the opportunity to share insights resulting from the Administration's efforts to mitigate the effects of the most serious housing crisis since the Great Depression.

Rationale behind the Administration's Efforts to Prevent Avoidable Foreclosures

As the Subcommittee examines the role of the government in the housing market, including the housing programs supported by the Troubled Asset Relief Program (TARP), it is important to remember where the housing market stood just over two years ago. When the Obama Administration took office in January 2009, the economic crisis had developed into the most serious housing crisis since the Great Depression. Home prices had fallen for 30 straight months. Home values had fallen by nearly one-third and were expected to fall by another five percent by the end of 2009. Stresses in the financial system had reduced the supply of mortgage credit, limiting the ability of Americans to buy homes. Fannie Mae and Freddie Mac had been in conservatorship for over four months. And millions of American families faced increasing difficulties in making their monthly mortgage payments – having lost jobs or income – and were unable to sell, refinance, or find meaningful modification assistance.

During its first month in office, the Administration took aggressive action to address the housing crisis, such as bolstering the Government's commitment to support to Fannie Mae and Freddie Mac, which originated during the Bush Administration, to ensure continued access to mortgage credit, and through the Federal Housing Administration (FHA), both of which provided liquidity for housing purchases at a time when private lending had almost evaporated. As part of the Administration's response, the Treasury Department immediately began work on a program that would improve the affordability of mortgages for responsible homeowners, consistent with the mandate of the Emergency Economic Stabilization Act of 2008 (EESA) to promote financial stability while protecting taxpayers.

Key Challenges of the Administration's Response to the Foreclosure Crisis

My testimony today will highlight some of the key challenges addressed in responding to the housing crisis and discuss how best to help homeowners. First, the industry did not have the capacity to effectively respond to the complexity of the foreclosure crisis. Mortgage servicers were ill-equipped to provide meaningful assistance to homeowners while maintaining their responsibility to investors and still struggle to balance the two. Second, effective outreach to homeowners is difficult due to the complexity of the challenges they face, and their understandable mistrust of servicers. Homeowners often are not aware of the free resources available to them, and servicers all must increase efforts to reach them. Third, homeowners need safeguards. We have learned that the foreclosure process has to pause long enough to allow homeowners enough time to find help and work out a solution. Fourth, modifications need to be affordable to work. In order to modify loans effectively – and sustainably – servicers must focus first and foremost on reducing monthly mortgage payments. And lastly, because the foreclosure crisis is complex, we had to remain flexible as we looked for solutions that could reach the maximum number of struggling homeowners.

We are working to address these challenges within the framework of the Making Home Affordable Program (MHA), which is predicated upon voluntary agreements between Treasury and mortgage servicers. The MHA program was designed to incentivize long term sustainable modifications by aligning incentives within the existing mortgage servicing framework of borrowers, servicers and investors thereby minimizing potential adverse market impacts.

Mortgage Servicers Did Not Have the Capacity to Respond to the Crisis

The mortgage industry at the outset of the foreclosure crisis was ill-equipped to respond the housing crisis adequately. Mortgage servicers had insufficient resources to address the needs of a market that was reeling from increasing foreclosures. In addition, their servicing expertise and infrastructure was limited to overseeing collections and foreclosing on those who failed to pay. While that model may have been sufficient for the industry during times of economic growth and house-price appreciation, it quickly proved seriously inadequate in 2007, when the industry experienced rapidly rising defaults and declining home prices.

In addition, there was no standard approach among loan servicers or investors about how to respond to responsible homeowners who wanted to continue making payments, but were in need of mortgage assistance. Most solutions offered by servicers before the crisis simply sought to add unpaid interest and fees to the mortgage balance. These options often resulted in higher, not lower, payments for homeowners. Although many of these early modifications may have attempted to address temporary hardships experienced by homeowners such as a medical emergency or divorce, they did not generally help over the longer term, because they did not make homeowners' monthly mortgage payments more sustainable. As a result, millions of responsible American families simply lost their homes.

The program that Treasury launched in March 2009, the Making Home Affordable program, includes the first lien modification program – the Home Affordable Modification Program (HAMP). Its goal was to offer homeowners who are at risk of foreclosure reduced monthly mortgage payments that are sustainable over the long-term. HAMP provided servicers with standards that could be applied to all modifications. As a result, these standards soon became national, industry wide models that were applied to the servicers' own proprietary modifications as well.

At the same time, it is important to emphasize that HAMP was not intended to help all homeowners. Nor was HAMP intended to stop all foreclosures. The program was intended to support financial stability by helping a segment of homeowners who were at risk of foreclosure or who would be at risk before the end of 2012. Today, there are approximately 5 million delinquent mortgages. Only about 1.5 million are eligible for HAMP, because HAMP eligibility is not extended to:

- high cost mortgages in excess of $729,750;
- mortgages on vacation, second homes or investor-owned properties;
- mortgages on vacant homes;
- homeowners who can afford to pay their mortgage without government assistance; and
- homeowners with mortgages that are unsustainable even with government assistance.

Additionally, not every mortgage servicer participates in HAMP and not every contract between servicer and investor allows for modifications. And HAMP is just one program in the waterfall of foreclosure prevention options at other federal agencies like the FHA and the Department of Veterans Affairs (VA).

Over the last two years, we have worked to develop policies and procedures in the MHA program to ensure that responsible homeowners who meet the eligibility criteria are offered meaningful modifications and other alternatives to a foreclosure. To address servicer shortcomings, we have required servicers to rapidly increase staffing and improve customer service. We have developed specific guidelines and certifications on how and when homeowners must be evaluated for HAMP and other options before foreclosure. We developed a clear process for promptly and fairly resolving homeowner complaints. We also have a comprehensive compliance program to make sure that homeowners are fairly evaluated for HAMP, and that servicer operations reflect Treasury guidance.

Today, HAMP continues to play a critical role in the market as the standard which servicers can use to evaluate assistance for struggling homeowners. Servicers have had to make significant operational changes to the way they handle foreclosure prevention. As a result, modifications made outside of HAMP generally follow HAMP's basic criteria. For the first time ever, making monthly mortgage payments affordable for the homeowner is now a touchstone of modifications across the industry.

Engaging Homeowners is Key

Homeowners facing foreclosure are often overwhelmed by the complexity of the challenges they face. They are stressed and often embarrassed by their financial difficulties, and may find it difficult to ask for assistance. As a result, we believe many homeowners fail to reach out for help.

Many homeowners facing foreclosure have lost their jobs. Others have reduced income due to underemployment or a new job that is lower-paying and are struggling to pay their bills. Often these homeowners exhaust their savings, fall into debt, and become delinquent on their mortgage before contacting their mortgage servicer for help.

Across the board, homeowners' experience with servicers has been frustrating. Servicers have had trouble keeping track of homeowner communication; different customer service representatives often do not have records of a homeowner's prior contact with their organization. Servicers lose documents or are difficult to contact. Through public reporting and compliance reviews, Treasury strives to improve the borrower experience when it comes to HAMP consideration.

Almost two years into the HAMP program, over 1.4 million families have received a trial modification which provided temporary relief, and most of those then received some form of further assistance, whether within or outside of HAMP. Nearly 580,000 homeowners have converted to permanent modifications and on average over the past six months, 30,000 more are being added each month. We know that many more families need help and we are working to bring as many eligible borrowers into the program as possible. Treasury has stepped up efforts to reach out to homeowners and guide them through the HAMP process. We recently launched a Public Service Advertising campaign across TV, radio, internet and billboards which has been viewed approximately 53 million times. We recently held our 50th homeowner outreach events, with more to come. We have trained close to 7,000 housing counselors. We continue to strengthen our resources at the HOPE Hotline and the HAMP Solution Center, enabling us to better support homeowners as they work with their mortgage servicer.

These efforts come on top of important policy changes that are designed to ease access into the program while making sure that we still use taxpayer funds prudently. First, we set requirements to reach out to homeowners as part of our homeowner protections guidance, and comprehensively review their compliance. Second, we simplified the HAMP documentation requirements. Third, we required that all trial modifications start only after fully documented requests for assistance, and that homeowners have their income verified by servicers before they can receive a HAMP trial modification. These changes were designed to simultaneously help homeowners get access to the program and ensure that those who enter the program are much more likely to convert to permanent modifications after completing the three month trial period.

Treasury is also working to make sure homeowners know that help is available. Homeowners can call their servicers and ask about a HAMP modification, or the HOPE Hotline at 888-995-HOPE, where they can talk to a free HUD-approved housing counselor who can guide them through the process and serve as an advocate in working with the servicer.

When asked what advice he would give to others, a homeowner from Cleveland who received a permanent HAMP modification said, "Don't be ashamed to ask for help. These are tough times and there is help out there. I am so grateful for the housing counselor I worked with. There is no charge to work with a housing counselor. The government has a lot of good resources that are all free." We are working hard to spread this message to more struggling homeowners.

Homeowners Need Some Safeguards

Early in the HAMP program, Treasury guidelines prohibited a foreclosure sale until a homeowner was fully evaluated for a HAMP modification. This rule protected homeowners in many cases, but permitted servicers to start the foreclosure process while simultaneously evaluating homeowners for HAMP. The servicer rationale for allowing this "dual track" was to expedite the foreclosure process in the event that homeowners fail their trial modifications, particularly in those judicial states that had long foreclosure timelines. However, this "dual tracking" of homeowners can cause enormous stress and confusion for individuals already in a difficult period.

To address these concerns, Treasury issued guidance that limited "dual tracking". This guidance became effective with trial modifications started on and after June 1, 2010. Specifically, program guidelines require participating mortgage servicers of loans that are not owned or guaranteed by Fannie Mae or Freddie Mac (referred to as the GSEs) to:

- evaluate homeowners for HAMP modifications before referring them for foreclosure. The focus here is on early intervention. Servicers must reach out to all potentially eligible homeowners when they are only two months delinquent and there is a still a viable opportunity to save the loan;
- suspend foreclosure sales against homeowners who have applied for HAMP modifications, while their applications are pending;
- halt all pending foreclosure actions when a homeowner makes the first payment under a fully verified trial plan;
- evaluate whether homeowners who do not qualify for HAMP (or who have fallen out of HAMP) qualify for other programs to prevent a foreclosure, such as a servicer's own proprietary modification program;
- evaluate whether homeowners who cannot obtain alternative modifications may qualify for a short sale or deed-in-lieu of foreclosure, including through Treasury's program, the Home Affordable Foreclosure Alternatives program (HAFA); and
- provide a written explanation to any homeowner who is not eligible for a modification, and thereafter delay foreclosure for at least 30 days to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless and until they have followed these guidelines. They must also first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached."

In addition, Treasury instituted a comprehensive compliance program to make sure that homeowners are fairly evaluated for HAMP, and that servicer operations reflect Treasury guidance. The MHA compliance program is designed to ensure that servicers are meeting their obligations under the MHA servicer contracts for loans where Fannie Mae or Freddie Mac is not the investor. Treasury's compliance activities focus on ensuring that homeowners are appropriately treated in accordance with MHA guidelines and servicers are subject to various compliance activities, including periodic, on-site compliance reviews as well as on-site and off-site loan file reviews. Treasury has engaged a separate division of Freddie Mac, Making Home Affordable-Compliance (MHA-C), to perform these compliance activities. Compliance activities are performed by more than 200 staff at MHA-C using a risk-based approach. MHA-

C's compliance reviews range from generally monthly for the largest servicers, to at least twice annually for the smaller-sized servicers.

MHA-C has performed more than 250 compliance reviews on participating servicers, many of which shaped servicer behavior in order to address the most vital issue: the ultimate impact on the homeowner. Examples of actions MHA-C has taken include requiring servicers to re-evaluate homeowners for HAMP, requiring servicers to make process and systems changes to accommodate MHA guidelines, and corrections to the servicer's net present value calculations. In one case, for example, MHA-C required a servicer to reevaluate more than 150,000 homeowners, with 150,000 letters sent out and more than 3 million follow-up phone calls made. In addition, this servicer was required to re-engineer certain HAMP processes and provide additional training for the servicer's staff in order to make sure that eligible homeowners were being reached.

Modifications That Focus on Making Monthly Payments Affordable for the Homeowner Are More Sustainable

The most recent Office of the Comptroller of the Currency (OCC) Mortgage Metrics Report found that modifications that provide deeper payment reductions tend to have lower re-default rates and that HAMP provides significantly more assistance than servicers' own proprietary modifications: "HAMP modifications made during the quarter reduced payments by an average of $585, compared with other modifications that reduced average monthly payments by $332 overall." Over the life of the program MHA data show that homeowners are experiencing a 37 percent median reduction in their mortgage payments – amounting to an estimated total, program-wide savings of over $4.5 billion to date for homeowners.

Homeowners in HAMP permanent modifications continue to perform well over time, with re-default rates lower than industry norms. December 2010 data for HAMP shows that after 12 months, nearly 85 percent of homeowners remain in a permanent modification. The OCC recently stated that "HAMP modifications were performing better than other modifications implemented during the same periods at the end of the third quarter of 2010. These lower post-modification delinquency rates reflect HAMP's emphasis on the affordability of monthly payments relative to the homeowner's income, verification of income, and completion of a successful trial payment period." Because of MHA, servicers have developed more constructive private-sector options as well. MHA's programs provided a model that servicers adapted to their own foreclosure prevention solutions. In the year and a half following the initiation of HAMP, servicers' home retention strategies changed dramatically. According to the OCC, in the first quarter of 2009, nearly half of proprietary mortgage modifications increased homeowners' monthly payments or left their payments unchanged. By the third quarter of 2010, almost 90 percent of proprietary mortgage modifications lowered payments for the homeowner and the average monthly savings has increased more than 50 percent from a year ago. This change means homeowners are receiving better solutions. Modifications with payment reductions have historically performed materially better than modifications that increase payments or leave them unchanged.

We Had To Remain Innovative

During the fall of 2009, the MHA program faced a number of challenges. The administrative complexity and unprecedented scope of HAMP, unexpected servicer execution challenges, and the lack of cooperation from servicers and investors tempered the potential impact of HAMP. In addition, as a result of the changing nature of the economic crisis, sustained unemployment challenges and negative equity mortgages became main causes of mortgage defaults and required greater attention. As a result, Treasury created new programs and designed the next phase of HAMP, with input from various constituencies, to better address these challenges.

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP was never intended to address every delinquent loan. In certain instances, the homeowner may benefit from an alternative that helps them transition to more affordable housing and avoid the substantial costs of a foreclosure. Consequently, the Administration launched the HAFA program, in which Treasury provides incentives for short sales and deeds-in lieu of foreclosure for circumstances in which homeowners are unable or unwilling to complete the HAMP modification process. HAFA sets out an important simplified industry standard for the complex process of a short sale or deed-in-lieu of foreclosure. These foreclosure alternatives have better outcomes than foreclosures for borrowers, neighborhoods and communities, and investors. The HAFA program applies only to non-GSE loans. In the coming months we hope to see increased servicer participation in the HAFA program.

In March 2010, the Obama Administration announced enhancements to HAMP aimed to more effectively address unemployment and negative equity, including providing temporary mortgage assistance to some unemployed homeowners, encouraging servicers to write-down mortgage debt as part of a HAMP modification, allowing more homeowners to qualify for modifications through HAMP, and helping homeowners move to more affordable housing when a modification is not possible.

The Unemployment Program (UP) requires servicers to grant qualified unemployed homeowners of non-GSE mortgage loans a forbearance period to have their mortgage payments temporarily reduced for a minimum of three months, and up to six months or longer when permitted by regulatory or investor guidelines, while they look for new jobs. Servicers are not reimbursed by TARP for any costs associated with UP, and there is no cost to government or taxpayers from the forbearance plans.

Under the Principal Reduction Alternative (PRA), servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. Incentives are based on the dollar value of the principal reduced. The principal reduction and the incentives are earned by the homeowner and investor based on a pay-for-success structure.

For many homeowners who want to stay in their home, we have learned that a modification is not always the most effective solution for the homeowner or the investor. A refinance can be a very effective tool to lock in a lower interest rate based and restructure the debt to be affordable for the homeowner over the long term. Treasury has worked with the FHA to establish the FHA Short Refinance option. It requires that the mortgage investor write off the unpaid principal balance of the original first lien mortgage by at least 10 percent. The new FHA loan must have a balance less than the current value of the home, and total mortgage debt for the homeowner after the refinancing, including both first and any other mortgages, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and an affordable monthly payment. Treasury has allocated nearly $11 billion of TARP funds to the FHA Short Refinance option.

Finally, the Administration has allocated $7.6 billion to the Hardest Hit Fund (HHF), to allow State Housing Finance Agencies (HFAs) in the nation's hardest hit housing markets to design locally targeted foreclosure prevention programs. The HHF has been rolled out to 18 states and the District of Columbia. Most states are using the funds to help unemployed homeowners make their mortgage payments, as well as to offer principal reduction for homeowners with high negative equity.

Looking Ahead for Housing

As a result of the Administration actions, homeowners have more viable tools available to them to avoid foreclosure. These programs have also established key benchmarks and homeowner protections that are now viewed as industry best practices. As a direct and indirect result, millions of families are still in their homes today because of these programs. Or, they have had the opportunity to relocate quickly to more affordable housing through a foreclosure alternative, such as a short sale. Their neighbors and their local communities have benefited as well. A vacant home can be dangerous and costly to a neighborhood. Therefore, we will continue to try to help as many eligible homeowners as possible, in a manner that safeguards taxpayer resources.

Yet, as we deploy a comprehensive suite of options to help families avoid foreclosure, we must remember, as the President noted, that not every foreclosure can be prevented nor should we try to avoid every foreclosure. That is why the TARP-funded Treasury housing programs aim to strike a balance between giving homeowners opportunities to avoid foreclosure and protecting taxpayers by paying incentives only when modifications are successful. In those cases where homeownership is no longer economically viable or appropriate to the homeowners' circumstances, our focus is on easing the transition to a sustainable housing situation. In so doing, these programs aim to limit market disruptions caused by rising foreclosures, while allowing the housing market to recover.

THE WALL STREET JOURNAL.
WSJ.com

REVIEW & OUTLOOK

MARCH 2, 2011

Housing Market Masochism

The latest bad idea to raid banks and delay a home-price recovery.

The U.S. housing market is still wheezing: The Case Shiller home-price index has fallen for five consecutive months and 22.5% of all residential properties with a mortgage are in negative equity, according to CoreLogic's latest data. Bank foreclosures are expected to accelerate, and prices in many markets still haven't touched bottom. The Obama Administration's solution? Prolong the pain.

The latest attempt at housing market masochism was reported in a page one story in this newspaper last week. Details are sketchy, but the idea seems to be to force the nation's biggest mortgage servicers to cough up $20 billion for principal write downs on "underwater" mortgages, in which borrowers owe more than their homes are worth. The money would be extorted as part of a settlement for the mortgage foreclosure kerfuffle of last year. Bank of America, Wells Fargo and J.P. Morgan Chase would likely be among the hardest hit.

This smells like a re-run of the failed Home Affordable Modification Program, or Hamp. Launched in 2009, Hamp was supposed to keep homeowners in their homes. Instead, the program swamped mortgage servicers as debtors rushed for the goodies, gummed up the foreclosure process and left some borrowers worse off. Special Inspector General for the Troubled Asset Relief Program, Neil Barofsky, said in January that Hamp falls "dramatically short of any meaningful standard of success."

Even if Hamp had been well-run, there's little evidence that forcing principal write downs is the way to fix the housing market. Some borrowers took on more debt than they could afford or have lost their jobs, and so the relief would be short-lived. The Obama Administration and even the Democratic Congress resisted write downs as part of Hamp because they are very expensive and reward reckless borrowers at the expense of those who are paying their bills.

So who's pushing this inside the Administration? Our sources point to Elizabeth Warren, the Harvard professor and driving force behind the new Consumer Financial Protection Bureau. After it became clear she couldn't win confirmation to run the new bureau, President Obama gave her an unprecedented position reporting to him and Treasury Secretary Tim Geithner with orders to start the bureau up anyway.

A $20 billion raid on mortgage servicers fits with her ideological agenda that banks are the villains of the credit crisis while distributing cash to homeowners who will presumably be grateful on Election Day 2012. A big bank payout may also let the state attorneys general who've fanned the foreclosure story claim a political victory.

But all of this would also do an end run around the established regulatory process for investigating bank behavior. The Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Reserve wrapped up an investigation of foreclosure procedures in December. Regulators are now figuring out which banks need to fix which processes, sorting out which customers should be compensated, and determining the proper penalties—in the order of millions, not billions.

We wonder what Mr. Geithner thinks of this new bank raid. Amid the foreclosure uproar last October, he sounded far more reasonable. He warned on PBS's "Charlie Rose" against causing "injustice to people who can afford to stay in their home" but added that "we also want to make sure that we're not going to make the problem worse." Mr. Geithner has to know that taking $20 billion out of the banks will not make them more eager to lend.

The larger context here is that Americans are figuring out that the multiple government programs to prop up the housing market have only postponed the day of recovery. They have given homeowners the false hope that they can stay in homes they can't afford, delayed foreclosures that are probably inevitable, and prevented prices from finding a bottom.

Better news for the housing market is coming from Congress, where House Republicans are moving to dump Hamp. Mr. Geithner played the recession scare card yesterday by telling a House committee that closing Hamp would "cause a huge amount of damage" to the economy. But Mr. Geithner has had two years to make a difference with Hamp, and he's done more harm than good.

We'd suggest Mr. Geithner save his political energy for debating Ms. Warren and others at the White House who want to bleed the banks one more time while further postponing a housing rebound.

The Washington Times

COLE: Obama's helping hand hoodwinks homeowners

Government mortgage assistance can be worse than nothing

By Rebel A. Cole

The Washington Times

6:42 p.m., Tuesday, March 1, 2011

Back in March 2009, the Obama administration unveiled the Home Affordable Modification Program, or HAMP, a program for helping delinquent borrowers save their homes from foreclosure - a problem that got worse again in reports released just last week. The goal of HAMP was to "help 3 to 4 million homeowners by 2012." This phrase should have read "help or hurt" because hurt is exactly what has happened to hundreds of thousands of homeowners who have attempted to use HAMP to save their homes.

How is it possible that a program for providing mortgage modifications could hurt homeowners? To understand this, we need only look at how HAMP has worked - in practice. As reported in its most recent report for December 2010, HAMP has led to 1.47 million "trial modifications" that have resulted in 580,000 "permanent modifications," but 735,000 "trial modifications [have been] canceled." The half-million permanent modifications are noteworthy achievements, so long as they don't result in a high percentage of re-defaults, as has been the case for past modifications.

But what about the almost three-quarter-million borrowers whose trial modifications were canceled? Are they better off or worse off from participating in HAMP? In perhaps hundreds of thousands of cases, the answer is worse - far worse. To understand how that happened, we must go back in time to see how and why these borrowers entered into the program. According to a survey by ProPublica, a nonprofit journalism organization, almost half of respondents reported that "they were advised, incorrectly, to fall behind on their mortgage in order to qualify for a modification." In other words, these homeowners were current on their mortgages and only defaulted in order to qualify for HAMP - because you had to be in default before you could get government help. Indeed, the survey respondents reported, they only fell behind on their payments after being advised by their lender, loan servicer or other supposedly reliable third party that it could help their situation. Extrapolating the survey results to the 1.4 million HAMP participants, this situation likely describes the experience of a half-million homeowners: duped into delinquency.

As bad as this sounds, it gets much worse because these borrowers typically were not told all the potential consequences of falling behind on their mortgages. Consider the case of one borrower I know who followed the advice of his servicer to default in order to qualify for a trial modification, as HAMP is only available to delinquent homeowners. This borrower successfully obtained a trial modification that reduced his monthly payment from $2,000 to just $1,200. The trials are supposed to last just three months, but after three months, this borrower was told to continue making the modified payments until a decision could be made on his application for a permanent modification. Eight months passed, with eight timely modified payments made to the servicer, and then the homeowner was notified that the application had been denied because of failure to file required paperwork that had, in fact, been filed but that the servicer had lost repeatedly. ProPublica reports that "losing documents and giving false information" is an almost universal complaint of respondents to its survey.

Worse yet, this homeowner was told that he was responsible not only for the next month's full mortgage payment of $2,000, but also for the cumulative difference in the trial and full payments for the previous eight months (a total of $6,400), for late fees ($800), for foreclosure fees ($1,900) and for foreclosure attorney fees (1,400), a grand total of $10,500. This borrower, who was never advised of this possible outcome, did not have $10,500 saved up for such a contingency and could not comply. Instead, the servicer initiated foreclosure proceedings, where the situation now stands. Fortunately, this borrower lives in a judicial foreclosure state where the process can take longer. In a statutory foreclosure state like Virginia, the house likely would have been lost already at a sheriff's sale.

Was this homeowner helped or hurt by HAMP? He was in financial distress but able to make his monthly payment by skimping on everything else. He reached out to HAMP for a lifeline; instead, he received a noose around his financial neck.

How could this situation have been avoided? Clearly, more disclosure would have helped. With the full set of facts regarding potential outcomes, this homeowner and the hundreds of thousands in similar situations never would have defaulted in the first place. Better yet, why don't regulators require servicers to accept the modified payment as payment in full for the length of the trial-modification period, require servicers to make a binding decision after the three-month trial period and require servicers to forgo late fees and other penalties when a trial modification fails? Or perhaps, as Republican lawmakers have suggested, it is simply time to pull the plug on HAMP and apply the $30 billion that remains allocated for HAMP to other purposes.

Of course, the servicers don't want to give up these lucrative sources of income, which have turned foreclosure into a profit center at the expense not only of borrowers, but also of the investor-lenders whom the servicers represent. Typically, fees get paid to servicers before principal and interest go to investors. In fact, investors want to change the terms of their contracts with servicers to put their own best interests ahead of the interests of the servicers. However, the trustees who represent most investors are other Wall Street bankers, who thus far have failed to take action against the servicers, who also are Wall Street bankers.

Just last week, the December S&P/Case-Shiller Home Price Index confirmed that housing has entered into a double-dip recession. December data from LPS Applied Analytics shows that 2.2 million mortgages are in the process of foreclosure; another 2.1 million are seriously delinquent and most likely headed into foreclosure. At the current rate of foreclosure sales, we are looking at three years or more before this inventory works its way through the legal system; as it does so, housing prices will continue to decline, dragged down by the sale of foreclosed properties. Until changes are made to the way delinquent mortgages are serviced in the United States, the housing market will continue to decline, likely dragging our economy into a double-dip recession.

Rebel A. Cole is professor of finance and real estate at DePaul University.

O