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STRENGTHENING OUR ECONOMY: FORECLOSURE PREVENTION AND NEIGHBORHOOD PRESERVATION

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

FORECLOSURE PREVENTION AND NEIGHBORHOOD PRESERVATION

THURSDAY, JANUARY 31, 2008

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

50–366 WASHINGTON : 2010

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

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STRENGTHENING OUR ECONOMY: FORECLOSURE PREVENTION AND NEIGHBORHOOD PRESERVATION

THURSDAY, JANUARY 31, 2008

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 11:03 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order. Let me welcome everyone here this morning.

Let me apologize to our witnesses and to our colleagues here and to the audience as well. Obviously, the stimulus package is a subject of important debate, and this morning the Democratic Majority Leader wanted to caucus with Senators to talk about where we are with regard to the stimulus package. And that is the reason for the delay this morning. I don't know, Dick, if there was a similar meeting with the Republicans on the side, but obviously it is an important issue, and we are trying to resolve it and move quickly on it. So I normally would not have held up a hearing like that, but given the importance of that subject matter, hopefully the witnesses and others will understand the reason for the delay. And I again apologize.

What I would like to do here is make an opening statement, turn to any of my—obviously Senator Shelby for any opening comments he would like to make this morning, as well as my colleagues, and then we will get right to our witnesses here. You are all fairly familiar with the practice and how we proceed here.

This morning, we have a very good panel, I think. The subject matter, "Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation," is obviously a critically important subject matter, the most important in many ways. I have tried to make the case over the last number of months that to the extent this economic crisis has a face, it is housing; and to the extent there is a face on the housing crisis, it is a foreclosure crisis. And so we need to address this in a thoughtful manner, obviously, but also in an aggressive manner. The problem is getting worse not better, as I think we all know.

The title of this Committee, of course, is the Committee on Banking, Housing, and Urban Affairs. And if you take the title of this

Committee, every single one of those institutions is affected by the subject matter of the hearing here this morning—banking, housing, and the condition of our communities and neighborhoods as well.

So I welcome everyone here this morning. Let me also welcome—he is not here yet, but I want to welcome Senator Corker of Tennessee, who is going to be joining the Committee, and express our good wishes to John Sununu, who is leaving the Committee and going to Finance as a result of a change. And Senator Corker has a very strong background in issues relevant to the Committee. We welcome his participation. He started and ran his own construction company as well as a number of other real estate concerns, and he helped to create the Chattanooga Neighborhood Enterprise, a nonprofit group designed to get low-income families into affordable housing. So we look forward to his constructive participation in the Committee's proceedings.

Let me also thank Senator Shelby once again and other colleagues for their work over the past year. We had a good year, a productive year. I am not going to dwell on this, but we had some 35 hearings in this Committee; 17 pieces of legislation moved out of this Committee; more than half of them are now the law of the land, adopted as well by the full Senate and the House. Several are pending, such as FHA, where we are trying to work out the differences on that bill. But that one passed 93–1 out of the Senate. Flood insurance as well, to get that done as well.

In his State of the Union Address, the President called this a "period of economic uncertainty." And while I agree that we are in an uncertain period, what we know with some certainty is that the current economic situation is more than merely a slowdown or a downturn—at least it is in my view. In many respects, it is a crisis of confidence. Consumers are fearful of borrowing and spending. Investors are fearful of lending.

Current economic data show how serious the problem is. Retail sales were down and unemployment up in December. Credit card delinquencies are on the rise. Inflation increased by 4.1 percent last year. Industrial production is falling. And we have been hemorrhaging jobs in the manufacturing sector. Our economy is clearly facing more than uncertainty. It is facing significant challenges to our Nation's future economic growth and prosperity.

If I can, let me just share some of the additional data that I think paints the picture more clearly than any specific language.

The housing market is wisely considered to be the worst since the Great Depression. Housing prices have declined by 8.4 percent in November. According to the Case-Shiller Index, this follows a 6.7 fall in October. A recent Merrill Lynch mortgage report predicts a 15-percent drop in housing prices this year and another 10-percent decline in 2009. The inventory of existing homes for sale stands at nearly 4 million units—almost double the number in January of 2005. This is equal to about 10 months of supply. The number of vacant homes for sale equals 2.6 percent or 2.1 million units of the stock of owner-occupied homes compared to the longstanding historical rate of 1.6 percent.

In 2007 as a whole, single-family home sales fell 13 percent. New home sales fell 40.7 percent year over year in December, the weakest performance since 1981. With over 1 million subprime and Al-

ternative-A borrowers that are 60-plus days delinquent in their mortgages, with about 1.8 million subprime ARMs, the adjustable rate mortgages, resetting to higher rates in the next 18 months, there is no doubt that this problem will deepen. Not surprisingly, we are experiencing historic highs in the rate of foreclosure starts, according to the Mortgage Bankers Association. Mark Zandi, an economist at Moody's, estimates that 3 million loans will default between 2007 and 2009, of which 2 million will end in foreclosure and sale.

Foreclosures, of course, tend to be concentrated, devastating whole neighborhoods. In addition to the losses suffered by homeowners who lose their homes, foreclosures lead to the loss of wealth surrounding homeowners, neighborhoods, and localities. According to the Center for Responsible Lending, the 2.2 million projected foreclosures will lead to a decline in house values and tax base of over $200 billion. Studies in Chicago and Philadelphia have found that for each foreclosed home, property values of nearby homes drop approximately 1 percent. In low- and moderate-income neighborhoods, this decline is over 1.4 percent for each foreclosed home. Decreases in property values result in lost tax revenues for State and local governments. The Joint Economic Committee found that approximately $917 million will be lost in property tax revenues as a result of the loss in housing wealth as a result of foreclosures, and this is based on a conservative estimate of 1.3 million foreclosures. The Center for Responsible Lending estimates that $4.5 billion will be lost by localities. In addition, the Woodstock Institute found that violent crime increases as foreclosures increase as well.

As with subprime lending, foreclosures, while occurring in many areas, tend to be concentrated in low-income and minority neighborhoods. According to the Federal Reserve in Minneapolis, in the Twin Cities the incidence of foreclosures is highest in our core cities, especially in neighborhoods where minority homeownership rose in the 1990s. Analyses done by the New York Times and the San Francisco Chronicle find similar patterns. In the Bay Area as well as in Cleveland, Chicago, Atlanta, minority neighborhoods are hit the hardest and minority homebuyers are lost significant equity. I would just share with my colleagues that background data and how important it.

The epicenter of this economic crisis is, as I said at the outset, the housing crisis. Housing starts are at the lowest levels in a quarter of a century. The housing sector has declined eight straight quarters, shaving 1.2 percent out of GDP in the last quarter alone. Home prices declined last year nationwide by 6 percent and are expected to decline again this year. To my knowledge, that will be the first time since the Great Depression that national home prices have dropped 2 years in a row.

The virtual collapse of the housing market, of course, was triggered by what Treasury Secretary Paulson has accurately described, in my view, and I quote him, "bad lending practices." These are practices that no sensible banker would have engaged in. Reckless, careless, and sometimes unscrupulous actors in the mortgage lending industry allowed loans to be made that they knew that hard-working, law-abiding borrowers would not be able to repay. And they did this in the full view of our financial regulators,

who acted much too late and far too timidly in my view. Even now, the Federal Reserve is not taking the strong steps I think we ought to be taking to protect consumers here. As a result, foreclosures are at a record level, the value of people's homes are declining, and the tax base for State and local governments is shrinking.

The catalyst for our economic problems is the housing crisis, and the face of this housing crisis is the historic increase in foreclosures. Therefore, in my view, any serious effort to address our economic woes must include an effort to take on the causes and symptoms of the foreclosure crisis. This morning's hearing is the beginning of that process. A number of very important steps have already been taken.

After what I regret to say was months of denial and delay, the administration finally put together the Hope Now Alliance, which has developed a set of standards by which homes can be more readily financed or modified. It is my hope that these standards will be applied quickly and in a broad, systemic way, as FDIC Chairman Sheila Bair has been advocating, and I commend her for it.

Unfortunately, the results to date have been disappointing. Moody's reports that only 3.5 percent of subprime ARMs were modified in the first 8 months of 2007. And while industry data paint a more optimistic picture, the Washington Post pointed out that even the industry's data shows, and I quote them, "delinquent borrowers are almost twice as likely to lose their homes as they were to reach an agreement with their lender."

For that reason, I believe we need to give serious consideration to other ideas. One such approach, which we will hear about later this morning, is the creation of an entity we are calling the Homeownership Preservation Corporation. Its general outline, such as an entity would capture the discount for which delinquent and near-delinquent loans are trading in the marketplace through a transparent, market-based process and transfer the discounts to the homeowners through new lower-balance loans so that more families could stay in their homes. Rather than a case-by-case approach, such an entity would purchase and restructure these loans in bulk to help many borrowers as quickly as possible. In my view, this entity could make use of existing institutions such as FHA and the GSEs to expedite the process and maximize the efficiency of this idea.

Every day that goes by without action means that more families are losing their homes. Obviously, many details would need to be worked out here. I understand that. That is one of the purposes of this hearing this morning. But the fact that this idea has been embraced by highly respected leaders of both the conservative American Enterprise Institute and the more progressive Center for American Progress tells me it is worth pursuing and looking at seriously. And while we continue to seek out ways to prevent foreclosure, we need to take other measures as well. These include enacting comprehensive FHA reform, which can give homeowners a chance to trade in foreclosure loans for stable, affordable, 30-year fixed-rate mortgages. This bill passed the Committee 20–1, and it passed the Senate, as I mentioned earlier, 93–1.

We should also help local communities cope with the rising number of foreclosed and abandoned homes that litter their commu-

nities. To that end, I believe we need to increase funding for the Community Development Block Grant Program by some $10 billion so that States and localities could acquire, renovate, and sell foreclosed and abandoned homes. These properties lead to a cycle of disinvestment, crime, falling property values and property tax collections, thereby leading to service cuts and further disinvestment. An increase in the CDBG Program I think could help reverse this vicious cycle.

In the long term, we also need to end the predatory lending practices that led to this problem. I introduced a piece of legislation last fall that I believe would crack down on these practices and help restore consumer and investor confidence in the market. That will be the subject of a future hearing and I hope a markup of this Committee.

Today and in the coming weeks, we need to work together to help American families keep their homes and their dreams alive, and I think that is a common goal that all of us share. And my hope is this morning we can explore some of those ideas and begin to move aggressively on how we can play a very critical, important role, as this Committee must, in providing some answers to these questions.

With that, let me turn to my colleague, Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. Thank you for calling today's hearing on foreclosure prevention and neighborhood preservation.

Mr. Chairman, as you and many others have alluded to, in recent months there has been considerable volatility in our Nation's housing, mortgage, and financial markets. It is critical at this time for our financial regulators to maintain close and extensive oversight of the financial soundness of our banking system. It is also a critical time to find effective solutions for dealing with foreclosures.

I encourage you in the ongoing efforts to mitigate the harm of foreclosures and to help deserving families remain in their homes. These efforts have been ongoing and at times successful when met by a willing homeowner. I believe, however, that these efforts should be targeted at those most in need and those most able to maintain homeownership. Efforts at foreclosure prevention should not reward speculators or those who freely choose to live beyond their means. Nor should foreclosures prevention efforts reward lenders or investors who willingly took on the risks associated with mortgage lending and investing.

Losses in the mortgage market have so far been borne by lenders and investors. With that in mind, I believe we should take every precaution to ensure that these losses are not transferred to the American taxpayer.

I have repeatedly stated my opposition to any taxpayer bailout of lenders or borrowers. It is not the responsibility, I believe, of the American taxpayer to bail out those who, for whatever reason, have found themselves unable to meet their financial obligations. It is, first and foremost, the responsibility of the borrower and the lender to work toward a mutually agreeable resolution. In the event that

is not possible, foreclosure may be an unavoidable though necessary step in the process.

Whether foreclosures have reached an unacceptably high level requiring some sort of Federal intervention is something we need to examine very closely, and I think we will today. While some have argued that direct Federal intervention is needed immediately, others have said that we should allow the market to run its course. Mr. Chairman, I tend to favor the latter because I believe that choices have consequences, and those consequences, although painful, may serve us far better than attempting to avoid them.

These are not circumstances that are wholly new to this Committee, or this Nation, for that matter. In a letter to President Washington regarding a Federal bailout of another kind, then-Treasury Secretary Alexander Hamilton said, and I quote, "The general rules of property frequently involve particular hardships and injuries, yet the public order and general happiness require steady conformity to them. It is perhaps always better that partial evils be submitted to than that principles should be violated."

Mr. Chairman, there may be a lesson in there for us to examine the entirety of the American mortgage market over the next several weeks, and I hope you will. And as we move forward, I hope that we can all agree that this is a time for serious thought and not precipitous action. We owe that to the millions of Americans who pay their bills on time, make wise financial decisions, and send their tax dollars to us every year with the hope that we will spend them as wisely as they spend the dollars they are allowed to keep.

I welcome all of today's witnesses to the Committee, and I look forward to your testimony.

Chairman DODD. Thank you very much.

Following the ancient practice of this Committee, we will recognize Members in the order in which they appeared here, and it is a longstanding tradition. By the way, Senator Corker, I welcomed you earlier before your arrival, and thank you for joining the Committee. Delighted to have you with us.

Senator SHELBY. May I say something?

Chairman DODD. You certainly may.

Senator SHELBY. I also welcome him. Glad he is here. I think he will add a lot. As Chairman Dodd said before you got here, your background and your experience in housing and banking will help us a lot. We need all the help we can get in this Committee.

Thank you.

Senator CORKER. I thank you both, and I certainly look forward to working with you. And I love your longstanding history of acknowledging people when they come, and I know I will be last. But thank you very much.

Chairman DODD. You will get over that enjoyment as you move up in seniority.

[Laughter.]

I thought it was a wonderful idea 20 years ago.

Well, Senator Schumer was here, but he is not here right now, so Senator Menendez. Bob.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. Let me begin by thanking you and Senator Shelby for holding what I think is not only a very important but very timely hearing on strengthening our economy. And I appreciate, Mr. Chairman, your leadership throughout this subprime crisis, which has been very commendable in looking to find ways to soften the blow both on our economy and families.

Since this is the first time you are back since your candidacy, I just want to take a moment. While it may not have ended up how you would have liked it, I really appreciate the issues that you drove, the manner in which you ran your candidacy, and the dignity which you brought to the race. So my commendations on the way in which you ran that race, and the issues that you drove, I think they are incredibly important.

Each Banking Committee that we have had on the subprime crisis and the ripple effect on it reminds me of our first hearing in March of last year when, though it is almost embarrassing to think of now, some had some doubt about the intensity of what I think then called a "tsunami of foreclosures." Some had doubt about the need for action, and some had doubt about the effect the crisis would have on our economy.

I do not know that we can pretend that we would have predicted where we are today, but many of us felt the tsunami real and knew action was needed and feared for the effect it would have. And I think some of our worst fears are coming true. Our economy is tinkering on the edge of a recession, and we should be taking every step possible to help turn the tide. We should be helping as many families as possible stay in their home. And in my mind, this is not the time for baby steps. Families across the country are scared to open their mail for fear of foreclosure notices, scared of looming interest rate hikes, and scared for their financial security. This is not an American dream. In many respects, it is an American nightmare. And the only way we can end the nightmare is to take real action to curb the crisis.

Now, I believe, as many others, that the market is a very important economic principle, but I also know that history teaches us that when there is totally unfettered markets, there is also the reality for excesses and abuses. And we certainly have seen some of that in this process.

I am looking forward to hearing the witnesses' testimonies today to hear about what currently is and is not working and to hear new ideas about how we can further help America's homeowners. And, Mr. Chairman, I am very intrigued about your proposal for a Homeownership Preservation Corporation. It is an idea that could be the turning point to help our families stay in their homes and get our economy back on track.

Finally, the President said earlier this week in his State of the Union address that our economy is undergoing a "period of uncertainty," I think were his words. But to me there is nothing uncertain about our situation. We are in trouble. American homeowners are in trouble. And unless we want to sink deeper into this crisis, we have to take bold steps in order to save our families' homes and their neighborhoods.

Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

Last weekend, I was in Davos where the whole question of the American economy and what ripple effect it might have on the rest of the world dominated all of the discussion. But the comment that was made in one of the panel's I attended strikes me here. One of the gentlemen said, "When I heard my cab driver tell me he had three houses, I knew we were in trouble." And we have had a bubble where speculation combined with genuine enthusiasm and hope that was not speculative but was overoptimistic, the two combined to create a bubble from which we must now recover. And the challenge we have in the Congress is to find a way to cushion the blow in such a way as to be compassionate and intelligent, and at the same time not become an enabler for those who would take advantage of the enthusiasm that was there.

We have got to let the market work its way through. The only way we are going to get out of this is to sell off the 10-month inventory. The only way we are going to get out of this is to let the law of supply and demand catch up with the oversupply that is there. And the rising American population will eventually start to demand new homes.

We have a classic recession situation. It used to be in automobiles where there were too many automobiles, and the car companies would shut down until the inventory was sold off. And then they would call the steel companies and the glass companies and the labor unions and say, "Come back to work because we don't have any cars and people want to buy them."

Now we need to do what we can to cushion the blow, but recognize that the real way out of this is to see the inventory get sold off, see the demand for housing occur, and eventually people start coming back to need shelter.

I am happy to say that in my home State of Utah, which has the highest birth rate of any State in the country, we are doing our very best to create demand for those houses. [Laughter.]

Chairman DODD. That large Irish Catholic population there.

Senator BENNETT. Yes, yes. We have that challenge as a Congress to balance the need to cushion the blow with the need to let the market forces work us through this. And it is a difficult balance. It is a difficult needle to thread. And I thank you for calling this hearing so that we can discuss ways to try to thread it.

Chairman DODD. Thank you very much.

Senator Johnson.

STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. Mr. Chairman, to move things along, I will submit my statement for the record.

Chairman DODD. Thank you very much, Senator. I appreciate it.

Chairman DODD. Senator Dole.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Chairman Dodd, Ranking Member Shelby, for holding this important hearing on foreclosure prevention and neighborhood preservation.

Let me first start by saying a few words about Sheila Bair. Sheila has a long history of public service that includes working as Deputy Counsel and Counsel when my husband was Senate Majority Leader. Sheila, thank you for your continued service to the public and the vital role that you are playing now to assure competence and confidence in this volatile housing and financial market. It is a real pleasure to see you this morning.

During my time in the Senate, I have made homeownership, Mr. Chairman, one of my top priorities. It is amazing how getting keys to one's own home is like getting the keys to a better quality of life and a brighter future. Parents who own their own homes provide more stable environments for their children. These children do better in school, and they become more involved in the community, as the studies show. These families are able to build wealth, many of them for the first time, thereby helping secure funds for retirement, for higher education for their kids. Families who own their own homes also are more likely to spend the money necessary to properly maintain the home and, thus, improve the neighborhood. So these positive results have a ripple effect throughout the community and the economy.

The homeownership rate is still close to 70 percent, and minority homeownership is around 50 percent. While these numbers are promising, we know there is trouble in the U.S. housing market. According to RealtyTrac, a mortgage researcher, in 2007 there were 2.2 million foreclosure filings, up 75 percent nationally from the year before. In my home State of North Carolina, foreclosures in 2007 rose to approximately 50,000 last year, a 9.4-percent increase. Furthermore, according to the Triangle Business Journal, Wake County, which includes Raleigh, our capital, had 4,461 foreclosures during 2007, up 20.2 percent from the 3,711 posted in 2006.

These statistics point to the alarming fact that foreclosure filings were on the rise in 2007, and it appears that this trend may not end in the near future, the near term. One of the ways that we can help combat increasing foreclosure rates is the modernization of the Federal Housing Administration, the FHA. Updating the FHA program will be of vital assistance to folks who are in risky mortgages and will help them find safer products. And I want to thank Chairman Dodd and Ranking Member Shelby for taking up this important piece of legislation last fall and also for working with me to resolve the issue of credit score risk-based pricing, which our Senate-passed bill addresses by placing a 1-year moratorium on this practice.

I hope the differences between the House and Senate versions of FHA modernization legislation will be worked out as soon as possible so we can get a finished product to the President for his signature.

In December, Chairman Dodd introduced the Homeownership Preservation and Protection Act of 2007, which has helped jump-start a discussion surrounding the issue predatory lending. It is my

hope that this Committee will work in a bipartisan fashion as we roll up our sleeves and dig in to tackle a difficult yet timely issue.

When we start talking about predatory loan legislation, we must strike a careful balance between protecting Americans from faulty loans while maintaining legitimate financial options for qualified individuals to become homeowners. I look forward to working with Members of the Committee concerning this important subject.

Last, let me reiterate my support for comprehensive GSE reform legislation early this year. As the President mentioned during his State of the Union address, this reform is all the more urgent now that it appears that the conforming loan limits for Fannie Mae and Freddie Mac will be lifted temporarily as part of a congressionally enacted economic stimulus package. I know this is also an issue of concern for Senators Hagel and Martinez and former Committee Member John Sununu. I welcome the comments that you have made in recent days, Chairman Dodd, indicating your commitment to comprehensive GSE reform, and I look forward to working with you, with Ranking Member Shelby, and other interested Committee Members to finally get this bill done.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Tester.

STATEMENT OF SENATOR JON TESTER

Senator TESTER. Yes, thank you, Mr. Chairman. I want to also start out by welcoming Senator Corker to the Committee. I always look forward to Bob's perspective, and I look forward to his perspective here on the Banking Committee.

I also want to thank you, Chairman Dodd and Ranking Member Shelby, for calling this hearing today. It is critically important. As the Senate talks about an economic stimulus package based on rebates to taxpayers, I think that this hearing is not only timely but it is of critical importance.

Economic pressures over the last 18 months were first felt a year and a half ago by Americans from Montana to Connecticut, and they felt it in local housing markets. In the months that have followed, foreclosures have skyrocketed, their rates, and communities in all 50 States have suffered.

I think it is imperative that we today start the discussion on solutions to minimize further damage to affected homeowners and also to homeowners who live in neighborhoods where the foreclosure rate has taken off.

As other folks on this Committee have given their speeches, I tend to agree. I am not inclined to bail out speculators. They have made their own bed. I am not inclined to bail out folks who were overzealous and made bad decisions. I will tell you, though, that I have empathy for the folks who were led astray and put into situations that were bad loans, particularly the elderly, and I think we need to figure out ways that we can help those in a reasonable way without busting the budget.

Economists have told us that we really have no reason to believe that the rising rate of foreclosures and corresponding declines in housing markets will level off in the near future. But the fact there

is uncertainty, how far we have to go before these housing markets levels off, is of great concern to me.

I look forward to hearing from the panel today. I think that your ideas on public private partnerships and solutions that will help protect our families from financial difficulties are critically important at this point in time, and how we deal with folks who dishonestly steered folks into risky loans is also a problem that we are going to have to deal with and tackle.

So I want to thank you very much, Mr. Chairman, once again, and I look forward to the hearing.

Chairman DODD. Thank you, Senator, very much. I should have mentioned this after Senator Dole's comments. We will have a hearing next Thursday on GSE reform, so we are going to—I have told the Secretary and others and Senator Shelby that we are going to move ahead and have the hearing. There are some differences, obviously, as we all know, but there are some things we all agree on. There are some other areas we are going to have to work out, but my hope is to get something done on that as well.

Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman.

I am very disappointed that we need to hold this hearing today. The problems in the housing market were foreseeable and preventable. Some of us have been sounding alarms for a long time. In 2006, Senator Allard and myself, with Senators Reed and Schumer, held hearings on the housing bubble and the coming problems in the housing market. But we were not the first to raise concerns.

At least as early as 2002, former Fed Chairman Greenspan was warned by one of the other Fed Governors to rein in the subprime lending by nine bank lenders, but he did nothing. As he cut interest rates after the last recession, Chairman Greenspan knew it would cause a credit bubble, but he did nothing. As the top bank regulator, he sat back and watched as lenders wrote more risky mortgages and borrowers dug deeper holes for themselves.

Chairman Bernanke took action last month to put an end to abusive lending practices. But it took him nearly 2 years to get around to it. As usual, the Fed has been asleep at the switch.

The proposed Fed regulations go a long way to addressing the problems in the mortgage market going forward. That leaves the question of what, if anything, can be done to clean up the mess.

As with any asset bubble, home prices got out of line with real values of the asset. Before things can get better, prices have to come back in line with value, and that can be a lengthy and painful process.

Industry is taking steps to help ease borrowers' pain through voluntary actions, and the administration is refinancing some borrowers into FHA loans. Interest rates have also fallen, enabling some to refinance into more affordable mortgages.

I am concerned that further Government action will expose taxpayers to excessive risk or be a bailout for borrowers and investors who made bad decisions. I do not think anyone here wants to do that, and any Government meddling could only make matters worse or prolong the pain.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator. I appreciate it. Senator Carper, I guess. Senator Reed is not here.

Senator CARPER. Thanks, Mr. Chairman. It is great to have you back.

Chairman DODD. Oh, Senator Reed, you are here. I am sorry. I apologize. I looked down at your normal seat. You were down two seats. You were sitting down two seats down earlier, so I apologize. Sorry, Jack.

Senator REED. I will sit up taller.

[Laughter.]

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you, Mr. Chairman, for convening this hearing. It is good to have you back.

Chairman DODD. Thank you.

Senator REED. Thank you very much.

The housing crisis obviously is a growing threat to every community in America. In my home State of Rhode Island, we are seeing a record number of foreclosures and mortgage delinquencies, and, moreover, this contraction of the housing market is impacting our entire economy and the global economy.

We all know it is a complicated and multifaceted problem. There are no simple solutions. I am particularly pleased that Chairman Bair is here with us today because she has demonstrated great foresight with respect to remedies in the subprime market as well as other financial issues like the Basel Accords. Thank you, Madam Chairman.

In addition, I look forward to hearing from Secretary Steels and the other panelists about what they believe is currently happening both in the markets and our neighborhoods today and how existing initiatives are working.

In December, months after the subprime crisis hit with full force, President Bush finally announced a proposal to deal with the rising tide of foreclosures. The central focus of his agenda is a voluntary public-private partnership called the Hope Now Alliance. However, there are many indications that the President's program is providing assistance to only a small fraction of people facing foreclosure, and I remain concerned that it will not be sufficient to deal with the massive scale of the housing crisis that we face. In part due to these ongoing concerns, I have introduced along with colleagues a number of bill, in particular the HOPE Act and the GSE Mission Improvement Act, which I believe could be helpful.

We are always endeavoring to strike a balance between private action, regulatory action, and legislative action. For their part, regulators have repeatedly assured the Committee that they have been working with market participants and were on top of this developing crisis. But, frankly, if we do not have the evidence that their efforts are achieving acceptable results, then we must consider additional legislative solutions to such an urgent situation.

The current number of modifications are unacceptable, and it is clear that the industry needs to significantly step up its efforts both in terms of real modifications but also in terms of meaningful reporting.

Today we are here again seeking answers to basic questions and practical and timely ideas about how to deal with the deflation of the housing bubble so that liquidity can return to the real estate sector, and at the same time we can restore confidence in American capital markets.

To be sure, it is possible that the latest rate cuts by the Federal Reserve could eventually rejuvenate the mortgage market if refinancing opportunities become more widely available. However, we must not forget to identify and heed the lessons of this chapter in our economic history. If the markets bounce back before we correct the regulatory gaps and systemic weaknesses that caused this situation, then any perceived recovery could be an illusion.

The way we deal with these problems will have profound domestic and global implications, and again, I thank the Chairman and look forward to the witnesses' testimony.

Chairman DODD. Thank you very much, Senator.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I would like to thank you and Senator Shelby both for holding this hearing today. Now, homeownership has long been an American dream, and over the last decade, numbers of families were able to become homeowners. Unfortunately, too many homeowners—some knowingly, some unknowingly—bought homes they could not afford. Many of them took out exotic mortgages that made wildly unrealistic assumptions about the housing market, namely, that housing values would continue to dramatically increase. These few people were moved from the American dream into what we should refer to as the American nightmare.

As we all know now, home price growth was unsustainable. Unfortunately, too many families are now facing the possibilities of foreclosure. Just as ownership brings many benefits to families and neighborhoods, foreclosures have dramatic negative consequences for both individual homeowners and the economy as a whole. We have seen a rapid increase in the number of foreclosures, and many experts predict that the number will continue to climb in the near future.

Accordingly, Congress is currently considering various proposals to help prevent foreclosures. I have been listening closely to a number of those proposals, and I have to admit that the one that has the most appeal to me is what I would refer to as the Isakson proposal. Senator Isakson, an individual who has been involved in home sales and homeownership as a realtor, reminded us of what happened in 1972, and the solution that proposed at that particular time is that there be a tax credit for homes that are sold. At that time the tax credit was $3,000. He is proposing $5,000—and that would be spread out over a 3-year period—to reduce the home inventory.

I agree with Senator Bennett that we have a problem now with the home inventory, and we have a problem with supply and demand. And you have to then decrease that supply in order to see the economy begin to respond. So I would have to admit that that has one of the strongest appeals that I have heard so far.

This hearing will be an important step toward better understanding some of the suggestions to assist struggling homeowners. As part of any proposal, though, I think we must be careful not to reward irresponsible behavior. Borrowers have a responsibility to understand the terms of their loan, and lenders have a responsibility to provide them with clear, accurate information in order to help them understand the terms. Borrowers have a responsibility to only borrow what they can repay, but lenders have a responsibility to only lend to those who can repay.

Should Congress choose to provide relief, it should not do so in a manner that is simply a bailout for either lenders or borrowers who acted irresponsibly. We should also not set a broad precedent that the Government will simply bail people out whenever they lose money or face tough times in the housing market.

I also believe that any efforts to address foreclosure should be done in a thoughtful, comprehensive manner. Any effort to provide foreclosure relief must carefully address any risks to taxpayers.

Finally, I would like to take this opportunity to thank Under Secretary Steel on behalf of the Treasury Department and Chairman Bair on behalf of the FDIC for their work to address foreclosures. Some have condemned Treasury and FDIC for too little, too late, and I appreciate their work. And I suspect the homeowners assisted under the agreements they negotiated would thank them as well. Foreclosures have been prevented because of them, and that makes their work a success.

While this agreement may not represent the full response to foreclosures, it is important to have the private sector actively involved in preventing foreclosures. Without their participation, any future Government-based solutions will be far less effective.

I would like to thank the witnesses for being here today, and I look forward to your testimony.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Schumer has joined us.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. Thank you for holding this timely and important hearing. I thank our witnesses.

You know, we hear the word "crisis" thrown around a lot, often haphazardly. But when you talk about housing in America in 2008, the word "crisis" is indeed accurate. And, fundamentally, the housing crisis has spread like outward circles in a pond and damaged our entire economy. The failure to deal with the housing crisis 6 months ago has certainly made the economy worse. We must deal with it now.

I am glad we have a stimulus package on the floor. I think that is very important. But that is not going to deal with the housing problems, by and large, except for lower interest rates. And if we do not deal with it, we have a problem because foreclosures have decreased housing values. Housing values decrease and the consumer spends less, and that creates a recession. It is outward circles. And foreclosures and the inability to evaluate credit has created a credit freeze as well.

So housing is at the center of our economic problems, and the way to fix something when you have a problem is not just nibble around the edges but go right to the heart of the problem, and that is housing. And I hope, Mr. Chairman, we will do a few things that are very, very important.

First is money for mortgage counseling. There are literally hundreds of thousands of those who do not have to go into foreclosure but will because there is no one on the scene to help them refinance. The good old days when a bank was always there are gone because the mortgage market has changed. And while we were able, Senators Brown and Casey and myself, with the help of Patty Murray, Senator Dodd, Senator Bond, to get money into the omnibus bill for counseling, and that money—Bob Casey organized a call where we let the people know that the money is already available even though it only passed a month ago—is not enough. We put in $180 million. We need approximately another $500 million.

Second, we need money to help. Once the counselors are there and the people who might go into foreclosure can be refinanced, you need money. Fannie and Freddie is the place. And, you know, I have been a big defender, Mr. Chairman, of Fannie and Freddie, but I am getting a little tired of them. They are not just a private agency, and when they say, "We cannot do this because it is not as profitable as other things," or "We cannot do this because our stock might go down," well, if that is their only criteria, then they should not have a Government guarantee. Now, I think they should have a Government guarantee, but they ought to be stepping up to the plate in many more ways than they are and not resisting those calls to step up to the plate and provide the kind of mortgage money in large amounts that we need on a temporary basis.

Third, we do have to, as the Chairman has put in legislation—I am proud to cosponsor it; I had very similar legislation. We need to regulate mortgage brokers who are not now regulated to avoid the crisis in the future.

And, fourth, we must look at the credit rating agencies who have really missed the ball here. And the fact that there is very little confidence in the credit rating agencies—it started with the mortgage crisis, but now is spreading throughout our entire economy.

And so those are the four things, I think, that must be immediately done. I think the Chairman's proposal for some kind of new Federal agency is important and is certainly worth looking at, and I really salute him for bringing it up. But the key issue there, one of the key issues, is timing. If you put something in place before the housing market has reached its bottom, it is not going to do much good. And so we just have to be focused on the timing there and not move it too quickly, and then they try to create a floor and you fall through the floor and it ends up costing much more than it should without doing the correction that it should. But, overall, I think it is an idea very much worth exploring, and I am glad we are here.

I want to thank both of our witnesses for the good work. We have worked together on this crisis since—I have been involved over the last year. But, in short, Mr. Chairman, what has happened in housing is one of the great, great bad marks against this Government because we should have been doing a lot more sooner, and

we could have avoided a lot of pain. Realizing that should importune us on to act, and act quickly.

Chairman DODD. Thank you very much, Senator.

Senator Corker.

STATEMENT OF SENATOR BOB CORKER

Senator CORKER. Mr. Chairman, I very seldom make opening comments. I like to listen to the witnesses, although I think this has been interesting. And, again, I want to thank, like everyone else, you for having this hearing. And one of the reasons I want to be on this Committee is I knew you were going to be very active, returning back to the Senate with tremendous energy. And I am glad to serve with you and Senator Shelby.

Chairman DODD. You know, I never left the Senate.

[Laughter.]

Senator CORKER. But I saw you took up residence in Iowa, and I just did want to make reference to that.

Mr. Chairman, I will say I am interested in all the jurisdictions of this Committee. When I was a young businessman and knew I was probably going to do OK, I began working in the inner city and saw that we had a lot of citizens there without housing, and it led to the creation of a nonprofit that has helped about 10,000 families there. And like everybody on this panel, I have tremendous compassion for people who, especially at the lower end of the economic spectrum, are dealing with foreclosures.

I do want to associate, on the other hand, myself with the comments by Senators Shelby and Bennett and know that we need to be careful not to be hyperactive, distort the markets, and in essence, create a moral hazard that will reap the bad dividends down the road.

And so I look forward to this hearing, and I thank you for your activity here. But I do hope that we will keep things in perspective as we go ahead.

I would also like to say that I am glad to hear that Senator Schumer mentioned that our economic stimulus package was not going to affect housing in anyway. There is no question it will not. I still do not know what it is going to do, and I hope we will debate that on the floor. But I hope we will look at some targeted ways of dealing with this housing crisis in a way that does not distort the market.

Thank you, Mr. Chairman.

Chairman DODD. Well, thank you very much. Actually, there are a couple of items in the stimulus package dealing with FHA, the loan limits as well, that we think could arguably have some positive impact on the housing issue, I might add as well.

Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thanks again, Mr. Chairman.

You know, I want to say Senator Corker was talking to me a week or two ago about whether or not he might want to try to get on this Committee as opposed to some other committee. And just listening to him for the last few minutes, I am very pleased that you have made this decision. I think not only are the issues before

us many and interesting and important, but I think you are going to bring a lot of experience and wisdom to the table. So we are delighted that you are here. And we are delighted that you are here to welcome back Senator Dodd, even though he never was really away.

But we have got a lot before us, Mr. Chairman, and I for one am—and I think we all feel this way. We are just happy you could be here full-time and provide the leadership that we very much need.

We are getting started late. I am going to ask that my full statement be submitted to the record.

I will say to our witnesses, Ms. Bair, Mr. Steel, thank you very much for your exemplary leadership; especially, Ms. Bair, you have been ahead of the curve trying to get us to where we need to be as a Nation, and I thank you for your just really exemplary leadership on this front.

Mr. Steel, with whom I worked about a year ago on GSE reform to try to put together a little bit of a consensus package, I think the time has now come, and I am happy to hear, Mr. Chairman, that we are having a hearing next Thursday to get us started.

The only other thing, we are getting started late, as our witnesses know, because our caucus, the Democratic Caucus, was meeting today to talk about a stimulus package. I wish that we could take the entire FHA bill that we have passed, which brings the FHA into the 21st century and makes it relevant for the 21st century, I wish it could be in the entire stimulus package. It is not. But some pieces of it are, and we are going to raise, at least for a period of time, the conforming loan limits for GSEs. They need a strong regulator, and it is all well and good that we do this on a temporary basis, raising the loan limits, but we need to get started on making sure they have the kind of strong regulator that they need.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Martinez.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Mr. Chairman, thank you very much. I think this is a very timely hearing, and I appreciate your bringing it about, and Ranking Member Shelby as well. The next time you run for President, move to Florida. The weather will be much more pleasant.

[Laughter.]

Senator MARTINEZ. And maybe the outcome would also be, but anyway——

Chairman DODD. Well, I will start in Iowa if I do it again.

[Laughter.]

Senator MARTINEZ. Anyway, but I want to also welcome my colleague, Senator Corker, to the Committee. I am delighted to have him here, and I am delighted to have him covering my left flank here and not putting me in danger of falling off the platform. But he is going to make a great contribution. I am delighted that he is a part of our Committee.

I think a lot of good comments have been made around the table, and I particularly want to also say that, in my view, the stimulus package is great and is tackling a lot of symptoms of a bad economy. We need to move ahead, though, to tackle the root cause of what is ailing this economy, which is the housing problem. So I hope we do not feel that when we do this stimulus that we have finished with our work. We really have to pursue some other things to work on what could be a worsening housing crisis from what we have even today.

New data reported earlier this week puts Florida in the dubious category of being No. 2 in the country in foreclosure filings. Last year, more than 2 percent of Florida households entered some stage of foreclosure. That is a 124-percent increase from 2006. The statistics are staggering, and I am afraid that they are only going to get worse during the coming year.

As we know, a million-eight subprime loans are prepared to reset in the next 18 months, and with more and more families facing the reality of foreclosure, we must use the resources of the Federal Government in a reasonable and responsible way in order to mitigate future losses and put our housing market on a pathway to recovery.

I would like to commend the industry for being proactive and working on a national solution to the foreclosure crisis and promoting steps that will help a great number of Floridians who are finding themselves in serious financial trouble. The Hope Now Alliance, 370,000 struggling homeowners have been assisted. I am eager to hear more about how this program is working and what we can expect from it in the coming weeks and months. However, despite all the current efforts to prevent foreclosures, data indicates that foreclosures are still outpacing loan modifications and repayment plans. Foreclosures hurt more than just families. They really hurt entire communities because abandoned properties become magnets for decay, for crime, and for home devaluations. And so this is something that not only destroys families but also neighborhoods and entire communities.

We cannot just sit back as a Congress and ignore what is happening, and we need to continue to move forward in proactive steps that will help this housing market and look for a long-term recovery. I believe we do need to get the FHA reform bill signed into law. I am encouraged that a piece of it is going to be in the stimulus. We should have the whole bill in the stimulus. But FHA reform cannot be lagging far behind. We need this modernization to FHA.

I also believe we need to facilitate better coordination between regulators to prevent unscrupulous mortgage originators from continuing to snare unsuspecting people into predatory loans. And I support efforts to establish uniform professional standards and a national registry for all residential mortgage loan originators. This is one of the problems that has been out there, and I know Senator Menendez from time to time has spoken about this problem with the broker industry, many good brokers out there. Not to condemn a whole industry, but we have got to get those bad operators that are out there, too.

We also need to do something about our Nation's growing housing stock, and I agree with Senator Allard that Senator Isakson has come up with a wonderful idea, one that I fully support. I think it would be a really interesting approach because one of the serious problems that we have in a place like Florida is not only the number of bank-owned properties now and foreclosed properties, but it is also the number of unoccupied properties. We had an overbuilding situation in many of our urban areas with condominiums, and these need to be brought down so that the inventory of housing can be back to something that resembles normal, and we can get this industry back functioning.

The economy is weak because the housing economy has become weak, and so I think ideas like Senator Isakson's are the type that we need to be entertaining to engage the private market and get us back into a healthy housing economy so that we can then have a healthy economy.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Martinez.

Senator Martinez, as all of us know here, was the Secretary of Housing in his previous life and did a very good job in that capacity. He brings a great deal of knowledge to the subject matter, so we welcome your participation.

Senator MARTINEZ. Thank you, Mr. Chairman.

Senator SHELBY. He also knows how to deliver votes in Florida. [Laughter.]

Chairman DODD. We will leave Presidential politics out of this here.

Senator Casey.

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Mr. Chairman, thank you very much, and thanks for bringing us together. I will try to be as brief as I can.

First of all, I want to reiterate a lot of what has been said already about your leadership here of this Committee this year and last year. We had, I am told—I think it was in your statement the other day—some 35 hearings last year, 17 pieces of legislation. So this Committee worked very hard last year and got a lot done on a whole range of issues from housing to currency to financial matters. So a lot done, and a lot more to do this year, but I want to thank you and Ranking Member Shelby for leading this Committee.

Chairman Bair and Secretary Steel, we welcome you here, and we do welcome a new Member, Senator Corker, a member of our freshman class. We are now second year, so we may change the word from "freshman." But we are grateful for your presence on the Committee, a good Committee and a Committee that has gotten a lot done already.

On this issue, I guess I wanted to focus on what the goal ought to be of any legislation that pertains to housing, but especially to the foreclosure crisis. And there is no other way to describe it. I was criticized by a journalist the other day for using that word, I think in the context of the stimulus and the housing challenge we have. But it is a crisis in the life of a lot of families. It is not some far off, esoteric problem. This is a real crisis.

In Pennsylvania, whether you look at delinquencies or full-blown foreclosures, it is going through the roof. There is a report that will be issued today about our State. We are No. 4 on the list. I could cite a lot of data. I won't. But across our State and across the country.

And here is the goal, here is what the goal has to be: keeping people in their homes and stabilizing neighborhoods. That is the bottom line here. And I know there is some concern about overdoing things. We have heard some of that expressed this morning. But, look, some of this is very simple. When you have a mortgage broker who is committing fraud or misleading people, we should take their head off. And legislation to do that—and I speak figuratively, but we have got to crack down on people that do that. And a lot of these people have been unregulated for years—unregulated cowboys in the market who could do whatever the hell they wanted. And it is about time we brought the law down on them to help families.

The $180 million for counseling that is in this year's budget is one of the best and most immediate ways to help people right now—not 6 months from now, not a year from now. Right now. We are in the process as we speak, as of last Friday, the application process is out there. So nonprofits from across the country, experts who know how to do this, are going to be applying for that money. The money will start to be spent in March of 2008. It is one of the best ways we can help on this.

I think Senator Schumer, who worked so hard on this, Senator Brown and I, Patty Murray and the appropriators did as well, we should add more to that. The $180 million is a great start, but we need more to do that. It is an immediate way to help.

Long term, I think we have got to get behind Senator Dodd's legislation, the Homeownership Preservation and Protection Act, a great way to deal with this in a global way down the road, and especially just in the next year or two. So I applaud the work that Senator Dodd has done to bring together a lot of good ideas under the umbrella of one act. He has worked very hard on this already.

But I think the goal here ought to be to elicit information in these hearings, to support legislation which will have as its goal to keep people in their homes and to stabilize our neighborhoods, however we get there and whomever we have to offend along the way to get that done.

Thank you very much.

Chairman DODD. Thank you very much, Senator Casey, and I thank our witnesses for their patience this morning, but you get an indication of the feelings and the importance of the issue here by, one, the level of participation but also the desire of our Members to be heard on this subject matter. We are all, to one degree or another, facing this issue. We had the mayors in town a week or so ago, and we have a new mayor in Bridgeport, Connecticut. There are three cities in Connecticut of 100,000 people. He is facing 6,000 foreclosures in a city of 100,000 people. And this is not a community of speculators. These are people with single-family homes. A thousand foreclosures would be devastating, in a city that is already suffering from difficulties economically over the years. So all of us can tell anecdotal stories about this, and I think Senator

Casey got it correct here. I hope for this we will not get into—there are clearly some clashes ideologically and philosophically about how we approach some of these issues. And to the extent we can step away from that and think about some solid ideas that will allow us to address this in a comprehensive, bipartisan fashion, it is going to mean a huge amount.

This Committee has a wonderful history—and Senator Shelby just pointed out to me a minute ago, talking privately here. One of the reasons we had 17 bills come out of this Committee last year is because we worked together here. I think we had two negative votes on 17 bills, and they were really more questions of people just had a different point of view. But other than that, we really worked things out together. And my hope is we will carry that spirit forward in this year—obviously more difficult always in Presidential election years to do it. We all know that sitting around this table. We have got to put that aside here and obviously focus our attention on how we can do some intelligent, thoughtful things that will make a difference.

And we have got two very good people here and a wonderful second panel as well to offer some ideas and thoughts. They represent some views across the spectrum ideologically as well as politically here, so we thank all of them for coming. And, again, I apologize for the delay, but, of course, all of us know Sheila and the wonderful work she does at the FDIC, and you heard Senator Dole obviously talk about earlier how many of us here knew of her work when she was up in the Senate working with Senator Bob Dole, where she was counsel to the majority. She has really been a leader in the effort to get the industry to adopt an aggressive posture regarding loan modifications, and we commend you for that. And we have worked since last year on that, and we sat down together just about a year ago on these issues. So I commend you for it.

Secretary Steel comes with a great deal of background and knowledge as well. He serves as the principal adviser to the Secretary on matters of domestic finance, leads the Department's activities with respect to the domestic financial system, fiscal policy and operations, governmental assets and liabilities, and related economic and financial matters. Prior to that he was for 20 years at Goldman Sachs with the Secretary, and so he has a wonderful background and experience in these areas, and we thank him for being here this morning as well.

And let me just say here that your statements will be included in the record fully. Members who were not here or who want additional information to be included in the record, that will be conformed with and allowed. And we would ask you to try and keep your remarks relatively brief so we can get to the Q&A period, if we can.

Chairman Bair, please.

STATEMENT OF SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Good morning, Chairman Dodd, Senator Shelby, Members of the Committee. Thank you for the opportunity to testify today.

As you know, the FDIC has been a strong proponent of voluntary, systematic loan modifications to address current problems in the housing market. We have been dealing with the mortgage problem for nearly a year, and there has been some progress. But too many people are losing their homes. Through September, there were over 1 million foreclosures, a 60-percent jump from a year earlier. And according to RealtyTrac data, the foreclosure filings are up 75 percent for the year.

Given the falling housing prices and the sheer volume of unaffordable resets in subprime mortgages, foreclosures will likely continue to rise. More than 1.7 million subprime borrowers will see their adjustable rate loans reset at much higher rates by the end of next year, most with monthly payments that they cannot afford.

I have proposed that, for owner-occupied homes where subprime borrowers are making timely payments at the initial rate but clearly cannot afford the reset payments, servicers should extend the starter rate for 5 years or more. Such a streamlined approach can be much faster than a loan-by-loan restructuring process. It makes economic sense, and it is an appropriate proactive response to rapidly changing market conditions.

Modifying loans before reset will avoid negative credit consequences for borrowers, permit borrowers to keep their homes while making payments that they can afford, preserve neighborhoods, and provide investors with an above-prime return that exceeds any return they would receive from a foreclosure. A systematic approach for this broad category of borrowers frees up servicer resources to help other, more distressed homeowners, including those who may already be delinquent or have more complex loans to restructure.

Last month, Treasury Secretary Paulson announced that the American Securitization Forum and the Hope Now Alliance had developed a set of standard guidelines for the mortgage industry to follow in achieving subprime adjustable rate loan modifications. Pulling together the competing interests was no small feat, and Secretary Paulson as well as Under Secretary Steel should both be commended, strongly commended for their efforts. This initiative, if fully embraced and implemented by the industry, has the potential to greatly accelerate loan modifications for hundreds of thousands of borrowers.

Lately, there are signs that major mortgage servicing companies are accelerating their loan modification activity. It is my hope that this is an initial sign of a widespread industry effort to streamline loan modifications where possible. However, the work has just begun. Mortgage lenders and servicers must aggressively pick up the pace of subprime loan modifications and do it systematically. And this also must be accompanied by prompt and transparent reporting that permits independent analysis of their efforts.

Speed is crucial. Our initial focus has been on subprime hybrid ARMs where unaffordable resets have been building and will peak this year. However, we must also anticipate additional credit distress from payment resets on non-traditional mortgages which will begin in earnest in 2009. Non-traditional mortgages include interest-only or payment option mortgages that typically require no payments of loan principal or that can increase the size of the loan

through negative amortization during the first 5 years. In short, when the option to make a minimum payment expires, you face a significantly higher monthly payment. Most of these loans were made to borrowers with higher credit scores. As interest rates drop, we hope that many will be able to refinance out of these mortgages.

One problem is that many of these loans were made in areas experiencing significant declines in home values. As a result, many may have difficulty in refinancing because their home is worth less than their mortgage debt. Our analysis indicates that as of October there were over 1.7 million of these non-traditional mortgages with balances of some $600 billion securitized in so-called Alt-A pools. Other studies say that three in four of these borrowers have been making only the minimum payment. And, again, the bulk of these loans will start adjusting in 2009. These are sobering facts and well known to the industry. Waiting to confront them in a declining real estate market would be counterproductive.

I urge the industry to apply systematic strategies such as standardized methods for measuring debt-to-income ratios to determine if these mortgages are affordable. And if a costly foreclosure can be avoided, it will require the servicer to consider creative solutions. For some borrowers, these may include writedowns of loan principal. In today's market, this is often a better option than foreclosure or short sales of the loans to third parties. Congress has made this a more viable option by approving the Mortgage Forgiveness Debt Relief Act in December. By taking the tax liability issue off the table, principal writedowns are now a more realistic alternative.

In the coming months, many subprime borrowers will face resets to higher monthly payments. Many will face default and possible foreclosure. And many borrowers with non-traditional mortgages will face increasing challenges. Congress, the Treasury Department, and Federal financial regulators have worked to assure that industry has the tools it needs under tax and accounting rules to modify unaffordable loans. To work our way out of our current problems, the industry must use these tools systematically and aggressively.

Thank you very much.

Chairman DODD. Thank you very much, Madam Chairman.

Mr. Secretary, thank you.

STATEMENT OF ROBERT K. STEEL, UNDER SECRETARY OF TREASURY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. STEEL. Chairman Dodd, Ranking Member Shelby, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on "Foreclosure Prevention and Neighborhood Preservation." These are important and challenging issues, and I look forward to hearing your perspectives and working together.

The Administration recognizes the importance of housing to our economy, and we have said that this housing decline is the most significant current risk to the economy. But this is about more than just economic statistics. It is about individuals, families, and homeowners. We recognize that many families will experience

strain due to resetting mortgage rates and home price depreciation. Too many American homeowners face the frightening prospect of losing their home, and a significant number of families already have.

The latest data indicate that 2007 was on track for a foreclosure rate of approximately 2.7 percent. But to give that number a bit of perspective, many homes end up in foreclosure every year, even when housing markets are strong. Between 2001 and 2005, more than 650,000 homeowners began the foreclosure process every year. This baseline rate of foreclosure can result from job loss or other such family events.

Over the next 2 years, we expect the foreclosure rate to remain elevated above its historic level.

In total, approximately 1.8 million subprime mortgages are expected to reset over the next 2 years, but not all will end in foreclosure. The challenge is to identify homeowners who are troubled but with a bit of assistance can stay in their home.

The Administration's response is based upon a three-point plan: first, to identify those homeowners facing challenges and connect with counselors those at-risk borrowers who can be helped; two, to develop additional products for homeowners; and, three, to increase the speed and efficiency of moving these at-risk homeowners into affordable and sustainable solutions.

Whenever facing a challenging public policy issue, the first step is full understanding. While we are continuing to learn, our response to date represents months of listening to outside experts to understand the best ways to help people keep their homes.

Last March, in a meeting hosted by Chairman Bair at the FDIC, we heard from several housing experts to help us understand the seriousness of these challenges. In April and May, Treasury hosted two large meetings where all relevant regulators were invited. And over the course of the summer months, we sought the sound counsel of dozens of outside experts, including leading counselors, mortgage servicers, academics, housing and consumer advocates, and other specialists, such as the late Ned Gramlich, a former Federal Reserve Governor and prescient housing scholar who predicted the significance of these challenges before anyone else.

On August 31st, President Bush announced a comprehensive plan to help at-risk homeowners stay in their primary residences. The President charged Secretaries Jackson and Paulson to lead this effort.

On October 10, Hope Now was formed as an alliance among mortgage market participants to maximize the outreach efforts to at-risk homeowners. The alliance grew and today servicers participating in Hope Now comprise over 94 percent of the subprime market. Hope Now adopted a centralized hotline for telephonic foreclosure prevention counseling.

Additionally, Hope Now servicers are contacting all adjustable rate mortgage borrowers 120 days prior to their mortgage reset.

Furthermore, Hope Now members are reaching out to at-risk borrowers and offering help. A direct mail campaign began in November to contact all borrowers 60 days or more delinquent on their loans. On December 6, President Bush announced a new private sector framework to streamline the process for modifying and

refinancing subprime mortgages for eligible homeowners. These guidelines, issued by the American Securitization Forum, created an efficient process for identifying borrowers who qualify for refinancing or loan modifications. This, in turn, will also free up resources to focus on those borrowers who require more analysis.

Last, Hope Now servicers and counselors have finalized best practices that will increase efficiency in communication among servicers, counselors, and homeowners.

As Secretary Paulson has said, we are committed to measuring the success of this program as it is being implemented. Today the alliance is standardizing a variety of measures needed in order to monitor performance. These metrics will allow us to gauge successful treatments and outcomes.

Early numbers have already been reported, and they demonstrate that material progress is being made. In August, Hope Now hotline was receiving an average of 625 phone calls a day; the Hope Now hotline is now receiving 4,000 new phone calls a day, a 540-percent increase. And over 16 percent, or 77,000 borrowers, have called for help in response to the 483,000 letters that Hope Now members mailed to delinquent homeowners who had previously avoided contact.

We also have made a great deal of progress in increasing the speed and efficiency of moving borrowers into affordable solutions. The ASF program announced just last month is helping fast-track-eligible borrowers into a refinancing or modification, and it is freeing up resources, allowing servicers and counselors to focus on those who need case-by-case help. The ASF streamlined plan is only one part of our effort, but we expect the results to show a meaningful increase in the number of modifications as reporting begins.

Hope Now reported that the industry helped 370,000 homeowners with subprime loans in the second half of 2007; 120,000 of these homeowners received modifications. Moreover, the rate of modifications of subprime loans tripled from the third to the fourth quarter of 2007, with even better progress expected in 2008.

The Administration also has requested that Congress do its part, and we are appreciative that significant progress has been made to date. As you know, the Congress appropriated an additional $180 million to fund counselor networks. We also applaud the swift action taken by Congress to pass the President's tax relief proposal, which was signed into law in December.

FHA modernization is moving through the Congress, and we are hopeful that it will reach the President's desk soon. Additionally, GSE reform has cleared the House of Representatives, and we look forward to working with this Committee as Members consider legislation on this subject.

Mr. Chairman, in conclusion, let me thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. We have made substantial progress since August, but there is much work to do. We will continue to learn as we move forward and look for additional measures to help avoid preventable foreclosures.

Thank you so much.

Chairman DODD. Well, thank you very much, Mr. Secretary. And why don't we give ourselves, say, 7 minutes here per Member. As I look around, we have got a pretty good participation here. We will try to move along so everybody gets a chance to raise some issues with you.

Let me just ask you off the bat, you have heard Chairman Bair talk about this idea that she has raised before, and that is, of course, freezing these adjustable rates where you have people who are in that distressed category here. What is your attitude, what is the administration's attitude about that idea?

Mr. STEEL. Well, I think that Chairman Bair was an initial and important clarion to raise this issue, when she began to discuss it, and we have had lots of conversations together, and we at Treasury have benefited from her advice. I think the key issues are twofold:

One is that there needs to be a systematic approach. The number of people who are going to be facing this challenge is much higher than the normal flow of people, so we need to have a systematic approach to deal with those and put people in categories so they can be dealt with in an organized way. Hope Now has taken on this idea for certain groups of people to maintain the starter rate for an extended period of 5 years. And the 5 years is important, too, and that was the advice of Chairman Bair, because it allows us to find a sustainable solution where people can be successful in their homes and not have them fall back. And that has become a part of the process of Hope Now.

Chairman DODD. Well, let me just, because obviously this goes back, the January 7, 2007—I guess according to Secretary Paulson, we expect most services to begin fast-tracking borrowers—2008, excuse me. We expect to begin fast-tracking borrowers in the next few weeks. Most servicers are not yet fast-tracking borrowers.

Mr. STEEL. Sir, the process as of this year, all the different issues have been dealt with, and right now this is the protocol that the Hope Now Alliance of servicers representing 95 percent——

Chairman DODD. You may not recall this, but a year ago I met in this room—Senator Shelby was there for a while—with all the stakeholders around the table. We developed some principles that were adopted in May to do exactly what you are talking about. So it is almost a year.

Senator SHELBY. Right there.

Chairman DODD. Right there. And it did not happen. I mean, this is not—you know, we are talking about listening, and I am a great believer in listening, but this has been a year now, and Moody's and others are telling us we are just not getting the traction on this area. And even looking at your own data on this stuff, I mean, of the—let me just use Hope Now's data. Of the 370,000 homeowners assisted, one-third—only one-third—were able to modify their loans on a long-term basis; and two-thirds were put into short-term repayment plans, which actually increased the cost to these borrowers in the short term; and 25 to 30 percent had re-entered into a default situation.

It seems to me we are fiddling around here in a way where there are some ideas. I do not know, Sheila, if you want to comment on this idea of a systemic answer to the Secretary's point here, but it seems to me to be able to put something out there that freezes this

thing so we get a handle on it and you do not have people falling into this foreclosure area. And listen, believe me, that is why a year ago when I was asked whether or not we are going to write some legislation on this, my reaction was no. I think if the market can deal with this thing, the market ought to deal with this. That is the best way for this to happen. And nothing would have pleased me more than to see that happen.

And I know it is difficult. I realize that finding the borrowers is difficult in some cases. They do not step up. They do not return the calls. Many of them hired Acorn and other groups to assist them so that there was a bridge between the lender that would actually communicate with the borrower. But it is not working, it seems to me.

Mr. STEEL. I think with all respect, Senator, that your observations about history are correct, and I do not disagree with what you have described. But I can tell you that the Hope Now Alliance has got the protocols, and right now this is happening. And we are committed to measures where they will be giving us the results on a monthly basis, with a 1-month lag, beginning February and March. And we will be able to measure the success. And if they are not successful, as they begin to roll this out, then certainly we will know that for sure.

Chairman DODD. Madam Chairman, do you have a comment on this at all?

Ms. BAIR. Yes. I was here. I heard the same assurances. The first really hard data we got was the Moody's report in the fall, and that is when it became clear this was not happening.

I think everybody is working in good faith here. I think a couple things have been going on. One is there were some accounting issues that needed to be worked through that took some time. I also think that there was more investor pushback than some of the servicers initially anticipated. And I think one of the advantages of the protocols that have been developed is to provide somewhat of an insulation against certain security holders wanting to sue because they feel that they would be better off with a foreclosed loan than a modified loan.

Those are very difficult issues to work through, but I do think that it is helpful and it should be emphasized. I also think, though, that the investor liability issue has perhaps been somewhat overstated. My personal view is that servicers can be sued for not modifying because a foreclosed loan in this kind of down housing market is usually going to cost the investment pool more than a modified loan.

Chairman DODD. Right.

Ms. BAIR. So I think that has been somewhat overstated, but it has been a perception. I think one of the helpful things about the ASF protocol was trying to develop a framework that provides some additional insulation, if they followed the protocols, and it was worked out between the servicers and investors. I think there were some complications, but I also think that servicers just need to do a better job. I think what they are telling us at senior management levels is not necessarily getting down to the people who are actually interacting with the borrowers. They need to do a better job staffing up. I think that is happening, and I think a lot of that is

because of the strong encouragement the Treasury Department has been giving. But industry needs to do more, and they have raised expectations. They told us they could do it. We went to a lot of trouble to clarify accounting rules and tax rules to make sure they have authorities. And they need to do this much, much more aggressively than what we have seen statistically so far.

Chairman DODD. It occurs to me that, you know, looking for a silver-bullet solution to this is kind of the mistake. It seems to me there can be a variety of things we could be doing, some of which will respond. And I think that—I cannot speak for everyone on this Committee, but I suspect what I am about to say, almost all of us would agree with. Ideally, we would like to see a market solution to this. That could be the answer. That is the best answer in many ways if that would happen. That would save us all a lot of going through and trying to come up with ideas here to avoid what at least many of us feel here is a very deep and very serious problem.

Secretary Steel, I listened to you, I heard your comments, and I appreciate trying to sort of modify what you think may happen. There are a lot of very serious people who think this is going to have huge implications not just at home here, but globally. And I listened to Senator Corker. Listen, I do not disagree. The stimulus package, I am going to be supportive of it because I think just the signal we are trying to do something here. But the reality of a $160 billion proposal here in a $14 trillion economy—and that is narrowly—because I think it is a global issue, not just a U.S. issue. But I think it is at least worthy of trying to get things going and to build some confidence.

So I still want to see the industry respond to this thing, but I cannot sit around necessarily, having watched a year of this, and not getting the kind of answers we should have had when it was clear a year ago in this very room people understood the dimensions of it. And so the idea that Chairman Bair has raised here I think is worthy of a lot more serious and more immediate reaction than sort of waiting a bit longer here as this is getting worse.

You are going to hear from a couple of witnesses coming up in a few minutes, Alex Pollock and Michael Barr. They usually come with very different perspectives economically, from AEI and the Center for American Progress, that really have given me the idea in a sense, and others going back historically, this idea of a Home Preservation Corporation idea with highly distressed mortgages. You are going to have people in the private sector in your previous life, Mr. Secretary, who will go out and are going to try to buy this.

I had dinner two nights ago with a very successful financial operator globally, and he said, "Look, of course we are going to buy this. The difference is we are going to sit on it for a long time until the market improves, and we are not just going to let the homeowner stay there. We will foreclose on them here, maybe improve it a little bit, and wait a year, 2 years, 3 years. We can afford to do it, and then put it back out on the market and make a profit."

The problem is that homeowner loses in the process, and so the idea, in addition to the other things we are talking about of coming up with a vehicle that has worked historically, at no cost except administrative cost to the taxpayer, where everyone takes a hair cut—the lender does, the borrower does, obviously, but we do ex-

actly what Senator Martinez talked about: stabilizes neighborhoods, stabilizes the tax base locally where you do not end up, as you might in Bridgeport, Connecticut—6,000 homes in a city that size, not to mention the ripple effect in values of houses there—you have got a major economic catastrophe, not just in that town but in that region of one State.

So I wonder if you might—I do not know if you have read the testimony or taken a look at Alex Pollock's ideas or not. What were you comments on that idea?

Mr. STEEL. I think that in your announcement last week, you basically said some of the same things you have just described.

Chairman DODD. Right.

Mr. STEEL. But you used some important words. You said it is time for people to be creative, think outside the box.

Chairman DODD. Right.

Mr. STEEL. And I hear that loud and clear.

I think when we began to think about this, we tried to incorporate that perspective, and we basically used some of the existing platforms for delivery and also used some new ideas. And let me try to elaborate.

Basically, FHA exists, it is a tool we should use, and people have alluded to today what FHA has done and can do. It exists, it is fast, it is to market.

Second of all is that we believe and have proposed that the States, if we adjust the rules that allow municipal bonds to affect not just new housing but existing housing, it is a mechanism where money can be targeted to areas as you just described so that that can be helpful, too. So those were existing platforms where things could be delivered.

The third thing, Hope Now, was something that was created from whole cloth, and basically that group of servicers have come together, and we think in an industry-organized way—and whether it is the contact, the telephone, the letters, and the modification, we are optimistic on that.

Now, let me get to the issue that you are describing. I have read the testimony and read about the idea of this. I think it is something that warrants study and will look forward to hearing the testimony today and the questions that come out. But I would just caution you that times were different. At that time, the foreclosure rate was 50 percent and the unemployment rate was 25 percent. And so the question really is to get the right tool for the task with the right time perspective, and so I will look forward to hearing and learning more about this. But we are driving hard on FHA and the other tools that we have for now.

Chairman DODD. Madam Chairman, do you have any comment on that?

Ms. BAIR. We are still learning, and we have had some discussions with Professor Barr, who I think is one of the more creative minds in financial services. We are still learning. I am afraid I cannot give you much more of a reaction than that. I think, short term, we need to absolutely keep the pressure on for loan modifications because this is happening—it is now. And so there are questions about how long it would take to set this up. Senator Schumer alluded to the fact that if you do it now with home prices falling,

the collateral that is purchased is going to keep going down. So that is an issue, I think, that we need to think through. And also how securitization structures will work with this. So I think it is good thinking. We need to learn more, and learn more about some of the outstanding issues.

I would just note that another tool I talked about—writing down principal amounts of mortgages—this was something we did not encourage before because of the tax liabilities for the borrower. Previously, before Congress passed this relief, there would be a tax liability to the borrower if the servicer wrote the principal down. But they have current authorities now to write down the principal amount on the loan to get the loan-to-value ratio below where it would qualify for an FHA loan, or perhaps simply refinancing. So if the investment pool is willing to take the discount now through a writedown, they can write down those loans far enough to make a lot of them GSE eligible.

So that tool is there already—that could be used right now. But the question is, are the economic incentives there? Do they understand this is going to be in their interest or not? But I think that would also be a question to be dealt with in working through something like this.

I think we need to explore all options because we have a very, very bad situation now, and the more foreclosed homes go on the market, the more they are competing with the excess inventory we already have. It is a bad situation all the way around.

Chairman DODD. Well, I want to invite—because I know the Treasury is doing it, but also you, Madam Chairman, and others—not another hearing. We could have hearings, but I would like to make sure we are getting the information to staff up here and others on these ideas so that we can actually develop them as quickly as we can to move forward. There is a sense of urgency about this. And, again, I am not—we are going to be careful, obviously, and balanced to make sure we are not overreacting. But, nonetheless, I do not want to be sitting around another year from now watching a situation even further deteriorating where the ability to respond to it is too late because people are out, and we have really done great damage because we just were so cautious that we refused to understand the depth of the problem, the seriousness of it. And there are serious people who believe this problem is not going away and going to get a lot worse and cause a lot more problem for our country—and basically outside the country as well.

Senator Shelby.

Senator SHELBY. Thank you, Chairman Dodd. I just want to pick up on—before I get into questions—Senator Dodd talked just a minute ago about the stimulus package. It sounds good. It is kind of like a political response to a strong economic problem. But somebody said to me the other day it is like pouring a glass of water in the ocean. If the economy is $14 trillion and we are going to borrow $150 billion, will it really help the economy? Maybe. Maybe not. Are we adding that debt?

So along those lines, I think, Senator Dodd, we ought to be very careful—and you mentioned this, too—not rushing ahead of this problem, but being on top of it. Because we do not know if this has bottomed out yet, and if we rush in too fast, the house could con-

tinue to burn, our neighborhoods burn, and we have no other avenue to go down.

I have a few questions. I will start with—well, I will ask you both this. Bond insurance. Because bond insurers have guaranteed, as you well know, more than $2.4 trillion of securities, there is a great concern that further downgrades of bond insurers by the rating agencies may trigger a wave of writedowns by banks holding securities guaranteed by bond insurers. A lot of the bond insurers are very thinly capitalized, as you well know.

Under Secretary Steel, would you provide your assessment from your perspective, 20 years on Wall Street, very involved, of the likely impact of both the financial system and the economy were additional bond insurers to lose their AAA ratings, which has been threatened? A lot of people are really concerned. And what impact would it have on the availability of credit? I think this is a serious question out there.

Mr. STEEL. Yes, sir, it certainly is. And it is something that is on our mind, too.

I think that the way I would start the answer to this question is that, first of all, as you know, these organizations are State regulated, and the good news is that the State regulators are engaged and seem to be working with them, with the different companies, and it is a fairly concentrated industry with a handful of firms providing the majority of the coverage that you described that has been underwritten.

From our perspective at Treasury, we have basically worked closely to stay involved and to monitor and be vigilant with regard to the situations. There are, as Senator Schumer suggested earlier, ripple effects to these types of securities.

Senator SHELBY. Absolutely.

Mr. STEEL. And I think that people are watching this and monitoring it, and that would be where we are today.

Senator SHELBY. Chairman Bair, if bond insurers—if more of them lose their AAA ratings, what would be the impact on the value of the securities that are held by banks? You know, investment grade securities. And would any writedowns materially affect bank capital levels, as some suggest?

Ms. BAIR. Well, we are closely monitoring this, obviously. That would depend on whether the bonds were held to maturity, held for sale, or in the trading book. If they are held to maturity, they do not have to mark them down. But the other two categories, they would have to be marked to market—and if in the trading book, that will have repercussions for their capital.

I think there are some other things to point out, though. Unlike the kind of distress we are seeing in the CDO market where there are problems with the underlying assets, in the municipal bond market the underlying assets are still fine. This is really just a knock-on effect from the bond insurer being downgraded. So I think there are some positive features that differentiate this from CDOs.

Senator SHELBY. Their fundamentals are probably fine, but what would be the psychological effect?

Ms. BAIR. Well, I think that is something——

Senator SHELBY. There has got to be a negative—I hope there will not——

Ms. BAIR. ——that a lot of people are thinking through right now. This is not something we have really confronted.

Senator SHELBY. And, Secretary Steel, you say you are on top of that?

Mr. STEEL. I think we are doing our best to monitor and be vigilant, sir, because as you say, it is an important issue. As Chairman Bair said, 75-plus percent of these assets are municipal bonds of the very highest quality, which makes you comfortable that the asset is a solid one in those cases.

Senator SHELBY. But it could be the lack of capital. A lot of guarantees out there and a run on the capital, same thing.

Mr. STEEL. Yes, sir.

Senator SHELBY. That you have seen all your life.

Senator Dodd brought this up, Secretary Steel. Logistic problems with securitization, especially the banking system's change. I would think it can be difficult to determine the specific owner of a mortgage given that multiple investors have ownership stakes in the same mortgage or pool of mortgages, because the mortgages have been packaged and repackaged through securitization.

In the old days, the banks made a loan, and they carried it on their books, real estate. They don't do that anymore. Very seldom. They pick and choose.

How does this affect the ability to proceed with an orderly unwinding or modification of the underlying mortgage note? It has got to compound that.

Mr. STEEL. Senator Shelby, it creates challenges, and you describe the engineering of the process right. There is a servicer who is responsible for acting on behalf of all of the investors——

Senator SHELBY. But they don't own the mortgage, do they?

Mr. STEEL. They do own the mortgage. The servicer has a contract called a PSA, or pooling and servicing agreement, and that gives guidelines as to what the servicer can do legally on behalf of all of these different investors.

Senator SHELBY. Can they modify the mortgage?

Mr. STEEL. Yes, sir.

Senator SHELBY. OK. That is good.

Mr. STEEL. But there are specific categories by which they can related to the value of the overall mortgages. And so part of this complicatedness that Chairman Dodd alluded to and Chairwoman Bair relate to having the ability to do that.

Senator SHELBY. OK. This was mentioned earlier, and I want to pose this question to you, Secretary Steel. GSE reform, we talked about this. I have worked on it, Senator Dodd has, Secretary Paulson, yourself. Fannie Mae and Freddie Mac, as we all know, are among the largest non-bank financial institutions in the world. They play a sizable role in the mortgage markets. Their outstanding debt in mortgage-backed securities are held by banks, pension funds, and foreign governments. In addition, their hedging activities link them to many other large financial institutions.

Secretary Steel, there will likely, more than likely only be a single chance of GSE reform legislation, and, therefore, the substance of such reform I believe is crucial, not only to this Committee but to the country.

I don't think we can accept just any old deal for a deal's sake. I believe that we have a responsibility in this Committee to pass meaningful reform in which we create a world-class regulator with the authority to address the full range of risks associated with GSE operations, including systemic risk.

Do you believe we need a world-class regulator, as Secretary Paulson has told us many times?

Mr. STEEL. Completely, sir, and I have worked hard in the House with Chairman Frank and look forward to engaging as Chairman Dodd has the same ambition here. And that is completely the view of the Secretary of the Treasury.

Senator SHELBY. What would be your basic conception of what would constitute a world-class regulator?

Mr. STEEL. Well, I think that——

Senator SHELBY. That would be more than what we have today, would it not?

Mr. STEEL. Yes, sir. I think that the construct should be viewed as we should have all the tools that a normal regulator would have——

Senator SHELBY. Like Chairwoman Bair, for example.

Mr. STEEL. Yes, plus even possibly more because of, as you describe, the large effect—things such as single source for both terms and conditions and mission, and safety and soundness, bringing them together, things like that. But basically exactly all the tools that you would want for a world-class regulator.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman, and thank you both for your testimony.

Mr. Secretary, I heard you, in answer to Senator Dodd's questioning and in your testimony, paint what I might refer to as a rosy picture to some degree of what is the response. But 3 days ago, the Center for Responsible Lending put out a document that is far less rosy. Let me read from it. It says, "Wall Street analysts estimate that there will be 3.5 million foreclosures over the next 3 years, resulting in losses of $350 billion to financial institutions. An estimated 3.5 million families are trapped in exploding adjustable rate mortgages that are due to increase to unaffordable interest rates in the next 2 years. And on many of these loans, the debt owed is more than the value of the house."

They go on to say, talking about the Paulson plan, "However, recent industry data, coupled with an updated analysis of who will qualify for the Paulson plan, clearly shows that voluntary initiatives are and will fall far short of the effort needed. Existing modification efforts are insufficient. The Mortgage Bankers Association data shows that foreclosures are outstripping modifications 7 to 1. For the subprime ARMs at the root of the current crisis, foreclosures outnumber modifications 13 to 1." And while they go on to say that the Paulson plan is welcome, only 3 percent of subprime ARM borrowers are likely to receive streamlined modifications under its terms.

That is not too rosy, as far as I am concerned. It is not the type of response I think we need to the crisis that we face. Do you want to comment on that?

Mr. STEEL. Sure. I have certainly seen the report that you suggest that came out last week, and basically it describes what has happened to date. As I said in response to Chairman Dodd, the process and the protocols are just beginning to be applied by the Hope Now Alliance, so we are just starting to see the progress.

Progress to date is inadequate in terms of the results we wish to have, and so now the efforts have been organized, and we should see significant progress from here. And we have committed to providing the information that showed the success that can be achieved.

Senator MENENDEZ. What has fundamentally changed? What has fundamentally changed that is going to give us a much different set of realities? And what do you expect that—what you are now telling the Committee is going to take place, what do you expect that its results will be in terms of the percentage of people who will be helped?

Mr. STEEL. Well, the way I would look at it, first of all, what has changed was your first question, and what has changed is that as of the 1st of the year, these protocols are being applied, that people are being fast-tracked and dealt with so that you can get those done more quickly. And second of all, that also allows more capacity for people that have more challenging situations that need individual attention and don't fall into the fast-track category. They can be considered also. So that has changed. That is just starting now. And we will be reporting back to you and to everyone as to the success with that program.

Senator MENENDEZ. Do you have any estimates of what do you project based upon your new protocols and the enforcement of those protocols? Which it seems we have waited on too long for and that the industry has waited on too long for. But what is your projection of what we are going to be able to achieve as a result of it?

Mr. STEEL. Well, the answer, what we have said, sir, is that of the 1.8 million resetting mortgages, 1.2 million should be the goal for trying to help, half of which would be a modification and half of which would be refinancing.

Senator MENENDEZ. That should be the goal. Let me just say I think that there are those who I hear, as we heard back in March when many of us were defining what was coming as a tsunami of foreclosures, we heard the counsels of patient and delay and study. We are now nearly a year later and hear many voices of the counsel of patient, delay, and study. And certainly for those who are losing their homes, for those who own homes around the neighborhoods where foreclosed properties are taking place and are losing value in their homes, and as a former mayor in communities which are having substantial reductions of ratable bases as a result of the reduction in values, this is an enormous consequence. So I have a real problem with the counsels of patient and delay as we continue to face a rising number of foreclosures here.

Let me ask Chair Lady Bair, in your statement, you say that, "Progress in achieving actual loan modifications has been unacceptably slow." And I would ask you to elaborate on that. And, also,

you said in your statement that hopefully the lenders, the holders of these documents, would come to understand that a foreclosure is far less valuable to them than even continuing the present loan rate.

Do you think that that is being captured by the industry as a principle that they accept? Or is it different?

Ms. BAIR. I think that it is, and I think one of the major accomplishments of the ASF agreement, which Secretary Paulson and Under Secretary Steel facilitated, was a recognition that fast track modifications or refinancing is appropriate for this large category of subprime hybrid ARMs, if they are current at the starter rate. I cannot overemphasize, these starter rates are high. They are 7 to 9 percent, over 8 percent, for most of the 2006 originations. So the starter rates themselves are high. They cannot make the reset, and I think there is general agreement that most will not be able to make the reset because of weak underwriting. They should either get a fast-track modification or refinancing. And there is a lot of technical detail in the ASF protocol basically trying to differentiate who can refinance and who needs a modification. But the point is, those loans should not be foreclosed upon. They should be refinanced or they should be modified, and it should be a long-term, sustainable modification of at least 5 years.

So that is what we understand the agreement to be. That is what we are expecting to see in the reporting that is going to go forward. There was some pick-up in modification activity toward the end of 2007. However, we saw far too many repayment plans, which just delay the inevitable. They are just capitalizing deferred interest. They are deferring the interest and principal to try to collect at a later date, which is just going to make the payment shock even bigger once you get to the end of the repayment plan.

So these are not long-term, sustainable modifications. This is just kicking the can down the road. And these loans are unaffordable for the vast majority of subprime hybrid ARM borrowers. They are going to be unaffordable 18 months from now, and they are going to be even more unaffordable if they just defer the principal and interest.

So that was what I was referring to when I expressed my disappointment in these numbers. We need modifications, real modifications. Repayment plans for certain categories of borrowers may be appropriate, but for the broad categories we are talking about, that is not what we are looking for.

Senator MENENDEZ. Well, Mr. Chairman, I appreciate your continuing diligence in this hearing. I find it interesting there are those who rabidly pursue the Federal Reserve to instigate and to act. Of course, we want it to act so that we do not have the economic consequences and the broad base of what is happening in the housing market to our overall economy. But those are ultimately at the end of the day about strengthening confidence and helping investors.

It seems to me that at the same time that we seek for economic forces to be unleased by a governmental entity to strength that, we should be looking at the governmental entities that can ensure that people don't lose their homes on an equal footing. And I look forward to the Chair's initiative in that regard.

Thank you very much.

Chairman DODD. I thank you for your comments and thoughts, and I could not agree with you more. So much of this actually—you talk about ripple effects. The optimism and the sense of confidence that is engendered as a result of these kinds of activities as well, has its own economic impact here. And in the absence of these things, the wait, look, and hope mentality has a certain appeal, except when it doesn't work and then you have created a massive problem, which I am worried about. I really am. Serious people think this is a problem that is growing, not shrinking, and that the hour is getting very late here. The listening period in my view ought to be over with here. We have watched and listened now for a year at this and hoped that certain activities would happen. And I am certainly going to watch very carefully, Mr. Secretary, how this proceeds. But I am very uneasy about the likelihood you are going to produce the kind of results we are looking for here, and I am fearful that we are going to find ourselves at a point where we are acting too late to deal with an awful lot of people where, had we acted more quickly, we could have avoided some of the problems we are looking at.

Senator Bennett.

Senator BENNETT. Thank you very much, Mr. Chairman. I agree with you about the seriousness of it and that it could spread, and as I indicated, there are a lot of people overseas who are very concerned about the implications of this throughout the financial system of the world.

I am, however, a little concerned that we do not have as much data about what is really happening as we would like. Let me drill down a little bit to discuss an aspect that I have not heard discussed at all, not only not by this panel but by any of the experts. And I realize my experience coming at this is entirely anecdotal, but I have seen people lose their homes in housing bubbles that have no—on a basis that has nothing to do with mortgage rates. I lived in California, and California was going through a housing bubble, and the property tax levels went up so dramatically that people who had been in their homes long enough probably to have paid the mortgage off were finding that the property tax was driving them out. And I have personal experience with a woman who lost her home because she could no longer afford the property tax.

And shifting the anecdote to my own property tax report that comes in from Arlington County, it was going up in a fairly steady basis every year, 5 percent, 10 percent. Suddenly it went up 50 percent, and the next year it went up another 20-some percent. I have forgotten the number because I do not even want to think about it.

All right. Last year, it came down—very slightly. If I were to draw a historic graph of the previous pattern of increase in property tax, I would say that the property value that that represents is now still, even with the drop, substantially above where it would have been if we had been on that steady pattern before the bubble came.

I am obviously not complaining about what is happening. I can handle it. But I wonder if we have any data, talking about people losing their homes, of the impact of the double whammy of the ad-

justment in the ARM and the increase in property tax. Because if we had the bubble, the property tax people were there to pick it up. We have former mayors on this Committee. Senator Dodd has talked about the impact of a mayor in his community. And this is an aspect of it that I have seen happen in very real terms.

Is there any data about the impact of property tax as a consequence of this bubble?

Ms. BAIR. No. I have our chief economist right behind me, and he tells me that, no, we have not looked—we have certainly seen property taxes going down now as the home values are going down. But, no, in terms of this feeding in and being part of the problem—the delinquency and default problem—no, we do not have that kind of data.

Senator BENNETT. They are going down, but they are going down from a bubble high.

Ms. BAIR. Absolutely.

Senator BENNETT. And so they are probably still significantly higher than they would have been at the time the loan was taken out.

Ms. BAIR. We will look into that. No, we do not have data at this point, but we will see if we can get it.

Mr. STEEL. No, sir.

Senator BENNETT. OK. Second, I made reference to the cab driver who had three homes. Do we have any idea what percentage of this universe that you are dealing with is represented by people who have no interest whatsoever in staying in the loan, it is in their self-interest to simply walk away? Because they are not living there, they never intended to live there, they were either going to flip it or in some other way make some killing on it. Are they going to benefit by virtue of what we are doing and then still turn around and walk away? And how many of them are there? Do we have any idea?

Mr. STEEL. Well, sir, I will comment and then Chairman Bair can add. From our perspective, first of all, with the Hope Now group, as they are managing their process, all of their protocols only apply to owner-occupied single-family homes. So those people that are speculating or in second or third homes are not able to avail themselves of the fast-tracking of the other protocols.

In terms of the numbers, this is something that people pursue, and I will defer to Chairman Bair, but I think something like 15 to 20 percent are some of the estimates that people say of the 1.8 million resetting, that would be a reasonable number. But I would not apply a huge amount of precision to that estimate.

Ms. BAIR. There is some percentage of what is called the "unsympathetic borrower," that there is some fraud or they are just in it for speculative purposes. One of the reasons we targeted our proposal to subprime hybrid ARMs is that those overwhelmingly are owner-occupied.

Senator BENNETT. OK, good.

Ms. BAIR. The Alt-A market, where you get the really low teaser rates and payment options—those seem to be more perhaps the product of choice for more speculative types because they are more highly leveraged.

Senator BENNETT. It may be an oversimplification, but if you look at the top four States that have been hit the hardest—Nevada, Florida, Michigan, and California—Michigan is the only one that has significant economic problems in the State. The others are clear candidates for flippers and people who want to get into condominiums and speculation.

Ms. BAIR. Well, but I think that is true. But they were also, because of home prices, ripe markets for so-called affordability products.

I think it is important to differentiate between Alt-A and subprime hybrid ARMs. The hybrid ARMs tend to be disproportionately found in working-class neighborhoods and minority neighborhoods. These have starter rates of between 7 and 9 percent, resetting to 11 and 12. It is tagged off of LIBOR. It is actually a complex formula they have to reset. But these high initial rates are not, I think, generally going to be the product of choice for a lot of speculative investment activity. There is some of that in the subprime hybrid ARMs, but these tend more to be owner-occupied, working-class families.

And, again, we thought by targeting loan modifications to those that were owner-occupied, where they had been making timely payments for that first 2- to 3-year initial period, that you would have a pretty good, sympathetic borrower.

Senator BENNETT. I agree with that, and I commend you for that. My only comment is if we try to get our arms around this whole thing and we start quoting universal statistics to each other, we run the risk of having included in those universal statistics information from borrowers that distort the picture and that we do not particularly want to help.

Ms. BAIR. It is difficult, and that is why I think going forward it is so important to get strong underwriting standards that apply across the board, because there are unsympathetic borrowers. There is a lot of unsympathetic lending going on here, people not documenting income, assuring ability to repay, just basic underwriting.

Senator BENNETT. Yes. OK. Thank you very much, Mr. Chairman.

Chairman DODD. Thank you.

Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

Secretary Steel, most observers suggest that FHASecure has had a limited impact to date. In addition, the Hope Now program is moving forward, but not with the speed, I think, and the results we would all like, which begs the question: Other than continuing to adjust these programs, what is Plan B? What are the next steps if these programs do not deliver a significant improvement, which at this juncture they do not seem to be doing?

Mr. STEEL. Well, if I could just observe, I think with FHA, with FHASecure, already there have been 70,000 mortgages made, and so that seems to have been working already. And if FHA modernization comes through, there is potentially more for FHA to do pretty quickly. So I would be a bit more constructive about the success of that.

With regard to Hope Now, we are now getting to the point where we should see results, and if we don't, we will drive this harder. When you were away, sir, I said that we were committed to metrics monthly. We should get them beginning within the next 30 to 45 days on a monthly basis. And beginning in January, we have the full power of these modification capabilities as were outlined by Chairman Bair. So I am optimistic. And we can do more with regard to these same tools, and so I think that is really where we are on this for now.

Senator REED. So you believe that these two basic approaches exhaust what can be done and will be successful?

Mr. STEEL. No. I think in my testimony I tried to say that we are open to suggestions. We are here to learn. This has been helpful to date to engage, and the second panel will give us ideas, also. So there is no ideological trap that we are stuck in, but instead we are open to ideas. These are the ones we are driving, and we think that they have gotten out of the gate pretty quickly, FHA was an existing program since 1935. We have used State and local governments to distribute and target the idea of adjusting the mandated municipal bonds so they are not just for new homes but for existing homes. And then we are driving with Hope Now.

So those were three areas where we think we have made good progress. We are committed to measuring our results, and we have no closed mind with regard to other ideas.

Senator REED. Well, I am glad you do not have a closed mind, but I think I would be comfortable if you also had a Plan B.

Chairman Bair, what is your observation? And thank you for your comments, Mr. Secretary.

Ms. BAIR. Well, I think we need to keep the pressure on for the systematic modifications, to free up resources for loans that need to be addressed on a loan by loan basis. I think this money you have appropriated for counseling—I would not understate the importance of that. I think empowering counselors and empowering borrowers to negotiate loan modifications is an important part of this.

We are open to talking—you know, encouraging creative ideas and talking and working with Congress on additional approaches that could be used. Another area you might want to take a look at is this issue of investor liability. I know the House—Congressman Castle has been looking at doing a bill to clarify a servicer's legal obligations to help protect against investor suits for responsible loan modification activity. That might be another thing to look at.

Senator REED. In your testimony, Chairman Bair, you talked about the Alt-A as being potentially more difficult in terms of loss mitigation issues. And that is a problem that has not exploded to the degree of the subprime, which begs the question. What are we doing now to anticipate what is likely going to happen? Is this market crumbling also?

Ms. BAIR. Well, I think the scope of the problem hopefully will be smaller because these are non-traditional, high-risk products, but a lot of them were made to people with stronger credit records. So we are hoping that the refinancing capability will be stronger than it has been in subprime. But for those who are in

unaffordable Alt-A mortgages, it will be much more difficult to use systematic approaches because the product terms vary so much.

I think that the Hope Now group is another one. I am hoping that they are starting to take a look at this. I think one thing you can do is use systematic approaches, for instance, debt-to-income ratios, you know, have a standard rule of thumb to lower a payment below a certain DTI standard. The FDIC and the Conference of State Banking Supervisors have suggested a 50-percent DTI—anything above a 50-percent DTI strongly suggests increased chance of default. So keeping it under that, you can use systematic benchmarks to aid in the modification process. But I think Alt-A is going to be more difficult. I am hoping the problems will not be as severe because there are stronger credit backgrounds with a lot of these borrowers. But this is going to start escalating in 2009, and so that is why—one of the reasons I am talking about it now to try to make sure you are aware of it, and we have been talking with Hope Now and others about it as well to try to get ahead of it.

Senator REED. Mr. Secretary, your comments on this?

Mr. STEEL. I would second Chairman Bair's comments.

Senator REED. Chairman Bair, we are drawing lessons from around the globe because this problem is spreading around the globe. With Northern Rock, the British bank which required assistance of the Bank of England, I understand the bank reported the Basel II advanced approach that allowed it to lower its risk-weighted average by 44 percent, and their CEO described this as "the benefits of Basel."

Can you comment on the bank capital rules? And can they continue to provide safety and soundness as we look at this new world of Basel?

Ms. BAIR. Well, I think that is true. Their own reports indicated that this bank—which, of course, as you know, now has cost the British Government around $49 billion—the risk-weighted assets were going to go down 44 percent. They were planning on paying a dividend because of their reduced capital requirements. So I think one of the key concerns we had, the quantitative impact studies showed that the Basel II—the advanced approaches of Basel II—would result in dramatic reductions in minimum risk-based capital for mortgages. And I am very glad that we did not institute it before we hit what we are in now, because if we had lowered those minimums, the industry would not be as strong as it is now to absorb what we are experiencing.

So I am glad that we used a cautious approach. I do think it is important to emphasize that there are positive aspects of the Basel II framework, but their use of external ratings as well as their use of models to drive regulatory capital I think are things that require a lot of thought.

Another issue that we are looking at now, which I think would be an unacceptable result, is the use of external ratings. For instance, AAA-rated CDOs—those are the structured finance instruments that have been responsible for some of the big writedowns you have been reading about. The capital charge is currently 20 percent under Basel I for a AAA-rated security. That would go down to 7 percent for AAA-rated CDO under the Basel II frame-

work. Well, that is obviously far too low for that type of what we know now is a very high-risk instrument.

So we do need to make adjustments going forward, and I think the U.S. should be commended for taking a very slow, gradual implementation process so we can make adjustments as we go along. We are doing a parallel run beginning sometime this year. That will have to happen a whole year before we actually start setting capital under the advanced approaches. And then there are 5 percent per year floors for a 3-year transition period. And, of course, we are keeping the leverage ratio too, so we have a lot of safeguards to make sure we don't get ourselves in trouble with this new framework.

Senator REED. Thank you very much. Mr. Secretary, thank you.

Chairman DODD. I see Senator Schumer has arrived. Just one question I wanted to raise—actually, two fast ones. And you may not have the direct answer, but Senator Shelby asked a very important question that could be the subject of just a hearing, and that is the bond insurance issues and how we are going to deal with that or what the administration is thinking about in dealing with that. And are you going to be looking to us to do anything? It would be helpful in the short term to get some more specific answers to the issues that have been raised here. It is a very, very important question that has been raised.

And, last, just having gone back and learning more about mortgage-backed securities and how they function and operate, more than I ever intended I would have to learn, but trying to understand the difference between a contract and a trust arrangement and where in the contract arrangements, is it your understanding, Mr. Secretary, that there is enough flexibility in these contract arrangements with the various ideas we are talking about including the modification efforts, are allowable under most of these or all of these contract arrangements? Or is there going to be some—I know the trust arrangement, for us to change the trust would require, I think, some legislative action, as I understand it. I am not sure exactly what we need to do, but those are fairly few. Again, the bulk are contracts.

Mr. STEEL. We believe that the bulk of the pooling and service agreements gives the alliance the flexibility to be able to work with modifications on these terms. But there will be disputes, but we believe that the flexibility exists to exercise this.

Chairman DODD. Great. Senator Schumer.

Senator SCHUMER. Yes, thank you. Thank you, Mr. Chairman.

I just want to follow up a little on the Hope Now initiative. I have been skeptical of it, and I have not seen really the results, because when you chop up mortgages into so many places and you go tell the mortgage servicer you can rearrange it unilaterally, it usually does not work. And I think that is what we have seen happen so far.

So my first question to Secretary Steel is: I am concerned, only one-third of the borrowers who have received Hope Now assistance got long-term modifications, and that is really what we are shooting for in all of this. Why aren't servicers and counselors in this program giving borrowers help that solves their problems over the

long term? Because if it is short term, we are just going to be back again a year from now or 2 years from now.

Mr. STEEL. Well, I think, sir, you are correct. We should be developing affordable, sustainable solutions, and that is why the 5-year stabilization of the existing rate was suggested. We consulted with Chairman Bair on this issue, and the 5 years was thought to ensure that we had the right time for a sustainable, crucial solution.

Second is that we are just getting started on the Hope Now. We have gotten accounting approval, and just beginning in January are we beginning the efforts, and we should see results. I have said that we are committed to providing metrics and results and sharing them with you so that we can all keep the pressure on to get the most done. And I pledge to you that is our commitment.

Senator SCHUMER. Right. No, I realize that. I just think basically the administration's sort of ideological allergy to getting the Government involved leads to all of these voluntary solutions, and instead of drawing a straight line to the heart of the problem. You sort of beat around the bush because of ideological problems. And even the projections of Hope Now were disappointing as to how many actual mortgagors it would reach, and I think—I know it is in its early stages, but I am not encouraged by the early returns.

Now, you both stated, you know, that current servicer actions have been inadequate. I will address this to Ms. Bair first. Why would a voluntary program be different? They could do this on their own right now. Now, I know you are giving them certain possible protections. But if I am a servicer, it is a lot easier for me and a lot better for me to just keep doing what I am doing rather than stick my neck out when the Government's sort of protection is not tested and hardly certain. And it relates to the second question to Ms. Bair. You mentioned servicer liability earlier. I mean, if I were a servicer, I do not care what the Government said. I would be worried that one of my 30 investors would sue me, you know, the one at the bottom of the line who is going to be cut out by this. And I think that is the major obstacle to Hope Now.

Could you, Ms. Bair, talk about the second question first, servicer liability? And then both of you talk about the general reason why this new program should work when it has not worked on its own, when, you know, the servicers have not been able to do things on their own. Ms. Bair.

Chairman DODD. As you pointed out, about a year ago, a set of principles were worked out, hoping that would be the answer.

Senator SCHUMER. Right. Exactly. Again, my view, Mr. Chairman, is they have come up with a plan that does not work very well because they just do not want to see Government involvement. That has been one of the big problems for this administration from the get-go in this crisis.

But, Ms. Bair, talk about liability first and then the general issue.

Ms. BAIR. Well, I think that investor liability is an issue. My personal view is it has been overblown. I think that the servicers' legal obligation is to the pool as a whole, not to individual tranche holders. And, clearly in the kind of housing market we are in with home prices going down, it is almost always going to be the case,

if you have an able and willing borrower to stay in that home and pay a modified mortgage, the value of that mortgage is going to be worth more than the foreclosure value.

So I think two things. One is there needs to be some investor education. As I indicated before, I think Congress might want to consider some legislation clarifying the servicers' responsibilities to remove this as kind of an issue. I think also, though, there have been operational issues that perhaps the servicing industry has not been as willing as they should have been to acknowledge. They are just not equipped to do this in scale. I mean, usually loan modifications are a very, very small, if any, minute portion of the loans that you service. They are not equipped to do it in this scale. They need to staff up. They need to get the word out to the people who are actually interacting with the borrowers that this is the plan—this is the 5-year modification—if they cannot refinance.

So I think those things have been lagging, but we are trying to save servicers money by doing systematic approaches so they don't have to go one-off one by one. But operationally, they are not—they have not been equipped and they are not in the mind-set to do this in scale, and I think we have had trouble overcoming that.

Senator SCHUMER. Thank you.

Secretary Steel, just one other question, and you can answer them all at once, and that will be my last one. FHA. The administration has pushed—Secretary Paulson has talked to me about it, you have on numerous occasions—FHA reform. Yet the administration in the stimulus package did not want to put it in. The House, I think Barney Frank and others, wanted to put it in, and the administration did not. Can you comment on that as well?

Mr. STEEL. I will start with the first questions about Hope Now.

Senator SCHUMER. Right. Yes.

Mr. STEEL. I think you are pointing to the right issues, that we need to have real success here. This is crucially important, and we are committed to doing so. Hopefully—as Chairman Bair said, historically this was a one-by-one, hand-to-hand combat issue on modifications. What the Hope Now procedure, which was originally outlined by Chairman Bair in the fall of a more systematic approach to deal with the increased scale, will allow for things to happen at a much faster rate and give guidelines to the servicer on how this can happen.

In addition to the efficiency that generates for those, it also allows more time for the more difficult situations that require more of a one-by-one approach. And so hopefully it will complement that, and we will see a good increase in the success.

I understand your perspective. We are committed to sharing the results, and we will see how it plays out, and we will make adjustments.

Senator SCHUMER. Do you agree that there needs to be ramping up? And how long is that going to take?

Mr. STEEL. Right now it is happening, and basically as fast as we can, and we will get the monthly results on just a 1-month lag, and exactly what is happening. And we will come back to talk about them with you as much as you like.

Senator SCHUMER. Then FHA.

Mr. STEEL. I really think that I do not have anything to add to the debate. The President charged Secretary Paulson. He dealt with the negotiations on a bipartisan, bicameral basis. And for me to have an opinion about one ingredient in this stew I think would be a good way for me to get in big trouble.

Senator SCHUMER. That is why I asked the question.

[Laughter.]

Mr. STEEL. I know that.

Senator SCHUMER. Thank you, Mr. Chairman.

Chairman DODD. I am impressed, Mr. Secretary. You have learned that rather early in your tenure here. Normally a person spends years here before they understand the importance of that question. Thanks very much, Senator, for your questions.

We raised in this very point here, getting away from the ideological box, I mean, I think a lot of this has to do with whether or not you accept the magnitude of the problem. And I fall down on the side that this is a growing and larger problem, and it is going to contaminate the entire economy here if we do not address it. And if you accept this as being something that just happens from time to time, we are just going to have to wait it out, then you probably come at a different point of view on this.

But there is a growing number of people, I think serious-minded people, who really do believe that we have got to be more proactive here if we are going to stem what could be a far deeper and more serious set of economic issues. And the issue is housing, and the issue is foreclosure here. And if you do not accept that notion, then it seems to me you are going to dance around this thing continually. So I subscribe myself to the same views that Senator Schumer has raised as well, and hopefully we can start to deal with this, as we have on this Committee with Senator Shelby and others, who historically we have different points of view about the role of Government in all of this. But I think if we come to the same conclusion about this and think of some common ways to address it, we can be well served.

Any closing comments, Dick?

Senator SHELBY. I will be brief, but I have talked with some of the heads of our rating agencies, and without calling their names, one of them told me—I asked him, I said, ″What is the bottom of this?″ Senator Dodd alluded to this. It is very important to find the bottom before we find the solution because the solution that we think we have found will not work. But I asked him. He said he did not know. He did not know. And if he does not know, do we know?

I think it is very important working with you, and others, that we find the bottom of this, because I agree with Senator Dodd, it is going to get worse probably before it gets better. But we need to figure out what can we do and how best to do it.

Chairman DODD. I have one additional question I meant to raise here. There are probably a lot more I will think of later, but I meant to ask you about the FICO scores. You have talked about this to some degree.

As I understand it, you are going to exclude people from these workouts who have FICO scores below—above, rather, 660. And I do not—Chairman Bair, I do not know how you feel about that, but

my concern is—and I understand the point, and again, you have got people who should be in better shape on these things. But there can be a lot of different other circumstances. There can be a major health problem. There are all sorts of things that can throw a person into a very different category than just relying on sort of a bright line here, everything above and below. I wonder if you might comment on that.

Ms. BAIR. Well, I also had this question. This was an industry-developed protocol. But if you have a FICO score above 660 you can still get a fast-track modification. As I understand it, based on the conversations that we have had with ASF, if your FICO is above 660, that will trigger some additional income verification. But if the income verification analysis indicates that you cannot refinance and you cannot make the reset, you will still get a streamlined modification. But if you are below the 660, then they can basically just send a letter automatically and say, "You qualify. You get the 5-year extension." And that helps because the FICO is something that can be independently verified without talking to the borrower.

There have been problems with servicers and borrowers connecting, but by relying on a FICO, which can be verified without actually having to talk with the borrower, it can basically just trigger automatically a letter being sent to the borrower saying that they qualify.

Chairman DODD. There are also problems with FICO.

Ms. BAIR. I agree. I agree. It is, again—but I think the reasoning of ASF—and, Bob, you might want to add to this—was that this was just something they could do without having to have actual borrower contact and go ahead and make a modification.

Mr. STEEL. You are always having this tension, Mr. Chairman, of basically wanting to make this so that it is as systematic and as successful as it can be. But this is a guideline not a rule, to let the Hope Now group get as much done as they can as quickly as they can.

Chairman DODD. I thank you both. It has been a long morning for you and into the afternoon here, and I apologize again for the delay. And I am going to keep this record open because I am very confident other Members will have additional questions and comments they would like to raise as well. And I want to go to the second panel. You have been very patient.

So we thank you for coming, and we will follow up with you, but the record will stay open. Thanks very much.

I will invite our second panel to come right up here and join us. Wade Henderson is a longstanding friend of mine and someone I have a high regard for. He is the President and CEO of the Leadership Conference on Civil Rights. Wade, thank you for being here.

Michael Barr, Senior Fellow with the Center for American Progress, and Professor of Law at the University of Michigan. Alex Pollock is a Resident Fellow with the American Enterprise Institute. And Doris Koo is President and CEO of the Enterprise Community Partners, Inc.

I am going to ask our witnesses to join us here at the table, and I thank you for that. We are getting people squared away here. These gentlemen all have very—and ladies, have distinguished careers and records, and I am going to put all of that in the record.

So I want you to know you will be well served in your introductions here, but for the purposes of moving right along, I am just going to turn right to your testimony, and we will start with you, Wade, if I can, and then go to Mr. Barr—we will go right down the line, if that is all right. And I apologize again to you about the delay in all of this. Hopefully the conversation may have been of some value as well to you as you have listened to some of the conversation here. I have been invoking the name of Mr. Barr and Mr. Pollock here with some—I hesitate to use the word "liberally," Mr. Pollock. [Laughter.]

Chairman DODD. But I have been using your name liberally here in conversation, and I am deeply impressed with what you have both been talking about, and I would be interested in hearing you maybe modify your own prepared statements in light of some of the comments that were raised earlier about some of these suggestions.

Wade, good to see you and thank you for being here.

STATEMENT OF WADE HENDERSON, PRESIDENT AND CEO, LEADERSHIP CONFERENCE ON CIVIL RIGHTS

Mr. HENDERSON. Thank you, Mr. Chairman. It is an honor to appear before you today.

I want to begin by saying why the growing number of mortgage foreclosures is a critically important issue to the Leadership Conference on Civil Rights and the constituencies we represent. Simply put, the right to the American dream of home ownership has always been an important goal of the civil rights movement. Home ownership is the means by which most Americans build wealth and improve their lives and it is essential for stable, healthy communities.

For decades the civil rights community has been struggling not only to break down the barriers to access to housing itself, but also to the credit that most Americans need to obtain housing. The institutionalized resistance that racial and ethnic minority communities have faced in obtaining this credit, from redlining to the scourge of predatory lending, lies very much at the root of the crisis in which we now find ourselves.

And indeed, after years of denial by many, most Americans now agree that we clearly do face a crisis. The rampant use of reckless and irresponsible, as well as blatantly discriminatory lending practices in widely unsustainable housing markets has stretched millions of homeowners far beyond their means. Too many families now see their American dream slipping away, and it is profoundly disappointing that the end result of the subprime lending debacle has been less home ownership, not more.

It is clear that Congress must craft a swift, pragmatic, multifaceted response to the problem. At the same time, it is important to avoid steps that saddle future generations with debt, increase the costs of credit, or resort to bailouts that encourage more irresponsible lending in the future.

I am glad the Administration and the industry have ramped up their efforts. The so-called Paulson Plan and the Hope Now Alliance rightly deserve praise. Every home that is saved from foreclosure is a step in the right direction.

But these voluntary efforts alone are woefully inadequate. The Paulson Plan will only cover 3 percent of subprime adjustable rate mortgages and a substantial number of homeowners will inevitably fall through the cracks of any other program, including the Home Now Alliance.

The importance of preserving home ownership to our communities and to our Nation demands that more be done. So I want to discuss additional proposals.

Last spring the civil rights community proposed a voluntary moratorium on subprime foreclosures. We argued it would give the industry time before the occurrence of irreparable damage of more foreclosures to put homeowners into more affordable loans. While it is true that some borrowers used subprime loans to speculate during the recent housing boom, a moratorium would provide time to find and assist borrowers who truly deserve help.

Unfortunately, the response we received from the industry was underwhelming. Lenders and servicers pointed out their desire to minimize foreclosures but it was also clear that a comprehensive, industry-wide effort to do so had not taken shape.

Last summer the Leadership Conference and other civil rights and consumer groups then turned to Federal Reserve Chairman Ben Bernanke. In our meeting, it was clear the Chairman was looking at ways to prevent future abusive lending practices. But he was short on solutions for addressing the current wave of foreclosures.

Since then, the mortgage industry has begun to make progress. But it is also clear that the extremely complex nature of mortgage securitization and other issues, such as conflicts between primary and junior mortgages, continue to pose barriers to meaningful relief.

Given these difficulties and the high and unacceptable number of foreclosures, I believe that the idea of a foreclosure moratorium should be revisited. And indeed, I believe this Committee, Mr. Chairman, should explore methods beyond voluntary participation in which Congress should also take steps to greatly improve loan modification practices, including requiring meaningful loss mitigation prior to foreclosure, requiring detailed reporting on loan modification activities, and improving protection for loan servicers from investor lawsuits.

And while I recognize that this would be a step that some would be reluctant to make, the Nation is clearly facing a situation unlike any other in modern time. A forced cooling off period would give the industry time to further improve its own solutions and greatly ease public concern about the devastating toll the growing number of foreclosures is taking.

Now, even if a moratorium is imposed, it is also clear that these efforts will not help everyone in need. And that is why I want to associate myself with the remarks of my colleagues on the panel in support of your proposal, Mr. Chairman, for the Federal Homeownership Preservation Corp. We think that is an important step and we believe it is necessary to help provide the kind of additional relief that is required.

And finally, I want to recognize that while this issue is not properly before your Committee's jurisdiction, the idea of letting home-

owners seek relief in Chapter 13 proceedings still merits discussion here. I believe that as a matter of last resort, it is one of the best solutions available, and that this simple but important step should be included in the stimulus package that the Senate is now debating. And I hope, indeed, we will make progress in that regard.

Finally, Mr. Chairman, I want to close by saying that this is a complex and deepening crisis and it is going to require using every tool at our disposal to bring needed relief to families and communities and to stabilize the housing market and the entire economy. While I give credit to the voluntary foreclosure preservation efforts, homeowners simply cannot afford to wait for an industry that collectively created this mess and is now being devoured by it to take the lead in cleaning it up.

I want to thank you for your leadership in finding solutions to this problem, and I look forward to your questions.

Chairman DODD. Thank you very, very much.

Mr. Barr, thank you for being here.

STATEMENT OF MICHAEL BARR, SENIOR FELLOW, CENTER FOR AMERICAN PROGRESS AND PROFESSOR OF LAW, UNIVERSITY OF MICHIGAN LAW SCHOOL

Mr. BARR. Chairman Dodd, it is an honor to be here today to discuss with you measures to strengthen our economy, to help prevent foreclosures, and to preserve our neighborhoods.

My testimony today is based on work with the Center for American Progress and a team of experts from a wide range of public and private institutions. We have been working closely with your staff, Mr. Chairman, and appreciate the Chairman's strong leadership on this issue.

I would like to join my fellow panelists also, as I am sure they will, in applauding the work of FDIC Chairman Bair and her leadership on this issue. And all of us, I know, lament that the late Ned Gramlich is no longer here to help us through this difficult crisis.

Today, our economy is facing a real and growing crisis, threatening the longest, severest liquidity crisis and period of economic stagnation since the Great Depression.

Nowhere is that problem more evident than in the wave of home foreclosures, with foreclosures up by more than 60 percent over last year. More than 1 percent of U.S. households entered the foreclosure process just last year, up by more than 75 percent over the previous rate.

In addition to the pain caused by individual homeowners, there are significant spillovers to neighborhoods and to communities. And foreclosures are further depressing house prices which have dropped, according to the recent index, by 8 percent over last year. Further declines significantly and predictably increase defaults, and the vicious cycle continues.

It is generally agreed, Mr. Chairman, that we are not close to seeing the bottom. Many homeowners are under water and drowning fast, with loans far larger than their homes are now worth. Our neighborhoods and communities are suffering and contagion from the housing crisis is drying up credit markets, from prime housing to commercial paper, to State and local government bonds.

We risk a vicious downward spiral, not just in housing prices but also in credit markets more broadly and in the real economy. Strong government policy is what we need and we need it now.

We need a plan that will solve two problems. First, how can the market move rapidly and transparently to reprice existing mortgage pools, build capital, and restore financial stability? Second, how can the market renegotiate millions of home mortgage loans in a timely manner to avoid widespread default, foreclosure, and broader contagion? Both problems must be addressed to get us out of this crisis.

The thrust of our suggestion is to provide new authorities to existing public and private institutions to help resolve the mortgage crisis, restore confidence and liquidity to America's financial markets and provide a needed boost to the economy. For shorthand, we have been calling the approach Saving America's Family Equity, or the SAFE, loan program. This program could be run by your proposed corporation, which is providing the avenue to move forward on this kind of approach.

The proposal calls for a Treasury pricing platform that would enable FHA lenders, Ginnie Mae issuers, and the Government Sponsored Enterprises to buy out existing mortgage pools at a market-determined steep discount. The Treasury process would bring all key industry participants to the table, providing a platform for broad, large-scale restructuring with a standard industry practice and transparency in price discovery.

Investors would take a hit. They would get liquidity and certainty in exchange for reduced principle value and lower yield. Once the mortgage pools have been repriced SAFE participants, the GSEs and FHA, would be able to sort the loan pools into buckets, using core criteria set in advance: loans that ought not to be restructured, loans that can be restructured, and loans that can continue on a sustainable path without restructuring.

As Senator Shelby suggested, some of these loans should and are going to go into foreclosure. But many of them can and should be restructured. The core criteria would include debt-to-income ratio, loan-to-value ratio, and payments made to date. Only owner-occupied homes would be refinanced. Sorting the pools in advance would reduce the cost of refinancing. And the loans would be refinanced through existing origination channels on terms that would reduce the likelihood of default, foreclosure, and costly liquidation.

SAFE loans would have a maximum loan-to-value ratio of 80 percent, fixed interest rates, and 30-year terms. Prepayment penalties would be waived. SAFE mortgages would be pooled into securities and sold into the secondary markets. Loans originated through FHA-insured lenders and Ginnie Mae issuers would be FHA insured and Ginnie-Mae guaranteed. And other SAFE loans would be securitized by Fannie Mae and Freddie Mac.

Over time, our expectation is that market liquidity will be restored and the SAFE loan program would include an automatic shut-off valve to end the program once discounts offered are not sufficiently steep.

While important details would need to be worked out regarding the SAFE loan plan, one should be able to rely on existing Government agencies, mortgage market institutions, delivery systems, and

instruments if authorized and required to do so by this institution, not on a voluntary basis. We need legislation.

In addition, the SAFE plan focuses on moving forward on a broad scale basis. In this manner, implementation would occur relatively quickly, in comparison to models that would rely on creating a wholly new institution.

Our policy is decidedly not a bailout, either fore investors or for mortgage holders who made unwise or speculative decisions. Investors and speculators will take a hit. The SAFE plan, on the other hand, can help to keep families in their homes, clean up the credit markets, contain the contagion, and avoid a vicious downward spiral that drags down the economy.

I agree with Mr. Henderson and the other panelists that other steps are needed as well, that they have talked about and will talk about in more detail.

As you said in your opening statement, Mr. Chairman, monetary and fiscal policy alone, while important, cannot restore liquidity, stability, and confidence to our credit markets. If we fail to take action now to facilitate private sector resolution of the crisis we face a serious prospect of continued deterioration and the risk and the need for more aggressive Government intervention later, a risk that none of us want to face.

We have a shared responsibility for setting things right, and thanks to your leadership, we have a shared opportunity to act swiftly, decisively, and wisely to help American families through these trying economic times.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much. Appreciate your testimony.

Mr. Pollock, good to have you with us this morning. Thank you for being here.

STATEMENT OF ALEX J. POLLOCK, RESIDENT FELLOW, AMERICAN ENTERPRISE INSTITUTE

Mr. POLLOCK. Thank you, Mr. Chairman. Thanks for the opportunity to be here. And thanks very much for referring to me liberally. As many conservatives say, I am a classic liberal, with a general belief in the superiority of markets over Government interventions. But I am also a student of financial history and a student of the many severe busts that have taken place and what might be done about them, which inspires the thoughts we have having here.

Chairman DODD. Thank you.

Mr. POLLOCK. We all know that the housing and mortgage bust continues its panicky downward course. I want to stress the panicky part, because the key risk is a major downside overshoot. We had a giant upside overshoot in the bubble of the new 21st century, and the risk is we will have a downside overshoot that is just as bad. We need a correction. We need repricing. But we do not need the needless destruction of a major overshoot on the downside.

Now bubbles are notoriously hard to control. I take Senator Shelby's points—and maybe you could mention this to him since he has left—very seriously about the responsibility for decisions taken by both lenders and borrowers.

I have a view that to encourage better decisions and better financial behavior in the future, that there is an essential long-term reform we have to make. It is clear and straightforward disclosure to borrowers of what loans really mean to them, really mean to their household income. That ought to be done in one page.

Senator Schumer has introduced S. 2296 with this goal in mind. I hope its provisions would be included in any legislation adopted by this Committee, because it will definitely mean fewer foreclosures in the next cycle.

As for this cycle, our recent bust and the bubble which preceded it display all of the classic patterns of recurring overexpansions and their painful aftermaths, many of which I have studied and a good many I have actually lived through as part of my financial career.

Once the bubble has happened, the deflation of the bubble is inevitable. And once that is happening, there are no choices that we really like; we have to choose what is most sensible under the circumstances.

Unfortunately, we face the possibility of a self-reinforcing downward spiral of defaults, losses, and credit contraction. Chairman Bernanke has called this a "financial accelerator" which can accelerate in the downward direction. To use a different economics term, there is a risk of a debt deflation in this huge housing and mortgage sector. As I see it, this needs to be addressed.

As a classic liberal, my view is that 90 percent of the time such intervention is not a good idea. But about 10 percent of the time, in financial crises, it is. And we are in that 10 percent period right now, in my judgment.

At a recent discussion of the mortgage bust, a senior economist intoned, "What we have learned from this crisis is the importance of liquidity risk." "Yes," I replied, "that's what we learn from every crisis."

Can we learn anything from the history of mortgage crises? As you know, my view is that we can. In particular, there is a very suggestive analogy to our present foreclosure issues presented by the history of the Home Owners' Loan Corporation, which I think worked quite well under the circumstances. The circumstances were different, as Under Secretary Steel pointed out, but they are analogous. I think Professor Barr's program actually takes its inspiration from this same experience.

The Home Owners' Loan Corporation was created by Section 4 of the Home Owners' Loan Act of 1933. I do like to point out that it took only three and a half pages of statutory text and was written, I believe, in a very clear and forceful manner.

It was understood from the beginning as a temporary, emergency intervention. The fundamental idea was that for 3 years, and only 3 years, the Home Owners' Loan Corporation would acquire defaulted residential mortgages from lenders and investors in voluntary transactions to avoid foreclosure and avoid dumping properties onto already overburdened markets, which is exactly what we have today.

The lender did not just have a modification. It was actually relieved of a nonperforming asset, but in exchange took a loss on the principal of the original mortgage. Chairman Bair previously point-

ed out the importance of the ability to reduce the principal. The realization of the loss of the principal in the 1930s program was an essential element of the reliquification program, as it should be now.

This was a refinancing program that started off with a new permanent loan, not just a modification of an old loan. A similar, temporary refinancing function, in my opinion, would make sense now, given the risk that I mentioned of a downward, self-reinforcing cycle.

Home Owners' Loan Corporation was a Government corporation. The Treasury was authorized to invest $200 million in its stock. Now $200 million 1933 dollars as a proportion of GDP would be equivalent to about $46 billion today.

If I were thinking about what we need today, I would say about $20 billion to $25 billion of capital. If leveraged 16 times, that would give a financing capability of about $300 billion to $400 billion, which strikes me as a reasonable size if we are looking at an ultimate default rate of something like 4 or 5 percent of total mortgages.

During its life, the Home Owners' Loan Corporation made more than 1 million loans, which were about 20 percent of the mortgages in the country. It owned, by 1937, 14 percent of the dollar value of mortgage loans outstanding. If you translate those percentages to today, that would be 10 million loans and $1.4 trillion of loans outstanding. Fortunately, we do not need this scale of operations, since our own mortgage bust, while it is very serious, as you pointed out, does not approach the collapse of the 1930s, thank goodness.

An important factor in all of this is that such an organization, as an at-risk lender, will inevitably experience redefaults and credit losses. That has to be simply part of the plan and has to be understood as part of the program.

An essential provision of the Home Owners' Loan Act was its unambiguous direction that the directors of the corporation "shall proceed to liquidate the corporation when its purposes have been accomplished and shall pay any surplus or accumulated funds into the Treasury." As you know, of course, they did do that. I recommend a similar provision for any Home Owners' Loan Corporation II or home ownership preservation idea.

A number of specific design issues naturally arise in thinking about this idea. One central one I will mention is whether a new organization should be created or you want to expand an existing one, such as for example the FHA. The advantage of using an existing organization is you have infrastructure already in place. That can also be a disadvantage if the infrastructure does not work the way you might want it to.

A new organization has the advantage of clarity of purpose, a temporary nature, and more ready enforcement of the sunset when its purposes have been accomplished. My written testimony discusses a number of other such issues.

Thank you very much, Mr. Chairman, for taking an interest in the possibility of creating such a refinancing capability to help address the ongoing mortgage and foreclosure problems obviously so prominently facing us.

On the House side, I have also been working with Congressman Mark Kirk along similar lines.

Thank you again for the opportunity to be here.

Chairman DODD. Thanks very, very much. We appreciate it immensely.

Ms. Koo, thank you for being here, too.

STATEMENT OF DORIS W. KOO, PRESIDENT AND CEO, ENTERPRISE COMMUNITY PARTNERS, INC.

Ms. KOO. Thank you, Chairman Dodd.

And I want to applaud the other panelists, especially the Center for American Progress, for the SAFE plan and for working with Enterprise on the Neighborhood Stabilization Fund.

I come before you today to discuss a very silent aspect of this foreclosure crisis, and that is about the impact this crisis will have on low and moderate neighborhoods.

You said earlier, Chairman Dodd, as did Senator Mel Martinez, that this is about saving neighborhoods. And a whole aspect of our discussion today did not touch on the silent victims and the innocent bystanders in this crisis are those families who work hard, who paid up on their mortgages, who are not involved in subprime borrowing, who are paying up on their mortgages and yet have now witnessed a wholesale depression of their own home values and have to live among vacant and abandoned homes in increasingly depressing neighborhoods.

As you know, Enterprise is a national provider of development capital and expertise to create decent affordable homes and stabilize neighborhoods. In the last 25 years, we have raised and invested $8 billion in equity loans and grants to support the creation and preservation of 225,000 homes around the country.

I am sorry Senator Corker has to leave because he came during the very early days of Enterprise and asked Jim Rouse, our founder, to help him set up the Chattanooga Neighborhood Enterprise which, to this day, continues a very important work in the Chattanooga neighborhood.

So far I think Congress has rightfully focused on helping individual homeowners from losing their homes. But as we mentioned before, the rising number of vacant foreclosed homes are threatening the health and stability of many low and moderate income communities. And without Federal intervention and resources, these foreclosed properties will destabilize neighborhoods, erose tax base, and bring down property values of neighboring homes as we struggle to deal with the rising tide of foreclosures.

Enterprise wholeheartedly support legislators, responsible lenders, and counseling organizations in their efforts to prevent foreclosures. Our contribution in this effort will be in the area of neighborhood preservation and stabilization.

In my written testimony, I detailed several models to deal with the serious challenges of neighborhood destabilization and offered some policy recommendations on how the Federal Government can play a pivotal role in restoring these neighborhoods. They generally fall in three categories.

First is to build on existing models that work, like the Federal Asset Control Area program. Second, we should pilot new and cre-

ative local effort such as the foreclosure response pilots taking place in Cleveland, in Columbus, Ohio, and in a number of other cities and States. Third, the enormity of the situation tells us that we have to create new financing mechanisms to take solutions to scale.

In the interest of time, I am going to focus on this last approach. Enterprise supports the creation of a neighborhood stabilization fund to provide immediate and flexible capital to remove troubled properties from holders of foreclosed mortgages and place them in the hands of local agencies, qualified nonprofits, and responsible entrepreneurs whose mission and interests are to preserve neighborhood viability and turn community liability back into community assets.

This fund ought to provide flexible capital to buy, sell, fix, and whatever is necessary—including temporary rent out—vacant, foreclosed homes. Each local fund should provide some of the following needed funding mechanisms, including startup capital for land banks or land trusts to hold foreclosed properties for redevelopment; construction loans; affordable second mortgage loans that can leverage prime first mortgages, loan loss reserves, and funds for local governments to board up or demolish abandoned blighted structures in targeted redevelopment neighborhoods.

Whatever the method, the ultimate goal is to get owner-occupants back to these neighborhoods hardest hit by foreclosures. A $10 billion investment in a neighborhood stabilization fund, one that can easily stream through an existing source like the Community Development Block Grant Program, will not only stop neighborhood deterioration but also generate significant national economic benefits.

Using construction activity multipliers developed by Texas A&M University and the National Association of Home Builders, we estimate that a $10 billion investment into this fund would generate at least 2.5 times, or $25 billion, in direct and ripple effect economic activity nationwide; will employ 80,000 people; generate more than $2 billion in a one-time revenue for all levels of government; and restore nearly $150 million per year in local government real estate tax collection.

These funds can also leverage other development finance resources, including tax and accounting incentives.

Once acquired, these homes would immediately be rehabbed and reoccupied by income qualified families using affordable and appropriate fixed-rate mortgage products. And in many cases, substantial repairs will be required.

Where stagnant market conditions preclude home ownership as a viable option, these homes may then be rented in a short period of time through a lease purchase program until demand for home purchases improves.

These resources should be income targeted with equal emphasis to help low and moderate income families as well as very low income families that include seniors living on fixed incomes who are now trapped in negative equity or facing foreclosure themselves.

In conclusion, I thank you for your leadership, Chairman Dodd, and we urge Congress to include a neighborhood stabilization fund in the economic stimulus package as a bold response to the

blighting and economically disastrous impact of over 1 million foreclosed homes sitting vacant.

I look forward to answering your questions and embarking on some further dialog.

Chairman DODD. Thank you very, very much. And I thank all of our witnesses here again for your valuable, very valuable, testimony and ideas and thoughts.

I would just say, Ms. Koo, I raised the issue, by the way, of the Community Development Block Grant proposal on numerous occasions over the last couple of weeks as the stimulus package has been emerging different ways. And people have been receptive, but I cannot say I have had any success at this point in having anything like that included. Which I think is unfortunate because it is a quick way to begin—if you target it.

I mean, I get nervous about CDBG money being so fungible, it ends up being used for a lot of other different purposes here. But if you target it specifically so it is explicitly to be used to deal with foreclosed properties and allows communities to more immediately address these questions, you can offer some real help and it can be important in the short term.

Let me begin by asking you to respond, all of you, if you would. You heard, and I apologize, they are not here, very patient for members again with the late start this morning and busy schedules around here. But how would you respond to the number of colleagues who raised the issue, including my good friend from Alabama, the former chairman of this committee, that you have got to wait for this, this thing has not bottomed out yet. And if we end up coming up with some ideas here ahead of that—I do not want to put words in his—try to frame his question. But that notion that this has a way to go yet and we would be acting prematurely with some of these ideas if we did not wait until this issue bottomed out.

My own reaction—you never know when things have bottomed out until after the fact. It is always in retrospect when you say that was when it happened. But you rarely have ever heard anyone say this is the moment. We are here now, at the bottom, or near the bottom.

But nonetheless, in fairness to him and others who have raised that, it seems to me it is a legitimate question, that we should let the bubble deflate, I guess, on its own.

There was also a similar point that was made, that the market can really address this issue. My sense of it was Secretary Steel, while he was receptive to a lot of these ideas, I think underlying his comments were basically this is an issue that the market can address. And it is not as serious as others would make it suggest, that these numbers, 600,000 foreclosures a year, are pretty standard. And while this is above that, we do not know it is even going to be that much above it, let us not get ahead of ourselves.

How do you respond? Maybe we will begin with you, just quickly, on this question?

Mr. HENDERSON. Thanks, Mr. Chairman.

Look, I strongly believe that there is an urgency to this problem. That view is obviously not shared by those who believe that market forces alone can address the issue.

There is also a troubling racial and ethnic dimension to this problem that cannot be ignored, nor can it be explained by market forces alone. African Americans and Latinos, even given similar credit profiles with white borrowers, are three times more likely to hold subprime mortgages than their white counterparts. And the only explanation for that appears to be, at this point, some mechanism of steering the market in that direction.

Here is the consequence——

Chairman DODD. I raised this, you may recall, a year ago.

Mr. HENDERSON. I know you did.

Chairman DODD. This very issue, because it comes out——

Mr. HENDERSON. And you were right on target in terms of identifying what we see as a central problem in the crisis that has largely traveled under the radar and has not been addressed by the issue.

Here is the consequence. I mentioned in my testimony that we believe that home ownership has always been a goal of the civil rights movement. In 2005, home ownership among Blacks and Latinos was roughly 42 percent of the population—I'm sorry, in 1995. In 2005, which was the peak period in the housing market, according to HMDA data, home ownership among that same community was roughly 49 or 50 percent. So there had been a significant increase between 1995 and 2005 in home ownership opportunities among Blacks and Latinos.

The truth is that the percentage of purchase money mortgages that, in fact, were used to fund that growth were largely found in the subprime market. About 55 percent of African Americans held subprime paper and about 46 percent of Latinos held subprime paper.

The foreclosures that we are anticipating will occur over the next 2 years will have devastating impact both on the communities in which these individuals live, but on the individuals themselves. And from our perspective, it represents potentially the greatest single loss of wealth ever recorded among African Americans and Latinos in the country.

From our perspective, this has an urgency that cannot be ignored. And when you leave it exclusively to market forces to address the problem, you will likely lose a number of individuals who would otherwise be saved by a myriad of programs that we have talked about today.

Chairman DODD. Mr. Barr.

Mr. BARR. Mr. Chairman, I agree with you. I do not think we can afford to wait. I think that the easy trap in financial crisis is to wait too long and do too little and watch the bad news dribble out and not be on top of it.

I think we have seen that, as your opening statement and the statements of the other members indicated, we have seen that process from the private sector certainly over the last several years. Every quarter there is a statement that says everything is just fine or everything is going to be just fine. And then the next quarter there is an additional adjustment required for capital, additional write-downs, and additional evidence of a worsening crisis.

I think if you look at the evidence of intervention in financial crises in the past, in serious financial crises, they are far more—those

interventions are far more successful if they are done rapidly and at scale, rather than dribbled out and slowly.

Your leadership on the international financial crisis in the 1990s, I think, demonstrates that. And that is the kind of leadership that we need today.

The market solution here, in normal economic times, is the right answer. Markets correct, markets go up, markets go down. In normal times, I agree that is completely the right way of thinking about the problem. But I share Mr. Pollock's concern that we are not in those normal economic times right now.

And I think it really—the evidence is mounting that the United States is at a serious risk of a long-term recession and stagnation if we do not see the leadership now to break the vicious cycle and restore stability to our financial markets.

Chairman DODD. Mr. Pollock.

Mr. POLLOCK. Mr. Chairman, you ask a very good question. Of course, I tried to address this a little bit in my notion of the 90 percent and 10 percent, which I draw from Charles Kindleberger, by the way, the great economic historian. When asked who is right, Adam Smith and the invisible hand or Keynes and intervention, said "Both, depending on the circumstances."

Chairman DODD. The kind of thought Harry Truman liked to talk about.

Mr. POLLOCK. Just as we don't know the bottom, as you so correctly point out, Mr. Chairman, we don't know the tops either, until after the fact. As bubbles are expanding, there is always someone who can write a book like "Dow 40,000" or in this current bubble, a book about why the real estate boom will not end so you can always make money on houses.

If you have had a bubble, which is a far departure from trend in price, financed by what becomes clear in retrospect to have been overexpansionary credit, what always happens is that leverage grows greater. Of course, leverage is the snake in the market Garden of Eden.

One way to think about all of the structured financing we have seen, is as ways to increase leverage in clever ways, including the bond insurance companies that Senator Shelby so rightly asked about, all ways to increase leverage.

So typically, as the bubble expands, leverage is increased. Now what should happen, if you were really doing this right and you were a philosopher king, is that you should be lowering your loan-to-value ratios as prices increase in the boom.

On the other side, as you are coming down, everybody grows conservative, credit contracts, we de-leverage. And at a certain point, just in mirror image, you ought to be stepping up to more credit as the prices fall. But it is very hard for people to do it. And that is where I think this kind of Home Owners' Loan Corporation type analogy actually makes a lot of sense.

So where will the bottom be? Well, you have the risk that the bottom will be far worse and far further down than it needs to be if the panic psychology and the self-reinforcing cycle goes like this. Defaults, of course, result in credit withdrawal, as we have already seen. Credit withdrawal reduces demand for properties. The price of properties is falling. The price of properties falling, with great

statistical regularity, causes higher defaults, less credit available, higher standards, more deleveraging, further price declines, further defaults, and foreclosed inventory dumped on the market. That is the downward cycle in the 10 percent of the not-so-well functioning times.

That is where I think these ideas, that at least three of us here believe are worth thinking about, really can come into play.

Chairman DODD. And so when I was saying earlier the question, I guess it is how you look at all of this. If you see this thing exactly as you have just described this, where this could be headed—and that is not to be an alarmist at all. We always try to be careful about language that we use, particularly as I sit in this chair here, knowing that my language and the words that I use can have their own self-fulfilling prophecy to them.

But I carefully thought this morning about whether or not I had expressed my deep concerns about where this is going. And I really am concerned about where it is going and the failure to understand and accept that. Hopefully I am wrong. I am not wishing this. But understanding that all the keys and all of the evidence point to that. Then it seems to me this is a time when you have got to step up and talk about—and I agree with Mr. Barr and I am confident you do, as well, Alex. And that is that under normal cycles here you would not even be thinking about something like this, at all, the need for it.

And that was my reaction a year ago when this began to happen, saying let's try this. Last year I went out with a piece of legislation here and, in fact, if you can get the kind of modifications and so forth that seem natural enough that the lending institutions would want, clearly the borrowers want, why not let that work? But obviously, that has not produced the desired results.

Under the question of the—when I asked Secretary Steel about it, he made some historical comparisons between the very modest amount—and you talked about earlier, that is where I draw the 1930s when a similar idea was surfaced. And it worked pretty well. But he said then you had 50 percent foreclosure rates and the economy was in much deeper trouble than the one we are talking about today.

How do you respond to that? What would your answers be to his historical analysis that this is nowhere near a situation that would warrant that kind of an action?

Mr. POLLOCK. In my paper that the American Enterprise Institute was kind enough to publish on this historical experience, I go to some lengths to point out what the 1930s situation was, including the numbers that the Under Secretary cited. It was actually at 50 percent of the loans in default. They were also in default on their property taxes, unsurprisingly. Those property tax liens were something they had to clean up along the way.

I think the analogy is clear. It is our good luck, and we hope we never have to face as total a collapse as our grandparents did and try to figure out what to do. But the analogy of the downward self-reinforcing cycle, I think, is quite close—on a less intense scale, but still a large, important and very worrisome scale.

When we talk about where we are going, we know house prices are going down. It was only 6 months ago that people were still

making speeches about "this is a contained problem, it will not be that bad." And they were very well-informed, smart people. It is always hard to know where we are headed.

But we do know that when everybody gets scared at once and uncertainty premiums become very high, you get in this danger of the big downside overshoot. And that is where these ideas, I think, can be useful.

Mr. BARR. I would just agree with Mr. Pollock on the importance of the historical analogy. I do think that if you look back at the time period, in the year of the creation of the Home Owners' Loan Corporation, you had 1 percent of Americans in foreclosure. We do not have that yet, but we have 1 percent of Americans who have entered the foreclosure process. And I think that is really a striking example of the historical analogy.

I should also say, just repeating the emphasis of the urgency of this, if we fail to act now we really risk serious downside stagnation of the kind that Japan went through that this committee is fully aware of in the 1990s of stagnation because of the combination of having expended all its fiscal tools and expended all its monetary tools and having significant overhang of non-performing loans. And we are beginning to look a lot like that.

So I think the Committee is absolutely correct and the Chairman is correct that now is the time to really take this up.

Chairman DODD. Let me be the devil's advocate of my own—my idea, your idea, our ideas on this thing, and just raise some questions that I tried to think of that I presume I will get, and probably a lot more than these, but ask you the questions and see how you would respond to them, as well.

One of the concerns that we are told we can face here is that so many of the subprime loans include piggyback second mortgages. And that while you are dealing with the subprime problem here, how do we address—can we address the piggyback loan? Because a substantial number of the people in the situations are exactly in that situation, that these were refinances that are occurring here.

What is the answer to that?

Mr. BARR. Well, I think that, as you saw from this morning's panel discussion, this is an enormously complicated problem. The second mortgages complicate things further. I do not think that we should prevent the existence of second mortgages on some aspects of the loans to prevent us from addressing the loans that we can address with only first liens that have been refinanced, and that is the whole mortgage.

I do think that there are ways of addressing second mortgages. They are likely to involve even deeper investor pain than those involving first mortgages and I think that is, you know, again a result of really horrible, weak underwriting standards that were conducted not just on first liens but on second liens.

Mr. POLLOCK. Mr. Chairman, the first answer to that point is you are absolutely right. There are second liens in this issue, and second liens are a problem. That is another positive analogy to the 1930s, by the way. Second liens were very popular in the real estate——

Chairman DODD. Yes, tax liens and others you talked about.

Mr. POLLOCK. No, I am talking about second mortgages.

Chairman DODD. Second mortgages. All right, I am sorry.

Mr. POLLOCK. Of course, you also have tax liens. But second mortgages were very popular in the 1920s and were one of the problems that the Home Owners' Loan Corporation faced.

One of the good things about foreclosure, if I can put it this way—and foreclosure, of course, is right in some instances—is that it takes care of the second mortgages by wiping them out. You do not want to have a program which redounds to the benefit of the second lien holders while you are giving a haircut to the first lien. And any program like this, I think you have to settle out the second liens in some fashion.

And that is what the 1930's experience was. There was a negotiation as part of the purchase of the mortgage by the Home Owners' Loan Corporation. They had to settle out the second liens. And the second liens will have some negotiating power, maybe for a couple pennies on the dollar.

Chairman DODD. And of course, the other question, I think, and I do not have any fast answer for you. There were people here who obviously did not go into this stuff. All their antenna went up and they said if it sounds too good to be true, it usually is, and I am staying away. Or I think I will buy a more modest place than the one I would like to get here.

And you can almost hear people saying all of a sudden now I am stuck with that mortgage. I am eating it, but I am doing it. And here people often did not do their homework enough here. You are rewarding them, I am stuck here in this situation.

I guess the answer to that is you are right, and again but you are not helping me solve the problem. I have got a problem here that is causing a bigger issue.

But the moral hazard issue of another one, you can see someone—again, this is a harder question, I suppose, to answer—that there are people who the mortgage is not quite distressed. You have got hard times. You are trying to hold on. And you are saying to yourself, sitting around that kitchen table at night after the kids have gone to bed, look, there is a new program out here. And if this mortgage becomes distressed, we get a whole new deal. Why not just stop payments here for a couple of months, get into that program. We will get a lower price, get a fixed rate mortgage. We will save ourselves a lot of money here. And we are fools not to take advantage of this.

Mr. BARR. I think, Mr. Chairman, those are legitimate concerns. I think, again, in normal economic times you would not want to set up a program—although we do all the time. But you would not want to try and set up a program that makes some homeowners eligible and others not.

I would say there are three answers to that. The first is that homeowners who are not in the program are suffering harm now. Those homeowners, the neighbors are suffering harm. And they are going to suffer harm unless you help their neighbors out. So this program is going to, in its narrowest sense, help some homeowners and not others. But in the broader sense it means my neighbor's home is not being foreclosed on. There is not crime in my house next door. My kids can walk to school without going past the crack

dealers. This is a program for all Americans. It is not a program just for the people who are narrowly helped in the program.

I think the second level of response is, in terms of the program structure and moral hazard, you would want to be careful not to set eligibility rules so that people who are defaulted are the ones eligible and people who are paying are not. And you will see in the program description that we have suggested, there are ways to go forward so that you are not focusing on defaulted loans, although they would also be in. You are focusing also on loans that are at risk of default.

Because the borrower is doing just what you have said. They are trying to keep up with their payments. They are working hard. They are trying to make the payment. But the house prices for their neighbors are declining and they have nothing they can do. I think both those elements are critical.

I guess I would say the last thing is you would want to set up a program that does not create moral hazard for the investors and for the securitizers and that part of the industry. And that is why I think it is really critical, whatever route that the Committee and the Congress decides to go, that investors take a substantial haircut as part of that process. There is shared responsibility along with shared opportunity.

Mr. HENDERSON. Mr. Chairman, I do think that we should require some meaningful loss mitigation efforts in advance of allowing borrowers to take advantage of a newly created program. I think you have to be able to document what steps are actually taken on the part of the borrower as well as the mortgage company that holds the note.

And in the final analysis, if you are not protecting borrowers or loan servicers from investor losses, then you are simply inviting a real problem. I agree with Mr. Barr that again, those who hold the notes have to share in some of the responsibility.

My concern right now though is that when you hear—and going back to your earlier question about those who are concerned about intervening in the market—we have been hearing that now, as you pointed out, for over a year. And in the process, we have seen hundreds of thousands of borrowers, some who could legitimately have been saved, who have lost their homes and have been forced into bankruptcy.

We are not advocating, for example, using Chapter 13 as a wholesale bailout. But we are saying that as a matter of last resort, when all else has failed and when good faith steps have been taken, there does have to be some resort at the end of the day that can allow borrowers to hold onto their homes if possible. And we think, for that reason, that the Durbin bill, which looks at using Chapter 13 in that way, is an appropriate response to the problem.

So it is really about combining a number of the solutions we have heard today in a meaningful way.

Chairman DODD. What I want to do is submit for you, I will not keep you longer today on this one, but the mechanics—I have some mechanical questions I would like to ask on how the auction process would actually work and setting price and so forth. Those are the obvious questions we are going to have people raise as we try

to move forward with this idea and develop some strong bipartisan support for this idea and concept along the way.

I wonder if anybody would comment, there was the article by William Gross in today's Washington Post. I do not know if you had a chance to look at this or not. But he argues that we are headed toward a Japanese-type property market crisis. He says that an expanded FHA program is needed, a program that offers below market 30-year mortgages to people.

Other private sector firms have approached us about making it easier for delinquent borrowers to get FHA loans. That was raised earlier, Sheila Bair raised that. FHA Secure has apparently not achieved that goal.

What are your thoughts about that? Do you have any comments on that? Ms. Koo, do you have any comments on that?

Ms. KOO. I do not think I am qualified to comment on that particular question. But I do want to talk about the timing of the market later.

Chairman DODD. I will come back to you on that question.

Mr. POLLOCK. Just as a preface on the issue of people going into default to get advantage from a program, you are going to have some of that. I found an article written in 1935 by Morton Bodfish, who was the then head of the U.S. League for Savings. He said oh, these people are just defaulting so they can get in this government program.

That is part of the cost I think you have to reckon with. And the answer is: well, you have a bigger problem, just as you said, Mr. Chairman.

On the FHA, these Bill Gross ideas, as you mentioned, functionally sound very much like creating a refinancing opportunity at a loss in principal to the original lender and a permanent loan on a sustainable basis for the borrower. So it sounds to me like a very similar functional idea. Then you can have a discussion, as I mentioned in my testimony, about what vehicle you might try to use for that.

I do not think we ought to be about creating a government housing bank on a permanent basis. The universal experience in the world is those are a disaster.

Chairman DODD. I agree with you on that.

Mr. POLLOCK. And so that is why I focus on the temporary nature.

Chairman DODD. And I am more inclined to go with existing platforms to the idea you can do this. I appreciate your point that you get more clarity. It is more difficult to sunset something if it is built into an operation where all of a sudden it becomes part of your portfolio and you want to keep it around. But I think the tradeoff is better that you get something, expertise built into an FHA, the GSEs in some way, that you can allow that—you do not have to go around hiring a bunch of people. You can probably use existing personnel to make it work.

So there are, I think, some obvious advantages of—and that would be appealing, I think, to people who are concerned about you are going to create a whole new entity here that—yes, you all talk about sunsets. Nothing ever goes away in Washington once you create something.

Mr. BARR. I agree with that very much, Mr. Chairman.

I would just add the key is, on using these existing institutions, FHA and the GSE, to be sure that the program rules work in such a way that the investor is taking a haircut that permits the write-down of principal value. There is some talk in this policy discussion behind the scenes about programs that, in my judgment, would be simply transferring the investor risk to the Government through FHA programs. And I think we ought to be quite cautious about ensuring that in the process of restructuring and refinancing these loans, the investor takes the appropriate haircut so that the new loan is affordable and the risk is not simply transferred to the Government or to the GSEs.

Chairman DODD. I agree with that, too.

Ms. Koo, you wanted to make a comment?

Ms. KOO. Yes, Mr. Chairman. The whole question you asked earlier about should we time the market, to me is a very academic question right now. When you hear all the disproportionate suffering that is hitting low and moderate income communities.

And I want to posit that in this day and age we know better how to hold public/private partnerships together. I, by no means, am supporting bail out or supporting the notion that any Government effort will essentially be letting investors go free. But I think there are mechanisms that the Federal Government can take, such as tightening the whole—offering CRA credit for banks that would donate properties at this time, that you require the haircut before the neighborhood stabilization fund investment would come in.

But there is now a community development industry of nonprofits such as the Hope Now Alliance on the rebuilding side that involve philanthropy, involve corporations, that are ready and willing to put money in to help resolve the situation. And all they are looking for right now is a clear and decisive signal from the leadership of this country, from the Government, to say we have a crisis, let's help resolve it. And not use the wait and see attitude.

Because in that sense, you are going to abandon a lot of the lessons that we have learned in 20, 30, 50 years to correct the crisis before it goes too far.

We have also learned about the moral hazard debate when we went to the Gulf Coast to try to help rebuild the devastation caused by Hurricanes Katrina and Rita. And there are some homeowners who would like to try to claim assistance that they do not deserve. But the bulk of the homeowners need that support. And I do not think this is the time to debate that question.

Chairman DODD. Well, listen, this has been very—this hearing has gone 3 hours, three and a half hours. Literally, we could spend the rest of the day on this. You all understand the demands on other Senators up here and the fact that they stayed and listened as long this morning and had some good questions, I thought. Your testimony will be valuable to their staffs.

There will be some additional questions they would like to ask. I would like to invite you to stay very involved with this. The idea was not just to have a hearing today to sort of say we've talked about the issue. But I have the sense of urgency about this. We are going to be reaching out now to members on both sides of this dais up here to find out whether or not there is some common ground

we can work on here to begin to move on this. And I will be soliciting your advice and counsel, if I can, to help us work our way through this and answer the kinds of questions that I am sure others will raise here about whether or not something like this can work.

And again, I do not think there is any one silver bullet. I think there are a variety of things that can be done here.

I have often said, and I felt this, and again I hesitate to say this in front of an economic historian, but I suppose it depends on who is writing the book. But it always occurred to me, reading back, I have always been fascinated by this 100 days that everyone has lionized between March 1933 and June 1933. I just finished reading a biography of Henry Wallace. He happened to be from Iowa. I do not know why I read a biography of Henry Wallace about Iowa.

But nonetheless, with all due respect to the history, the historical parts about Iowa were fascinating. But the real fascinating history begins when he goes to Washington as the Secretary of Agriculture in the first Roosevelt Administration in March 1933. And then that wild period that goes on that has been, as I say, sort of a lot of mythology about it.

But one of the things that struck me about it is not so much what they did. And they did some things. But it was the level of movement. It was the confidence building action that people were stepping up and trying to help out.

Again, I think you can over-exaggerate the importance of that, because clearly things have to be done. But I do not think you can over-exaggerate the importance that people out there see leaders in their country rolling up their sleeves, going to work, and understanding what people are going through and trying to make a difference.

It does not solve the problem. But the thing I worry more is the intangible lack of optimism, the intangible lack of confidence that tomorrow this is going to get OK. And I know that is not working or this is not working particularly, but there are people who are going to make a difference.

Again, I am sounding like I am exaggerating the importance to that. But I have a feeling that had an awful lot to do with people's sense of hope here. And I think that we are in a critical moment here with a lot of bad news out there, that we demonstrate to people in this country that despite all of the other differences here, just as a Michael Barr and an Alex Pollock can come from a different perspective to a common conclusion, that this is maybe one idea we ought to consider.

And I am not trying to lionize it, but nonetheless, this is what is needed desperately in the country, that they are looking for that kind of leadership. I think we have got to try and go that, meet that goal here. So I am deeply grateful to all of you to follow on additional conversations and leave the record open.

I thank you very much.

Mr. BARR. Thank you, Mr. Chairman.

Chairman DODD. The Committee stands adjourned.

[Whereupon, at 2:21 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

Statement of Senator Tim Johnson
Senate Banking Committee
"Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation"
January 31, 2008

Chairman Dodd, thank you for holding today's hearing on foreclosure prevention and other possible options to address our economy's weaknesses from the subprime mortgages crisis. I think we all know how timely and important this hearing is today.

I look forward to testimony of today's witnesses, and hope that it provides a closer look at programs currently being used to address the foreclosure crisis like HOPE NOW, and other ideas like a Federal Homeownership Preservation Corporation that could provide more relief. We are in urgent need of good advice.

Earlier this week, new home sales posted the biggest drop on record, and that is expected to continue this year. Median home prices are down 10% from last year, and the nation's home builders continue to report losses. In my state of South Dakota, total homes sales fell. None of these reports bode well for the economy.

I continue to hear from South Dakotans impacted by the subprime mortgage crisis. Those who have Adjustable Rate Mortages (ARMs) were aware when they financed their homes that their payments would increase, but were not prepared for the drastic increase when it came. It doesn't help that Americans face high health care costs and prescription drug prices, stagnant wages, unemployment, elevated energy prices and dwindling savings.

I also have great concerns of the impact of the subprime mortgage crisis outside the subprime market. I am concerned about the record write-downs of many of our nation's largest banks, and we now see reports that homes financed by conventional mortgages have also dropped. If the availability of financing dries up, decreases in interest rates may not serve their intended purpose. It is yet to be seen the full effect of the subprime crisis on small lending institutions and the availability of credit to their customers.

As Congress considers an economic stimulus package, we must address the weakening of the housing market. When the Department of the Treasury estimates that an additional 1.8 million loans will reset during 2008 and

2009, we need to bring all available options to the table to prevent further foreclosures. The HOPE NOW initiative is making strides, but the solution should also utilize the FHA loan program for individuals and expand options for banks to access liquidity in the secondary market. We must also allow Freddie Mac and Fannie Mae to be part of the solution in a safe, secure and regulated manner.

It is my hope that today's hearing will provide Banking Committee members with a better idea of additional programs and legislative items that could be beneficial to those facing foreclosure and provide a stimulus to the economy as a whole.

Statement of U.S. Senator Elizabeth Dole
Banking Committee Hearing on "Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation"
10:00 a.m. Thursday, January 31, 2008 - 538 Dirksen
Opening Statement

Thank you, Chairman Dodd and Ranking Member Shelby for holding this important hearing on foreclosure prevention and neighborhood preservation.

Let me first start off by saying a few words about Sheila Bair, the chairman of the Federal Deposit Insurance Corporation. Sheila has a long history of public service that includes working as Deputy Counsel and Counsel when my husband was Senate Majority Leader. Sheila, thank you for your continued government service and the vital role you are playing to assure competence and confidence in this volatile housing and financial market.

During my time in the Senate, I have made homeownership one of my top priorities. It is amazing how getting keys to one's own home is like getting the keys to a better quality of life and a brighter future. Parents who own their homes provide more stable environments for their children. These children do better in school and become more involved in the community. These families are able to build wealth, many for the first time, thereby helping secure funds for retirement and higher education. Families who own their own homes also are more likely to spend the money necessary to properly maintain the home and thus improve the neighborhood. These positive results have a ripple effect throughout the community…and the economy.

The homeownership rate is still close to 70 percent and minority homeownership is around 50 percent. While these numbers are promising, we know there is trouble in the U.S. housing market. According to RealtyTrac, a mortgage researcher, in 2007 there were 2.2 million foreclosure filings, up 75 percent nationally from the year before. In my home state of North Carolina, foreclosures in 2007 rose to approximately 50,000 last year, a 9.4 percent increase. Furthermore, according to the Triangle Business Journal,

Wake County, which includes Raleigh, had 4,461 foreclosures during 2007, up 20.2 percent from the 3,711 posted in 2006. These statistics point to the alarming fact that foreclosure filings were on the rise in 2007, and it appears that this trend may not end in the near term.

One of the ways that we can help combat increasing foreclosure rates is the modernization of the Federal Housing Administration (FHA). Updating the FHA program will be of vital assistance to folks who are in risky mortgages and will help them find safer products. I want to thank Chairman Dodd and Ranking Member Shelby for taking up this important piece of legislation last fall and also for working with me to resolve the issue of credit score risk-based pricing, which our Senate-passed bill addresses by placing a one-year moratorium on this practice. I hope that differences between the House and Senate versions of FHA modernization legislation will be worked out soon as possible, so we can get a finished product to the President for his signature.

In December, Chairman Dodd introduced the Home Ownership Preservation and Protection Act of 2007, which has helped "jump-start" a discussion surrounding the issue of predatory lending. It is my hope that this committee will work in a bipartisan fashion as we roll up our sleeves and dig in to tackle a difficult yet timely issue. When we start talking about predatory loan legislation, we must strike a careful balance between protecting Americans from faulty loans while maintaining legitimate financial options for qualified individuals to become homeowners. I look forward to working with members of the committee concerning this important subject.

Lastly, let me reiterate my support for comprehensive GSE reform legislation early in this session. As the President mentioned during his State of the Union address, this reform is all the more urgent, now that it appears that the conforming loan limits for Fannie Mae and Freddie Mac will be lifted temporarily as part of a Congressionally-enacted economic stimulus package. I know this is also an issue of concern for Senators Hagel and Martinez, and former committee member, John Sununu. I welcome the comments you have made in recent days, Chairman Dodd, indicating your commitment

to comprehensive GSE reform, and I look forward to working with you, Ranking Member Shelby, and other interested committee members to finally get this bill done.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

STRENGTHENING THE ECONOMY: FORECLOSURE PREVENTION AND NEIGHBORHOOD PRESERVATION

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
U.S. SENATE

January 31, 2008

538 Dirksen Senate Office Building

Chairman Dodd, Senator Shelby, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding foreclosure prevention and neighborhood preservation. As the Committee members are well aware, problems in the subprime mortgage markets are affecting the broader U.S. housing markets and the economy as a whole, and pose a significant policy challenge for the industry and regulators.

We are now entering a second year of significant distress in U.S. mortgage credit performance. Based on data from the National Delinquency Survey of the Mortgage Bankers Association, we estimate that there were approximately 1.1 million foreclosures in the first three quarters of 2007, an increase of over 60 percent from the same period in 2006. Current market conditions indicate this negative trend will continue, as a significant rebound in housing market activity or home prices is unlikely during the coming year. Problems in mortgage credit performance are expected to continue as the downside of this housing cycle continues to play out. Although much attention has been focused on the impact on borrowers from payment resets on subprime hybrid adjustable rate mortgages (ARMs) which were building throughout 2007 and will peak this year, we also should anticipate additional credit distress from payment resets on other nontraditional mortgages, such as interest-only or payment-option loans, as we move forward in time and as market conditions remain relatively weak.

The combination of declining home prices and scarce refinancing options will stress borrowers with subprime hybrid ARMs and other nontraditional mortgage loans and could result in hundreds of thousands of additional mortgage foreclosures over the next two years. These foreclosures, if they occur, will inflict financial harm on individual borrowers and their communities as they drive down home values. Studies show that property sales associated with foreclosures tend to reduce average home prices in the surrounding neighborhood, placing stress on remaining homeowners and their communities.

My testimony will provide some brief background on the current situation and describe an approach to loan modifications that I believe provides the best means we have at this juncture to avoid unnecessary foreclosures and provide for long-term, sustainable solutions. While recent agreements have incorporated many of the strategies I have been advocating, progress in achieving actual loan modifications has been unacceptably slow and the increasing levels of foreclosure remain too high. In addition to discussing loan modifications for subprime hybrid ARMs, my testimony also includes a discussion of additional developing problems in the mortgage industry, including the upcoming resets of many Alt-A[1] and prime nontraditional mortgages, as well as possible strategies for addressing the issues they will create.

[1] Alt-A loans are those made under expanded underwriting guidelines to borrowers with marginal to very good credit. Alt-A loans are riskier than prime loans due to the underwriting standards of the loans, not necessarily the credit quality of the borrowers.

U.S. Housing Markets and Mortgage Credit Performance Have Deteriorated

The U.S. housing boom of the first half of this decade ended abruptly in 2006. Housing starts, which peaked at over 2 million units in 2005, have plummeted by half, with no recovery yet in sight. Home prices, which were growing at double-digit rates nationally in 2004 and 2005, are now falling in many metropolitan areas and for the nation as a whole. With declining home prices, there are large increases in problem mortgages, particularly in subprime and Alt-A portfolios. The deterioration in credit performance began in the industrial Midwest, where economic conditions have been the weakest, but has now spread to the former boom markets of Florida, California and other coastal states.

Over the past year, investors and ratings agencies have repeatedly downgraded their assumptions about subprime credit performance. A study published over the summer by Merrill Lynch estimated that if U.S. home prices fell by just 5 percent, subprime credit losses to investors would total just under $150 billion and Alt-A credit losses would total $25 billion. The latest data show that the Case-Shiller Composite Home Price Index for ten large U.S. cities had fallen in November to a level that was already 8.4 percent lower than a year before, with futures traded on this index now pointing to the likelihood of further declines over the coming year.

The complexity of many mortgage-backed securitization structures has heightened the overall risk aversion of investors, resulting in what has become a more

generalized illiquidity in global credit markets. These disruptions have led to the precipitous decline in subprime lending, a significant reduction in the availability of Alt-A loans, and higher interest rates on jumbo loans. The reduced availability of mortgage credit has placed further downward pressure on home sales and home prices in a self-reinforcing cycle that now threatens to derail the U.S. economic expansion.

Subprime Hybrid Mortgages and Securitization

The current problem in subprime mortgage lending arose with the rapid growth of 2- and 3-year adjustable rate subprime hybrid loans after 2003. Between year-end 2003 and mid-2007, nearly 5 million of these loans were originated. Of these, just over 2.2 million loans with outstanding balances of $441 billion remain outstanding.

The typical structure of these loans has been to provide for a starter rate (usually between 7 and 9 percent), followed in 24 or 36 months by a potentially steep increase in the interest rate (often as much as 3 percent within the first year after the reset depending on the level of market interest rates) and a commensurate change in the monthly payment. Almost three quarters of subprime mortgages securitized in 2004 and 2005 were structured in this manner, as were over half the subprime loans made in 2006. Most of these loans also imposed a prepayment penalty if the loan was repaid while the starter rate was still in effect.

During 2008, subprime hybrid ARMs representing hundreds of billions of dollars in outstanding mortgage debt will undergo payment resets. Based on owner-occupied subprime mortgages included in private mortgage-backed securitizations (MBS), the FDIC estimates that almost 1.3 million hybrid loans are scheduled to undergo their first reset during 2008.[2] An additional 422,000 subprime hybrid loans are scheduled to reset in 2009, which means these problems will not end anytime soon.

Given the steep "payment shock" these loans may impose on subprime borrowers, most were only able to perform through refinancing. For a time, rapid home price appreciation in many areas of the U.S. allowed even highly-leveraged borrowers to refinance or to sell their homes if necessary when the loans reset without a loss to themselves or mortgage investors, thereby masking the underlying weakness of the structure and underwriting of these products. In today's much more challenging environment, payment reset will lead less often to refinancing and more often to default and foreclosure.

The securitization of these 2/28 and 3/27 subprime hybrid ARMs has been very common in recent years and increases the complexity of achieving loan modifications. While initially there was concern that the securitization documents and the pooling and servicing agreements (PSAs) might place limits on the ability of servicers to modify loans in the securitization pool, most documents provide the servicers with sufficient

[2] FDIC estimates are based on the Loan Performance Securities Database. They reflect data collected through August 2007 on first-lien mortgages secured by owner-occupied properties where the mortgage has been securitized in private MBS issues. These figures have been adjusted to include an estimate of subprime securitized loans that are not included in the Loan Performance database.

flexibility to modify loans. In practice, however, third party servicers have been slow to exercise this flexibility on a large scale.

Two key elements of most PSAs determine how servicers can modify loans. While the language varies, the majority of PSAs require that servicers: (1) protect the interests of investors, and (2) conduct a net present value (NPV) analysis when determining the appropriate loss mitigation strategy in a default scenario.

Under the guidance developed by the American Securitization Forum (ASF), servicers should be bound to the interests of bondholders in the aggregate.[3] This guidance provides a common sense approach to a very thorny issue because it simplifies the servicer role in attempting to protect investor interests overall by limiting losses to the pool, instead of trying to consider how each loss mitigation decision will impact each class of bondholder and speculating as to what the various classes might desire.

In evaluating loss mitigation options, servicers determine whether the net present value of the payments on the loan as modified are likely to be greater than the anticipated net recovery that would result from foreclosure. Particularly in today's declining housing market, the NPV of keeping resetting mortgages at the starter rate generally will be

[3] American Securitization Forum Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, June 2007 (page 4). ("Generally, the ASF believes that loan modifications should only be made: a. consistently with applicable securitization operative documents (including amendments that can be made without investor or other consents); b. in a manner that is in the best interests of the securitization investors in the aggregate; c. in a manner that is in the best interests of the borrower....")

greater than the NPV of foreclosure and will be in the best interest of the securitization of the pool as a whole.

Studies show that foreclosure costs can run to half or more of the loan amount.[4] These loss rates will only rise in today's troubled housing markets -- particularly if more subprime borrowers are needlessly pushed into foreclosure. Studies also show that foreclosures tend to drive down the value of other homes located nearby.[5] As these loans reset from the starter rate to the full contract rate, credit losses will mount as more borrowers default and enter foreclosure. This will be self-defeating for investors, impose hardships on homeowners, and have wider negative effects on local communities and the overall economy.

Achieving Long-term Sustainable Loan Modifications

Last October, I proposed a systematic approach to addressing subprime adjustable rate mortgage loans for owner occupied properties where the borrowers are current on their payments but will not be able to maintain the payments following reset. If servicers do nothing and allow all of these loans to reset to the full contract rate, the result will be the eventual default and foreclosure on hundreds of thousands of additional loans.

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[4] Karen Pence, "Foreclosing on Opportunity: State Laws and Mortgage Credit," Federal Reserve Finance and Economics Discussion Paper 2003-16, May 13, 2003, p. 1.
[5] Dan Immergluck and Geoff Smith, "The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values," *Housing Policy Debate* (17:1) Fannie Mae Foundation (2006), www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1701_immergluck.pdf

For this group of borrowers, I have recommended that servicers take a systematic and streamlined approach to restructuring these loans into long-term, sustainable loans at the starter rate -- which is already above market rates for prime loans. Servicers should reach out proactively to borrowers approaching their reset dates to determine the borrowers' ability to make payments following reset of interest rates using common metrics, such as debt-to-income ratios (DTIs). For example, the FDIC, the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators have jointly advised that DTIs for all recurring debts in excess of 50 percent will increase the likelihood of future difficulties in repayment, as well as delinquencies or defaults.

Where the homeowner has generally remained current at the starter rate, but cannot make the higher reset payments, the loan should be modified to keep it at the starter rate for a long-term, sustainable period of five years or more. In today's market, this modification generally will exceed the net present value of allowing the loan to go into foreclosure. In addition, with the volume of resets that many servicers are facing, loan-by-loan approaches will not maximize the value of the loan pool because servicers lack the resources to address the loans on a timely basis. Failure to act aggressively is likely to increase substantially the NPV of losses to the investors.

Finally, I would note that brief extensions of the starter rate or temporary repayment plans will not provide stability to the borrower, investors, or the market. Brief

extensions simply increase the resource stress on servicers and decrease the ability of the market to determine market prices for mortgage assets.

Growing Acceptance of Loan Modifications

As servicers examined the benefits of a systematic approach to loan modifications, many of them came to recognize that there are several advantages to the approach I recommended. A streamlined approach can be undertaken much more rapidly than a loan-by-loan restructuring process. Also, this approach does not involve a bailout involving federal tax dollars. In addition, this policy does not involve government action that would affect the contractual rights of mortgage investors because it is based on voluntary action by servicers and existing legal rights and responsibilities. This approach makes economic sense and is an appropriate, proactive response to rapidly changing market conditions. Modifying loans before reset will avoid negative credit consequences for borrowers, permit borrowers to keep their homes while making payments they can afford, preserve neighborhoods and provide investors with a return that exceeds any return they would receive from foreclosures. Under today's conditions, the net present value analysis itself can be streamlined for many markets. Declining housing prices and experience point to the likelihood of substantial losses through foreclosure in contrast to the income stream that can be achieved by sustainable, long-term loan modifications.

Under the leadership of Secretary Paulson, the Treasury Department brought together market participants to develop a shared framework to address the level of

upcoming resets. Last month, the Secretary announced that ASF and the Hope Now Alliance had developed a set of guidelines to be adopted as the standard practices for loan modifications across the servicing industry. This initiative, if fully embraced and implemented by the industry, has the potential to greatly accelerate loan modifications for many borrowers and to achieve real results. Pulling together the competing interests in the industry was no small accomplishment and Secretary Paulson should be commended for his efforts in this area.

In addition, last November, the Governor of California announced that he had reached an agreement with several large loan servicers, including Countrywide, GMAC, Litton and HomEq, to keep current homeowners facing unaffordable resets at the starter rates to help them stay in their homes. This agreement is based on the principles in my proposal. Since then, many of the remaining large subprime mortgage servicers have agreed with Governor Schwarzenegger to apply these principles.

While I am encouraged that servicers have recognized the benefits of addressing problematic loans on a systematic basis by entering into these agreements, now is the time to show progress. Servicers must demonstrate an aggressive effort to dramatically increase the pace of loan modifications. This must be accompanied by prompt and transparent reporting that permits independent analysis of their efforts. The peak of monthly payment resets on subprime hybrid ARMs is still approaching. Current estimates are that initial resets of subprime hybrid ARMs will peak at over 350,000 loans in the third quarter of this year, compared with about 270,000 loans in the first quarter.

Unfortunately, at this point, the available information seems to show that foreclosures continue at an unacceptably high level while true loan modifications are lagging. It is important that servicers demonstrate and document real progress soon or they invite regulatory and legislative action to supplement the industry's actions.

Additional Legal Protections for Servicers Engaging in Loan Modifications

One of the reasons stated for the slow pace of loan modifications is that some servicers remain concerned about the potential for legal liability based on those modifications. Given the flexibility provided in most PSAs, it seems unlikely that a servicer engaging in loan modifications to avoid greater losses through foreclosure will be legally liable to investors. In addition, loan modifications that avoid greater foreclosure losses are consistent with industry standards embodied in the principles and guidance provided to servicers by ASF, which should provide an additional degree of protection from legal liability. In fact, servicers who take no action to address upcoming unaffordable resets in their loan portfolios and choose to rely on the traditional loan-by-loan process leading to foreclosure probably run a greater risk of legal liability to investors for their failure to take steps to limit losses to the loan pool as a whole.

Based on existing industry standards and the flexibility provided in servicing agreements, we believe that sufficient legal authority exists to protect servicers from liability for engaging in loan modification activity. However, if Congress determines that statutory affirmation of this authority is desirable, the best approach would seem to be

legislation establishing a clear statutory standard regarding servicers' fiduciary obligations. For example, such a standard could state that any duty servicers have to maximize net present value is owed to all parties in a loan pool, not to any particular parties, and that a servicer acts in the best interests of all parties if it agrees to or implements a loan modification or workout plan for which: (1) the loan is in payment default, or payment default is reasonably foreseeable; and (2) anticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis. This standard would be consistent with most existing contracts and a confirmation of existing law. Importantly, it would not change the servicers' normal contract obligations. In addition, as long as the statutory provisions do not take away or abrogate existing contractual rights, this approach should avoid the constitutional problems that would be inherent in legislative proposals that altered or overrode existing contractual rights of the parties. The FDIC stands ready to assist Congress if it considers such legislative action necessary.

Additional Developing Problems in the Mortgage Markets

One of the most important arguments for addressing the relatively straightforward problems posed by resets of subprime hybrid ARMs on a systematic basis is that it will free up servicing resources to deal with additional difficult problems that are developing in the mortgage markets. For example, large home price declines in some troubled markets are leaving borrowers owing more than the value of their homes. Past

experience is that borrowers may walk away from properties that are significantly "underwater," leaving lenders with a costly foreclosure process.

In addition, the mortgage servicing industry is facing a wave of impending resets on nontraditional mortgage loans that will begin in earnest in 2009. These interest-only or payment-option loans typically require no amortization -- or even permit negative amortization -- during the first five years. Although loans of this type have been available on a limited basis for many years, they became especially popular after 2003 in coastal markets that were seeing large double-digit home price increases. These loans were typically made to borrowers with prime credit scores and they were often securitized in nonconforming Alt-A pools because of the additional risk features in their underwriting and structure. These riskier loans often included more hazardous underwriting approaches such as stated income, low- or no-documentation, and other risk-layered features. More than four in five Alt-A loans securitized in 2006 were low- or no-doc loans.[6] The FDIC's analysis indicates that as of October there were just over 1.7 million nontraditional mortgages with outstanding balances of almost $600 billion securitized in Alt-A pools. Preliminary analysis indicates that large volumes of these loans will undergo payment reset and require amortization beginning in 2009, in market conditions that may not be much better than we see today.

Although nontraditional mortgages made to non-prime and prime borrowers do not typically involve the large interest rate resets typical of subprime hybrid ARMs, they

[6] See March 12, 2007 Credit Suisse Equity Research, "Mortgage Liquidity du Jour: Underestimated no More" at 4.

may expose borrowers to an even greater degree of payment shock if the borrower has been making the minimum payment and must now make the fully amortizing payment -- often on a larger principal amount after negative amortization. Borrowers who were making the minimum payment during the initial period may find themselves either owing more than the value of their home, facing a significant increase in their monthly payment, or both. Studies indicate that 75 percent or more of borrowers with payment-option loans have been making the minimum payments during the starter period, resulting in negative amortization. As in the case of the subprime payment resets, this is a problem that can be foreseen based on available data. However, Alt-A loans present potentially more difficult loss mitigation issues than subprime hybrid ARMs because of their additional risk features. As a result, it is essential for servicers to start now to develop strategies that will minimize losses to investors and the broader housing market by avoiding unnecessary foreclosures. Waiting to confront the next reset problem will once again create the risk of falling behind a fast-moving trend.

In addressing the growing numbers of nontraditional mortgages facing reset and borrowers who did not qualify for the initial loan modification agreements, servicers should consider applying systematic approaches to restructuring these loans that are similar to the strategies for addressing the subprime hybrid ARMs. By applying reasonable measures of the likelihood of default, such as a 50 percent debt-to-income ratio, servicers can quickly identify loans facing likely default, develop broad templates for restructuring these loans into fixed rate loans and proactively initiate that process. Temporary repayment plans will only provide a short-term fix for these nontraditional

mortgages, whereas the goal should be to create long-term, sustainable mortgage obligations that homeowners can afford to repay while providing a continuing income stream to investors.

Unfortunately, some borrowers pose even more difficult issues because their debt far exceeds the value of their homes. Servicers have always had to evaluate whether the best option in these cases is foreclosure or some other process, such as a short sale, that results in the loss of the home. There may be no alternative except foreclosure for loans that were made to speculators, under fraudulent circumstances, or to borrowers who have no reasonable ability to repay (even with restructuring). However, in today's market, servicers should carefully consider whether some writedowns of part of the principal balance to the value of the home or forgiveness of arrearages of principal and interest are better options than foreclosure or even short sales in appropriate circumstances. Permitting borrowers with an ability to make reasonable payments to stay in their home would provide greater value to lenders and investors than forcing foreclosures that undercut the value of the property and harm the value of other properties in the neighborhood.

Until recently, strategies involving writing down the value of the loan did not provide a feasible alternative for most borrowers. When lenders restructured loans in this manner, borrowers faced a potential tax liability on the amount of the forgiven debt.

Last month, however, Congress addressed the issue of tax liability for mortgage debt forgiveness in a way that makes long-term workouts involving principal writedowns a reasonable alternative to foreclosure. Such an option might be considered for borrowers having financial difficulty making their payments after their loans reset and where foreclosure is a looming possibility. Congress is to be commended for enhancing the workout options available to borrowers and lenders for negotiating long-term, sustainable restructurings.

Enactment of the Mortgage Forgiveness Debt Relief Act of 2007 provides an additional option for keeping borrowers in their home. This Act recognizes that cash strapped borrowers who are already facing financial difficulty cannot afford a potential tax liability that could hinder their ability to make their modified loan payments. It also provides greater assurance to lenders and servicers that borrowers will be able to perform after their loans are modified and decreasing the principal value will decrease the loan to value ratio, thereby potentially expanding the number of homeowners who could qualify for GSE refinancing. This will allow lenders and servicers to consider forgiving a portion of the principal balance owed to a level a borrower can realistically afford to repay, as long as it produces a net present value that is greater than the anticipated net recovery that would result from a foreclosure. This would require lenders and servicers to ascertain the existence and amount of any second mortgages, and obtain releases from these obligations to the extent appropriate. While this type of modification results in the recognition of a loss by the lender or servicer, it is virtually certain that the amount of the

principal write-down will be less than the amount of loss sustained from foreclosure in today's market.

Permanently forgiving part of the principal amount can provide a better financial result for investors than foreclosure by creating long-term, sustainable solutions that will allow borrowers to stay in their homes. This approach also has the added benefit of limiting the overall adverse affect of declining property values on communities.

Conclusion

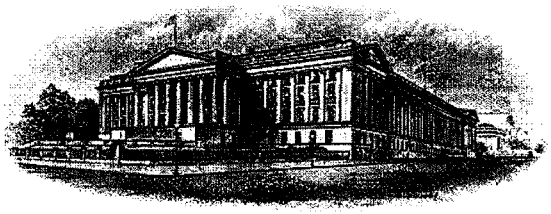
Poor underwriting and abuses in the subprime mortgage market are having a significant negative impact on the housing markets and the U.S. economy. In the coming months, large numbers of subprime adjustable rate mortgages will reset to higher interest rates and borrowers will generally be facing default and possible foreclosure. In addition, a wave of nontraditional mortgage resets is looming in the next year.

The FDIC is advocating a systematic approach to loan restructuring for borrowers who cannot afford their payments after their loans reset that will create long-term, sustainable solutions that enable borrowers to stay in their homes and provide a better financial result for investors than foreclosure. A systematic approach to restructuring for these borrowers also will free up servicer resources to work with troubled borrowers who will require more individualized solutions. In addition, recent congressional action has removed a potential tax impediment for restructurings that include the forgiveness of

debt. The problems in the subprime mortgage markets are only going to increase in coming months and servicers need to be much more aggressive in utilizing the tools available to them to address these issues. Servicers should take proactive measures to deal effectively with upcoming resets to minimize unnecessary foreclosures and losses to both lenders and borrowers. It is especially critical that this process is done in a systemic manner for subprime borrowers.

Congress, the SEC, the Treasury Department, as well as federal bank regulators have expended considerable time and effort to assure that the industry has authority under tax and accounting rules to modify loans proactively. The industry needs to demonstrate greater commitment to using those authorities.

Thank you for the opportunity to testify. I would be happy to answer any questions the Committee might have.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10:00 a.m. (EDT), January 31, 2008
CONTACT Jennifer Zuccarelli, (202) 622-8657

UNDER SECRETARY FOR DOMESTIC FINANCE ROBERT K. STEEL TESTIMONY BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

WASHINGTON - Chairman Dodd, Ranking Member Shelby, Members of the Committee, good morning, I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on "Foreclosure Prevention and Neighborhood Preservation." These are important and challenging issues; addressing them will require collaborative work on all our parts, and I look forward to hearing your perspectives and working together.

Let me begin by broadly examining the characteristics of foreclosure, in both good times and bad, then describe how our approach to this issue has developed, and finally provide an update on the progress we are making to address current challenges.

Characteristics of Foreclosure

We are experiencing a period of adjustment in the housing sector of our economy. Fortunately, our economy is resilient and diverse, and our long-term economic fundamentals remain strong. Nevertheless, the Administration recognizes the importance of housing to our economy, and as Secretary Paulson has said many times, the housing decline is the most significant current risk to our economy.

In addition to the housing decline exacting a penalty on economic growth, many individual families will experience firsthand strain due to resetting mortgage rates and home price depreciation. Too many American homeowners face the frightening prospect of losing their home in foreclosure – and a significant number of other families already have. Foreclosures also pose negative externalities, placing hardships on neighboring homes and undermining the financial stability of broader communities and the families who live there. Many homeowners who are paying their mortgages on time face lower property values due to foreclosures in their neighborhood.

The latest available data (from the third quarter of last year) indicate that 2007 was on track for a foreclosure starts rate of 2.7 percent. To put that number into perspective we should recognize that many homes end up in foreclosure every year, even when housing markets are strong. Between 2001 and 2005, for example, the U.S. annual rate of foreclosure starts averaged approximately 1.7 percent, meaning more than 650,000 homeowners began the foreclosure process each year. This baseline rate of

foreclosure can result from events such as job loss, credit problems, changes in family circumstances, or other sources of economic instability.

Over the course of the next two years, we expect the foreclosure rate to remain elevated above its historic level. A rising foreclosure rate during a period of housing price depreciation is not surprising. Yet, largely because of relaxed underwriting standards in recent years – particularly in the subprime market – and resetting mortgages, the number of homeowners facing hardship will be higher than during other recent housing downturns.

In total, approximately 1.8 million subprime mortgages are expected to reset over the next two years, but not all will end in foreclosure. Many homeowners will be able to afford their new payments without trouble or may be able to qualify for refinanced, fixed-rate mortgages on their own. In fact, of the 2/28 subprime ARMs originated in 2005, 88 percent had not defaulted as of late last year. Others, however, have stretched far beyond their means, and unfortunately, foreclosure may be unavoidable. In fact, many loans enter into foreclosure before ever reaching the reset date. A third group of homeowners facing resets falls somewhere in the middle. The challenge is to identify the homeowners in this middle group, who with a focused and timely response can stay in their homes.

Treasury's Response

The Administration's goal is to prevent foreclosures for homeowners. It is not about assisting lenders or bailing out investors.

Our response is based upon a three point plan: (1) to better identify, reach and connect with counselors those at-risk homeowners who can be helped, (2) to assist in developing additional products for homeowners, and (3) to increase the speed and efficiency of moving these at-risk borrowers into affordable solutions.

Whenever facing a challenging public policy issue, such as this one, the first step is full understanding. While we are continuing to learn, our response to date represents months of listening Congress to leading academics, servicers, mortgage counselors, lenders, homeowners, and investors to understand the causes of foreclosures and the best ways to help people keep their homes.

Last March, in a meeting hosted by Chairman Bair at the Federal Deposit Insurance Corporation (FDIC), we heard from several housing experts to help us understand the scope and scale of these challenges. In April and May, the Treasury Department hosted two large meetings, inviting all the relevant regulators to help us gain a greater understanding of the problem and map out potential policy responses. Over the course of the summer months, we sought the sound counsel of outside experts. We spoke with dozens of individuals, including leading counselors, mortgage servicers, academics, housing and consumer advocates, and other experts, such as the late Ned Gramlich, a former Federal Reserve Governor and prescient housing scholar who predicted the significance of these challenges before anyone else.

On August 31, President Bush announced an aggressive, comprehensive plan to help at-risk homeowners stay in their primary residences. The President charged Secretary Jackson and Secretary Paulson to lead this effort.

As the Treasury Department and the Department of Housing and Urban Development (HUD) met with a variety of mortgage market participants and non-profit credit counselors in the late summer and early fall of 2007, it became clear that while many market participants were working diligently on their own trying to reach and help homeowners, but it was inadequate given the scale and pace of pending resets.

On October 10, HOPE NOW was formed as an alliance among counselors, servicers, investors, and other mortgage market participants to maximize outreach efforts to at-risk homeowners and help them stay in their homes. The Alliance grew and today servicers participating in HOPE NOW comprise over 94 percent of the subprime mortgage loan market.

HOPE NOW adopted a centralized hotline for telephonic foreclosure prevention counseling (888-995-HOPE, operated by the Homeownership Preservation Foundation). Expanding and sustaining the capacity of the HOPE hotline was essential as outreach efforts increased. Servicers and investors now reimburse HOPE hotline counselors $100 for every counseling session completed. This is an important step toward maintaining a sustainable funding model for counseling, as government and foundation funding have traditionally been the sole source of counselor support.

Additionally, HOPE NOW servicers are contacting all adjustable-rate mortgage borrowers at a minimum of 120 days prior to their mortgage reset. This will allow servicers' early identification of borrowers who will have challenges – greatly increasing their options for help. While some servicers were already doing this, we believe it was an important step to standardize this practice for all HOPE NOW servicers.

Furthermore, through coordinated outreach efforts, HOPE NOW members are reaching out to all at-risk borrowers and offering help through both mortgage servicers and non-profit credit counselors. A direct mail campaign began in November to contact all borrowers who are 60 days or more delinquent on their loans with no prior servicer contact. This letter informs them that help is available.

Secretary Paulson has also encouraged HOPE NOW members to expand and expedite mortgage solutions for at-risk borrowers. On December 6, President Bush announced a new private-sector framework to streamline the process for modifying and refinancing subprime mortgages for eligible homeowners. These new industry guidelines, issued by the American Securitization Forum (ASF), created an efficient process for identifying borrowers who qualify for refinancing or loan modifications. This, in turn, will free up resources and allow mortgage servicers to focus on those borrowers who require more in-depth analysis.

Lastly, HOPE NOW servicers and counselors have finalized best practices that will increase efficiency in communication among servicers, counselors and homeowners. Through these best practices, including the continued development of cross-industry technology, more homeowners will be helped as counselors are more effectively able to connect with servicers.

Early Progress

As Secretary Paulson has said, we are committed to measuring the success of this program as it is implemented. Before the establishment of HOPE NOW the industry did not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance or to evaluate counselors' effectiveness. Today, the Alliance is standardizing a variety of measures which policymakers, homeowners and investors need in order to monitor performance. These performance measurements include data such as the number of loans in default, outcomes for these loans, and success rates for modifications and refinances. These metrics will allow us to identify categories of borrowers who can be helped, determine successful treatments, and measure the rate of successful outcomes.

Early sets of numbers have already been reported, and these demonstrate that material progress is being made.

For instance, early data indicate that Alliance members are identifying and connecting with more at-risk borrowers than just a few months ago.

- Since its launch, HOPE NOW has worked to increase significantly the awareness and capacity of the HOPE hotline – in August the hotline was receiving an average of 625 phone calls a day; the HOPE hotline is now receiving 4,000 new phone calls a day. That is a 540 percent increase.

- Moreover, in the first two months of a new monthly mailing campaign, HOPE NOW and its members have mailed 483,000 letters to delinquent homeowners who had previously avoided contact, with a response rate to date of over 16 percent. That is an estimated 77,000 borrowers who called for help after receiving a letter.

In addition to outreach, new affordable mortgage solutions are being developed to help homeowners.

- On August 31, the Administration announced FHASecure to offer homeowners foreclosure alternatives; since then, over 75,000 Federal Housing Administration (FHA) insured loans have been closed putting over $10 billion to work. In addition, it is estimated that about 100,000 more applications are in the pipeline.

- Just last month, Congress passed a temporary mortgage debt tax relief act that will provide homeowners relief from taxes that would have otherwise been due from principal forgiveness. This tax relief will help homeowners avoid nearly $200 million in taxes a year for the next three years.

- The Administration has advocated temporarily raising the cap on tax-exempt bonds for state housing authorities to help borrowers refinance. This proposal would increase the total annual cap on existing programs by $15 billion over three years, with this extra cap targeted at refinancing existing loans of subprime borrowers. This is important because real estate markets are regional and states are well-positioned to tailor programs that meet the specific needs of their communities.

We also have made a great deal of progress in increasing the speed and efficiency of moving borrowers into affordable solutions. The ASF program announced last month is helping fast-track eligible borrowers into a refinancing or loan modification, and it is freeing up resources, allowing servicers and counselors to focus on borrowers who need detailed case-by-case help. The ASF streamlined plan is only one part of our effort, but we expect the results to show a meaningful increase in the number of modifications and refinances as reporting begins.

The Mortgage Bankers Association and HOPE NOW have both made good progress in helping us evaluate performance to date. Although a more in-depth analysis of recent activity, including the beginning progress of the fast-track plan, will be available in the coming weeks and months, HOPE NOW reported that:

- The industry helped 370,000 homeowners with subprime loans in the second half of 2007 through modifications or new repayment plans, and 120,000 of those homeowners received modifications.

- Moreover, the rate of modifications of subprime loans tripled from the third quarter to the fourth quarter of calendar year 2007, and even more are expected as we move forward in 2008 and the ASF framework begins to take effect.

The Administration also has requested that the Congress do its part and we are appreciative that significant progress has been made. As you know, the Congress appropriated an additional $180 million to NeighborWorks to fund counselor networks. We also applaud the swift action taken by Congress to pass the President's tax relief proposal, which was signed into law in December.

FHA modernization is moving through the Congress, and we are hopeful that it will reach the President's desk soon. Additionally, government sponsored enterprise (GSE) reform has cleared the House of Representatives, and we look forward to working with this Committee as Members consider legislation on the subject. The Treasury Department also looks forward to working with the Congress on the Administration's proposal to allow state housing authorities to issue tax-exempt bonds to help refinance borrowers into affordable mortgage products.

Conclusion

Mr. Chairman, in conclusion, let me thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. We have made substantial progress since August and there is much more work to do. We will continue to learn as we move forward and look for additional measures to help avoid preventable foreclosures.

Thank you and I look forward to your questions.

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STATEMENT OF
WADE HENDERSON, PRESIDENT & CEO
LEADERSHIP CONFERENCE ON CIVIL RIGHTS

"STRENGTHENING OUR ECONOMY: FORECLOSURE PREVENTION AND NEIGHBORHOOD PRESERVATION"

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

JANUARY 31, 2008

Chairman Dodd, Ranking Member Shelby, and members of the Committee: I am Wade Henderson, President and CEO of the Leadership Conference on Civil Rights (LCCR). Thank you for the opportunity to testify in today's hearing on options for preventing foreclosure and preserving neighborhoods in the midst of a growing crisis in our nation's home mortgage lending system.

LCCR is the nation's oldest and most diverse coalition of civil rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, the Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. LCCR consists of approximately 200 national organizations representing persons of color, women, children, organized labor, persons with disabilities, the elderly, gays and lesbians, and major religious groups. I am privileged to represent the civil and human rights community in submitting testimony for the record to the Committee.

I would like to begin by explaining why the growing number of foreclosures is of such critical importance to LCCR and the communities we represent. Simply put, the right to the American Dream of homeownership has always been one of the most fundamental goals of the civil rights movement. It is vital because homeownership is the means by which most Americans build wealth and improve their own lives and the lives of their families, and homeownership is essential to the development of stable, healthy communities of which all Americans can be proud. For decades, the civil rights community has been struggling to not only break down the barriers to housing itself, but also to the credit that most Americans need to obtain housing. The resistance that racial and ethnic minority communities have faced in obtaining fair and sustainable mortgage loans, from the practice of redlining to the scourge of predatory lending, lies very much at the root of the crisis in which we now find ourselves today.

And indeed, after years of denial by many, there is a growing consensus that we do face a crisis. It is now finally well-accepted that the mortgage lending industry engaged in the widespread use of utterly reckless and predatory lending practices during the nationwide housing market "boom" that took place throughout much of this decade. While the use of *responsible* subprime lending could have created meaningful homeownership opportunities for people who might otherwise be

left out of the market, many homeowners were deceptively steered into expensive subprime mortgages even though they qualified for prime loans, with unreasonable terms and hidden fees that made it impossible for homeowners to stay current, much less get ahead – and there were clear, significant racial and ethnic disparities in the manner in which this was done.[1]

To make things worse, many lenders – lured by the prospect of easy profits through the rise of securitization – took exotic practices such as "2/28s," "interest-only," "pay-option," "low-doc" or "no-doc" mortgages, prepayment penalties, and "yield spread premiums," and made them commonplace, abandoning sensible loan underwriting and appraisal standards in the process.[2]

The use of these sorts of practices, in housing markets that were bound to reach unsustainable peaks, guaranteed that millions of people would be unable to handle their monthly payments. Needless to say, too many families now see their American Dream slipping away – and it is profoundly disappointing to see that the end result of recent subprime lending practices is *less* homeownership, not more.[3]

As a steady stream of information about growing foreclosures[4] and softening property values[5] continues to flow in, and with growing uncertainties about our economy, it is clear that Congress must take a swift, pragmatic, multifaceted approach to restore homeowner confidence and preserve the communities that we have all worked so hard to develop. At the same time, I am

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[1] *See, e.g.* Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, at 19 (available at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf), May 2006; National Community Reinvestment Coalition, *Income is No Shield Against Racial Differences in Lending: A Comparison of High-Cost Lending in America's Metropolitan Areas* (available at http://ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf), July 10, 2007; Rich Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007 at A1.

[2] *See, e.g.* Comptroller of the Currency John C. Dugan, sharply criticizing widespread use of "no/low-doc" loans:

> Sound underwriting – and, for that matter, simple common sense – suggests that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she had the means to make the required monthly payments. But the norm appears to be just the opposite: nearly 50 percent of all subprime loans last year accepted stated income. . . . I do find it telling that, when faced with new housing market conditions, lenders have responded first by tightening standards on stated income. . . . Apparently verified income is viewed as a critical factor in determining whether a loan can be saved, which of course begs the question: if loan verification is such an important predictor of the borrower's ability to repay in the current environment, why wasn't it equally important when the loan was first made?

News Release: "Comptroller Dugan Expresses Concern Over 'Stated Income' Subprime Loans," *Comptroller of the Currency*, May 23, 2007, available at http://www.occ.gov/ftp/release/2007-48.htm.

[3] Center for Responsible Lending, "Subprime Lending is a Net Drain on Homeownership," CRL Issue Paper No. 14 (March 27, 2007).

[4] *See, e.g.* Press Release: "U.S. Foreclosure Activity Increases 75 Percent in 2007: More Than 2.2 Million Foreclosure Filings on Nearly 1.3 Million Properties Reported," *RealtyTrac*, Jan. 29, 2008, at http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3988&accnt=64847 (accessed Jan. 30, 2008).

[5] *See, e.g.* Michael M. Grynbaum, "Home Prices Sank in 2007, and Buyers Hid," *The New York Times*, Jan. 25, 2008; "Bloomberg News, "S.& P. Home Price Index Continued to Fall in November," Jan. 30, 2008, at http://www.nytimes.com/2008/01/30/business/30home.html.

mindful of the concerns that many have raised – particularly in light of the looming fears of difficult economic times ahead – about the need to avoid steps that saddle future generations with additional debt, increase the costs of credit, or resort to "bailouts" that might encourage more irresponsible mortgage finance practices in the future.

The Administration – and as I am pleased to note, the lending industry as well – has already taken one very significant step in addressing the current foreclosure epidemic. The so-called "Paulson Plan" and the related "Hope Now Alliance" in particular, and voluntary industry-based efforts in general, rightly deserve praise. Every home that is saved from foreclosure is a step in the right direction.

But it is clear, from the lending industry's own numbers, that voluntary efforts are far from sufficient.[6] Only three percent of subprime adjustable rate mortgages will be eligible for relief under the Paulson Plan.[7] When I testified in a House Judiciary Committee hearing this Tuesday,[8] a fellow witness and friend, Ms. Faith Schwartz of the Hope Now Alliance, acknowledged during questioning that voluntary efforts were indeed not going to save every homeowner, and I appreciated her candor and agreed with her observation. The importance of preserving homeownership, to our communities and to our nation, demands that more be done. With that in mind, I strongly urge this Committee and Congress to quickly move forward on several additional, important steps.

Moratorium on Foreclosures, Revisited

Last spring, Mr. Chairman, following a series of discussions that you convened with leaders of the lending industry and stakeholder organizations, the civil rights community proposed the idea of a voluntary, industry-led moratorium on subprime mortgage foreclosures. We believe that such a moratorium would give the industry time, before the irreparable damage of more foreclosures occur, to work actively with homeowners to help them keep their homes by providing more affordable loan products. While I am mindful that some borrowers utilized subprime loans in an effort to reap profits during the recent real estate boom, as opposed to borrowers who simply wanted to own homes in which they and their families could live, we argued that a moratorium would provide the time needed to find and assist borrowers who truly deserve help.

While we were relieved that a number of major originators and servicers of subprime loans at least took the time to respond to our call for a moratorium, unfortunately, the nature of those responses was underwhelming. Those who responded said that they wanted to minimize foreclosures, and I had no reason to doubt their sincerity, but it was very clear to me from their correspondence that a comprehensive, industry-wide effort to do so had not yet taken shape.

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[6] Mortgage Bankers Association, "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans, and Other Loss Mitigation Activities in the Third Quarter of 2007," Jan. 2008, at 22.
[7] Center for Responsible Lending, "Voluntary Loan Modifications Fall Far Short," CRL Issue Brief, Jan. 28, 2008.
[8] Hearing: "The Growing Mortgage Foreclosure Crisis: Identifying Solutions and Dispelling Myths," U.S. House, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, Jan. 29, 2008.

While I do not dispute that the industry has been making progress in developing more widespread foreclosure avoidance efforts since we called for a moratorium, it is also clear that the extremely complicated nature of mortgage securitization structures that developed in recent years pose a major challenge to the success of those efforts.[9] Potential conflicts between primary and junior mortgage liens also raise difficulties in many cases.[10]

Given these difficulties, and the still-unacceptably high number of foreclosures that have been taking place to date despite the efforts of many in the industry,[11] I believe that the idea of a foreclosure moratorium should be revisited. Indeed, I believe that this Committee should explore ways in which it could mandate one, in order to circumvent the barriers that make a voluntary one unlikely. While I realize that this would be a drastic measure, we are clearly facing a situation in the housing market and the economy unlike any other in recent history. A forced "cooling off" period could give the industry time to further develop its own solutions, and greatly ease public concerns about the devastating toll that the growing number of foreclosures is taking on our economy.

Bankruptcy Reform: Chapter 13 Relief

Even if a foreclosure moratorium provides more time to further develop industry-led efforts, it is indisputable that those efforts alone will not help every deserving homeowner. And while I recognize that matters involving bankruptcy law lie outside of the jurisdiction of this Committee, I believe that proposals to allow borrowers to seek relief in Chapter 13 bankruptcy proceedings are worth briefly discussing in the context of today's hearing.

Certainly, Mr. Chairman, as a cosponsor of Senator Durbin's bill, the "Helping Families Save Their Homes in Bankruptcy Act of 2007" (S. 2136), you are already well aware of the merits of this approach. But I would like to encourage each of your colleagues on the Committee to join you in this effort, if they have not done so already.[12] LCCR strongly believes that Chapter 13 reform is one of the most important policy options available to Congress in the effort to reduce the number of foreclosures.

A proposal like S. 2136 would give literally hundreds of thousands of borrowers who are in danger of foreclosure a chance to save their homes through the use of bankruptcy proceedings. It would enable bankruptcy courts to: 1) reduce the principal owed on a subprime or non-traditional mortgage to reflect the actual value of the home; 2) reset interest rates to affordable-but-fair levels; and 3) eliminate prepayment penalties and other abusive fees.

There are several major benefits to this approach. One key advantage is its cost. Because bankruptcy proceedings would not involve the use of public funds, it would not give the appearance of a "bailout" or raise moral hazard issues. Indeed, for people who want to utilize

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[9] *See, e.g.* Center for Responsible Lending, *supra* note 6; Testimony of Kurt Eggert, Hearing: "Subprime Mortgage Market Turmoil: Examining the Role of Securitization," U.S. Senate Subcommittee on Securities, Insurance, and Investments, Apr. 17, 2007 at 19-26.
[10] *Ibid.*
[11] *Supra* note 6.
[12] I am very grateful to Senators Brown, Menendez, Reed, and Schumer for also cosponsoring S. 2136, and to several additional Senators not on this Committee.

bankruptcy laws to save their homes from foreclosure, it will still come at a heavy enough cost – monetary and otherwise – to encourage wiser financial decisions in the future.

At the same time, such an approach would clearly benefit not just individual homeowners who cannot be adequately helped by industry-led efforts, but the entire public and our economy at large. Every home that gets saved from foreclosure – by any means – helps to protect the value of the homes surrounding it from unnecessary declines, meaning that other homeowners will be less likely to get "upside down" on their own mortgages and possibly face foreclosure as well.

I am all too aware that the mortgage lending industry has voiced strong opposition to this bill. In particular, opponents argue that it would substantially raise the risk of mortgage losses, and therefore raise the cost of future loans. While I take such concerns very seriously, I am not convinced that those fears are warranted with respect to S. 2136 as it is written. Indeed, I believe that it is a wise and long-overdue change to our bankruptcy laws.

On Tuesday, however, I testified before the House Subcommittee on Commercial and Administrative Law in strong favor of a greatly-modified version of H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007." In an effort to address even the *potential* risk that H.R. 3609 might adversely impact the costs of mortgage loans in the future, Chairman John Conyers and Representative Steve Chabot crafted a very thoughtful compromise that, in the opinion of a majority of the witnesses in Tuesday's hearing, eliminates those risks beyond a shadow of a doubt. In particular, the Conyers-Chabot compromise would apply only to subprime and non-traditional mortgages that were originated between January 1, 2000 and the date of enactment, and would sunset in seven years. While I still believe that permanent changes to Chapter 13 are warranted, the Conyers-Chabot substitute would certainly be an acceptable approach for dealing with the mortgage crisis that we are facing here and now.

Additional Good Ideas: "Federal Homeownership Preservation Corporation" and "Great American Dream Neighborhood Stabilization Fund"

Naturally, because of the tremendous toll that it inflicts on a borrower, the Chapter 13 bankruptcy relief I discussed above must always serve as a last resort. With that in mind, and while several of my fellow panelists will discuss them in much greater detail, I want to briefly touch on two additional proposals fro the Center for American Progress that I am happy to see are under discussion today and that I am pleased to support as additional ways to deal with our foreclosure epidemic.

The proposed "Federal Homeownership Preservation Corporation" (FHPC) is a welcome throwback to the Home Owners Loan Corporation (HOLC), a New Deal-era program that saved nearly one million homes from foreclosure during the Great Depression of the 1930s. Like the HOLC, Senator Dodd's proposal would facilitate the purchase of troubled pools of mortgage-backed securities at a substantial discount from investors, and leverage existing institutions' capacity to quickly replace the underlying mortgages with newly originated loans to homeowners at fair market values and reasonable fixed rates.

This idea worked in the 1930s, and I believe it can work in 2008 as well. It could spare a great number of homeowners from foreclosure, put the losses where they belong, and be not just cost-neutral to the public but even profitable. At the same time, it would allow home prices to correct without – unlike foreclosures or abandonment – letting them crash through the floor.

Another important proposal, named the "Great American Dream Neighborhood Stabilization Fund" ("GARDNS") would address the problem of homes that are already vacant. It would create grant funds to allow community land trusts, community development corporations, or similar entities to purchase foreclosed or REO ("real estate owned") homes in troubled areas at substantial discount, and sell them to low- or moderate-income buyers while retaining a share of the value. The initial grant moneys could be leveraged several times over as the proceeds from each sale would flow back into the fund to allow for new REO acquisitions. Like the FHPC, the GARDNS proposal carries with it the added benefit of already having been proven to work.

Conclusion

I believe the use of responsible, sustainable subprime lending practices *can* expand home ownership and, at the same time, prove rewarding to investors. But the idea of subprime lending went terribly astray in recent years. And with a foreclosure crisis unlike anything we have seen in decades, homeowners – and our economy as a whole – simply cannot afford to wait for an industry that collectively created the mess, and is now being devoured by it, to take the lead in cleaning it up. I want to thank you for your leadership and for holding this hearing on more comprehensive action, and I look forward to any questions you may have.

Prepared Testimony of Michael S. Barr
Senior Fellow, Center for American Progress
Professor of Law, University of Michigan Law School
Before the
United States Senate Committee on Banking, Housing, and Urban Affairs
Hearing on
"Strengthening our Economy:
Foreclosure Prevention and Neighborhood Preservation"
January 31, 2008

Chairman Dodd, Ranking Member Shelby, and distinguished Members of the Committee, it is an honor to be here today to discuss with you measures to strengthen our economy, help to prevent foreclosures, and preserve our neighborhoods.

My testimony today is based on work that I have been doing with the Center for American Progress (CAP) and a team of experts from academia and a wide range of public and private sector institutions.[1] Shortcomings, of course, are my own.

Many homeowners are under water and drowning fast, with loans far larger than their homes are now worth. Our neighborhoods and communities are suffering. And contagion from the housing crisis is drying up credit markets. We risk a vicious downward spiral in housing prices, credit markets, and the real economy. Strong government policy is needed to restore stability and confidence and to head off a long period of recession and stagnation. The time to act is now.

The thrust of our suggestion is to provide new authorities to existing public and private institutions to help resolve the mortgage crisis, push through the backlog of loan modifications for homeowners, restore confidence and liquidity to America's financial markets, and provide a needed boost to the economy. For shorthand, we've been calling the approach, Saving America's Family Equity, or SAFE. Under the proposal, through a Treasury pricing platform, FHA lenders/Ginnie-Mae issuers and the Government-Sponsored Enterprises (GSEs) would buy out existing pools at a market-determined discount and would arrange through responsible existing origination channels for the refinancing of the loans at terms that reduce the likelihood of default, foreclosure, and liquidation. The SAFE loan plan would provide a restructuring process to help borrowers stay in their homes. Over time, our expectation is that market-pricing and liquidity will be restored, and the SAFE loan plan would have an automatic shut-off valve at that point.

The SAFE loan plan I will outline today is broadly consistent with Chairman Dodd's call for a Federal Homeownership Preservation Corporation and related efforts being advanced not only by the Center for American Progress but also by my

[1] The Center for American Progress (CAP) proposal for the Family Foreclosure Rescue Corporation, an updated version of the Home Owner's Loan Corporation, was first described in Andrew Jakabovics, "Throwing Homeowners a Lifeline: A Proposal for Direct Lending to Qualified Troubled Borrowers," Center for American Progress, 2007. Legislation based on that proposal was introduced in the House by Representative Baca as H.R. 4135. CAP has assembled a team of experts who are working together to adapt that initial idea to existing instruments and delivery systems on a wholesale basis, so that a solution might be able to be put in place more quickly than if one created a new government entity. The team of experts working on the proposal includes David Abromowitz, Michael S. Barr, Andrew Jakabovics, Susan Wachter, Sarah Wartell, Ellen Seidman, and Laura Tyson (see Appendix A).

distinguished fellow panelist, Alex Pollock of the American Enterprise Institute. The policy options I will discuss today are based on principles of shared responsibility for the crisis we are in, and shared opportunity to move forward together.

Our plan is designed not just to help out those facing foreclosures but to contain the severe contagion effects of foreclosures on property values; consumer credit, spending, and confidence; commercial real estate markets; and the functioning of credit markets. An unprecedented number of foreclosures and liquidations under current market conditions, with the crisis of confidence and liquidity in credit markets, will result in home price declines that would not occur under normal market conditions.

We need a mechanism for market investors transparently to take their losses, home owners to stay in their homes, and financial institutions to build capital, in order to stabilize the market and restore confidence in our financial system. Our policy proposal is decidedly not a bailout for either investors or for mortgage holders who made unwise or speculative decisions. Rather, the SAFE plan can help to keep families in their homes, clean up the credit markets, contain the contagion and avoid a vicious downward spiral that drags down the economy. Monetary and fiscal policy alone, while important, cannot restore liquidity, stability, and confidence to credit markets.

The Current Housing and Financial Crisis

Today, our economy is facing a real and growing crisis, threatening the longest, severest liquidity crisis and period of economic stagnation since the Great Depression. Nowhere is that problem more evident than in the wave of home foreclosures, which are already up by more than 40 percent over last year. Even with recent initiatives undertaken by Treasury and the private sector, up to two million foreclosures are anticipated within the next two years. In addition to the pain caused to individual homeowners, there are significant spillovers to neighborhoods and communities, and foreclosures are further increasing available housing stock and further depressing home prices. Currently, half a million new homes and nearly four million existing homes are up for sale, with inventories having grown to more than nine months of available supply.

Nationally, home prices have already fallen by over six percent from last year, according to the S&P/Case-Schiller Home Price Index. The NAR measured median home price has fallen nationally for the first time since the Great Depression. According to one estimate, home prices may decline by 24 percent before reaching bottom.[2] In the process, home price declines are wiping out family equity and with it the average American's rainy day fund, asset to fund college tuition, and retirement nest egg.

It is not only subprime or other at-risk borrowers who are brought down. Foreclosures and steeply falling house prices affect their neighbors who may have paid off their mortgages long ago, their communities whose tax bases are eroding quickly, and by extension, all Americans. Homebuilders see vacant properties and half-built projects, and construction workers are facing layoffs. Rapid and sustained declines in home equity depress consumer spending, contributing significantly to erosion in the real economy. Further declines in home prices, moreover, significantly and predictably increase defaults

[2] Lawrence H. Summers, "Risks of Recession, Prospects for Policy," Brookings Institution, December 19, 2007.

and foreclosures, and the vicious cycle of house price declines, defaults, and foreclosures continues. It is generally agreed that we are not close to seeing the bottom.

The Federal Reserve reports that 21 percent of subprime loans were 90 days or more past due or in foreclosure as of the third quarter of 2007, with more than 350,000 new foreclosures in that quarter alone. Delinquencies, defaults, and foreclosures are likely to continue to worsen as borrowers with subprime, adjustable-rate mortgages face significant rate resets, and continued house price reductions prevent these borrowers from refinancing. In addition, problems in the subprime sector are appearing in the "Alt-A" and prime markets and fear of contagion may be helping to generate problems in other credit markets as well. With this deterioration, there has been significant credit tightening that is contributing to slowing the economy. As the Treasury Department recently stated, "[f]inancial markets have deteriorated considerably since the start of the year and credit conditions for households and businesses remain tight."[3] Many observers believe that there is a serious risk of a sustained recession, or worse.

A significant portion of our capital markets appear to be frozen. It is self-evident that large mortgage pools have significantly increased in risk and declined in value, but real transparency is lacking. As former Treasury Secretary Lawrence Summers has stated, a "capital market where the same loan is valued at one price in a bank, another in a different bank, another in a conduit and yet another as a hedge fund asset to be margined cannot be the basis for sound economic performance."[4] Moreover, the capital markets have, to date, not been able to unlock these pools through sales or widespread restructuring of the underlying mortgages. Investors cannot determine the value of their assets, and servicers fear legal liability if they restructure mortgage pools without having a market mechanism and established industry practice to determine that the restructurings are consistent with their obligation to investors. In the absence of a mechanism to determine pricing and establish a new standard practice of broad restructuring or refinancing, servicers have been reluctant to act.

The dangers of a weakened economy further undermining the housing market and the housing recession providing negative feedback to a declining macro-economy are real. We need only look to the midwest states such as Michigan and Ohio to see the severe effects of the interaction of falling housing prices and unemployment. If declining housing prices become the long-term expected norm, we would be in unchartered territory. Many mortgages, and other credit instruments, would then be in danger.

Save America's Family Equity (SAFE) Loan Plan

There is no silver bullet for these problems. Undoubtedly, monetary policy and fiscal stimulus will continue to play important roles, but they are not enough. There is a growing consensus among economists and financial experts that a range of housing-specific initiatives are required. As Yale economist Robert J. Shiller has recently written, "[w]hile a temporary tax cut and interest rate cuts are good ideas, they don't address the

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[3] Treasury Assistant Secretary for Economic Policy Phillip Swagel, Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association, January 28, 2008.
[4] Lawrence H. Summers, "Beyond Fiscal Stimulus, Further Action is Needed," *Financial Times*, January 27, 2008.

underlying crisis of confidence… [and] they won't restore faith in the financial markets."[5]

FDIC Chairman Bair has testified to the importance of accelerating loan modifications and broadening the rate set freeze that the private sector, bank regulators, and Treasury announced last month. Chairman Bair has correctly pointed out that the progress thus far has been quite limited. Only 28,000 loans were modified in the third quarter of last year, according to data released by the Mortgage Brokers' Association. The mortgage servicing industry appears ill-equipped to handle millions of individualized decisions regarding loan modifications. I strongly agree with Chairman Bair that a broad, streamlined approach is required. Even with a broad approach to freezing resets, however, many mortgage loans will undoubtedly continue to fail, as home prices continue to decline, credit markets stall, and the economy continues to slow.

One potential strategy is to use an approach modeled in part on Roosevelt's successful Home Owners' Loan Corporation (HOLC), updated to the realities of today's financial marketplace and relying on existing private and public institutions for immediate implementation. A brief history of the HOLC may help set the context.

A Brief History of the Home Owner's Loan Corporation

In 1933, when a larger share of all homes—one percent of every housing unit in the country—went into foreclosure than any other time in American history, President Roosevelt and Congress worked together to establish the Home Owners' Loan Corporation. The HOLC was authorized to issue new loans to replace the existing liens of homeowners in default. Instead of a short-term, interest-only loan, the HOLC loans were fully amortizing over 15 years. In addition, the HOLC was far more patient with borrowers than the banks could have been, and delinquent loans received individualized attention, including debt counseling, family meetings, and budgeting help. Of the nearly 1.9 million applications to HOLC between June 1933 and June 1935, half were withdrawn or rejected. HOLC provided widespread assistance, but homeowners had to demonstrate a determination to meet their financial obligations and a history of doing so.

In order for the HOLC to issue a loan, it needed to pay off the existing liens. This potentially posed a serious problem, as HOLC loans were never to exceed 80 percent of the appraised value of a property, which was often below the outstanding loan balance. The HOLC had to convince the existing lenders to accept those losses. The HOLC was able to succeed because it made lenders an offer they couldn't refuse: A government guarantee of four percent interest in the amount of the new loan, which was worth far more—even at a reduced valuation—than the zero percent they were effectively getting from delinquent loans. Add to that the cost of servicing, foreclosure, and disposition, and the decision to take HOLC's offer was clearly sound.

The HOLC actively issued loans for only three years, between 1933 and 1936. It was a short-term entity designed to deal specifically with the problem of widespread foreclosures. After 1936, the HOLC existed only to service existing loans and dispose of the properties it acquired through foreclosure. The HOLC was liquidated in 1951 at a small profit. Despite its short active lifespan, its innovations have had a long-lasting impact, from the government-insured loans offered by HOLC's successor, the Federal

[5] Robert J. Shiller, "To Build Confidence, Try Better Bricks," *New York Times*, January 27, 2008.

Housing Administration, to the long-term, fully amortizing "conforming" loans offered to homebuyers today that are backed by the GSEs.

Policy Options to Implement the SAFE Loan Plan

We need a plan that will solve two puzzles: First, how can the market move rapidly and transparently to re-price existing mortgage pools, build capital, and restore financial stability? Second, how can the market renegotiate millions of home mortgage loans to avoid widespread defaults, foreclosures, and broader contagion? Both problems must be addressed to get us out of this crisis.

We at CAP have begun to explore options in this regard, and I would like to share our provisional thoughts to help keep more homeowners in their homes and reinvigorate the housing credit markets. CAP initially suggested that Congress consider creating a wholly new corporation; however, we have concluded, given the swift housing downturn, that we simply do not have time to build a new government entity from the ground up, and in many ways, we do not need to do so, because unlike the crisis in the 1930s, we have institutions today that can be readily adapted to serve these goals. With new authorities, Treasury, the FHA, and the government-sponsored enterprises can be brought together under a homeownership corporation to implement the SAFE loan plan.

We need to accelerate the re-pricing of existing mortgage pools to improve market transparency, end uncertainty, and restore liquidity to the credit markets. Ideally, the markets would do this work themselves, but they are not. Investors cannot price their assets, and servicers and trustees are not willing to move aggressively to sell at a discount in the face of uncertain values, lack of standard industry practice, and the potential for investor lawsuits. Divided ownership and conflicts of interests generated in part by tranches and layers of securitization, as well as tax consequences, further complicate the process. Meanwhile, delays in restructuring troubled loans further erode value. The servicing industry is under enormous strain and appears to lack the revenue stream, incentives. and operational capacity to modify millions of individual loans. Moreover, given current market conditions, there is simply no liquidity to fund new loans that would enable borrowers to exit. The key is to speed up the sale of mortgage pools, refinance at-risk loans, and restore liquidity and confidence to the credit markets.

One possibility is for the Treasury Department to establish an auction or similarly transparent market platform for the re-pricing of mortgage pools at a steep discount. Through back-to-back transactions, SAFE participants would be the ultimate purchasers. Investors would get liquidity and certainty in exchange for reduced principal value and lower yield. Treasury engagement would bring all key industry participants to the table, promote standard industry practice, and provide a platform for transparent price discovery. Treasury's platform would be "triggered off" automatically if the discounts offered are not sufficiently steep. Requiring a steep discount to continue the program would ensure that the program ends automatically when the private market for mortgage pools is on a path toward being restored.

Once the mortgage pools have been re-priced, SAFE participants—FHA-lenders/Ginnie Mae issuers and the GSEs would sort the loan pools into "buckets" using core criteria set in advance—into those loans that should be refinanced, those loans that could continue on current terms with sufficient underlying home equity, and loans that

cannot be reasonably restructured at affordable terms and values and must go into foreclosure. The core criteria would include debt-to-income ratio, loan-to-value ratio, and payments made to date. Only owner-occupied homes could be refinanced. By sorting the pools into buckets in advance, SAFE participants could reduce the costs of refinancing.

Using existing origination channels, SAFE participants would arrange for the refinancing of the eligible loans into new, fixed rate, 30-year mortgages. Prepayment penalties would be waived. Ultimately, these mortgages would be pooled into securities and sold into the secondary markets. Loans originated through FHA-lender/Ginnie-Mae-issuer channels would be FHA-insured and Ginnie Mae guaranteed. Other SAFE loans would be securitized by Fannie Mae and Freddie Mac.

Certain FHA program limitations and GSE conforming loan limit and other restrictions would need to be temporarily eased for SAFE loans. New eligibility criteria based on maximum loan-to-value and debt-to-income ratios would circumscribe the available SAFE loans. GSE investment portfolio caps may need to be temporarily eased to the extent of the SAFE loans purchased and held. In addition, the portfolio of new SAFE loans will require credit enhancements. In the case of FHA-lenders, FHA already provides credit insurance, and Ginnie Mae already provides guarantees. Treasury's FFB could provide backstop credit enhancements for other SAFE loans, for which Treasury would charge a guarantee fee.

While important details would need to be worked out regarding the SAFE loan plan, one should be able to rely on existing government agencies, mortgage market institutions, delivery systems, and instruments. In this manner, implementation could occur relatively quickly, in comparison to models relying on creating a new institution. Moreover, the SAFE loan plan would contain a shut-off valve that ended the program once market confidence and liquidity are restored. I and the other members of the team working with the Center for American Progress would be pleased to continue to work with all of you and your staff to develop these proposals in the weeks ahead.

Range of Responses Needed

Along with the SAFE loan plan, Congress ought to enact a range of complementary policies to address the housing crisis. As my fellow panelists will discuss in more detail, judicially supervised modifications of home mortgages should be permissible under certain narrow circumstances. Moreover, with significant foreclosures comes concentrated, local economic harm, including depressed property values, abandoned buildings, and crime. Congress should help hard-hit states and localities with additional, timely funding for Community Development Block Grants and HOME funds, as well as state and local aid to deal with abandoned and foreclosed properties, as outlined by CAP, NHS, and Enterprise, and discussed by my fellow panelist Doris Koo.

Moreover, we need to fill what my friend, the late Federal Reserve Governor Ned Gramlich aptly termed, "the giant hole in the supervisory safety net."[6] We should take this opportunity to implement common sense reforms to the mortgage market, to reduce the likelihood of such a crisis in the future. In the Senate, Chairman Dodd and Senator Schumer and others have introduced important legislation to clean up the mortgage

[6] Edward M. Gramlich, "Booms and Busts: The Case of Subprime Mortgages," Presented in Jackson Hole, Wyoming, Aug. 31, 2007.

process and regulate mortgage brokerage to drive out abuses. Such legislation should be enacted. In addition, the Federal Reserve Board's recent proposals to bar unfair and deceptive mortgage practices should be implemented immediately. Moreover, to increase transparency, all borrowers need to be able to get firm price quotes on loans and settlement services in order to comparison shop. We also need to increase public disclosure and regulatory monitoring of credit standards.

In addition, Harvard economist Sendhil Mullainathan, Princeton psychologist Eldar Shafir, and I have argued for a new, opt-out mortgage plan.[7] While the causes of the mortgage crisis are myriad, a central problem was that brokers and lenders offered loans that looked much less expensive than they really were, because of low initial monthly payments and hidden costly features. As Ned Gramlich asked, "Why are the most risky loan products sold to the least sophisticated borrowers?"[8] Many borrowers took out loans that they did not understand and could not afford, with predictable results.

In retirement policy, behavioral research has led Congress to promote "opt out" plans under which employers sign workers up for retirement benefits unless the worker chooses not to participate. This policy has significantly improved people's retirement savings. Under an opt-out home mortgage plan, borrowers would be offered a standard set of mortgages, with sound underwriting and straightforward terms. And that's the mortgage they'd get, unless they opted out. An opt-out system would mean borrowers would be more likely to get straightforward loans they could understand, without blocking beneficial financial innovation.

Conclusion

Let me conclude by saying that there are undoubtedly risks to this approach. The federal government would end up bearing some residual risk, and there are potential problems of adverse selection and moral hazard. There are also concerns of equity, as some homeowners will be helped, while other homeowners will be left to pay their loans in full. There are steps one can and should take to mitigate these concerns, some of which I have outlined above, but they cannot be fully eliminated in any program.

On the other side must be balanced the risks of doing nothing, with mounting foreclosures and a serious credit crunch further depressing the economy and causing widespread harm to families, communities, and our national economy. Our financial markets are currently unable to get us out of this crisis, and the consequences are getting worse every day. If we do not take the steps today to facilitate the private market restructuring these loans and restoring liquidity and confidence, we risk finding ourselves in six or nine months with a crisis so severe that the best option available is direct government intervention. While the question is not without difficulty, in my judgment the risks of the proposal are significantly outweighed by the risks of failing to act.

Stabilizing housing markets will be crucial to working through excess housing inventory and setting the economy on a road to normalcy. As Treasury Secretary Henry Paulson has stated: "The overhang of unsold houses will contribute to a prolonged adjustment, and poses by far the biggest downside risk [to the economy]."

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[7] For details of the opt-out mortgage proposal, see Michael S. Barr, Sendhil Mullainathan and Eldar Shafir, "Behaviorally Informed Home Mortgage Regulation," Joint Center on Housing Studies, 2007.

[8] Gramlich, op. cit.

The SAFE loan plan can help to restore confidence and liquidity in our housing finance markets. It could help to keep responsible borrowers in their homes. And it could help to end the vicious cycle of defaults, foreclosures, credit tightening, and contagion to other markets, which have put us at a real risk of sustained recession or stagnation if we fail to act.

We have a shared responsibility for setting things right, and thanks to the leadership of Chairman Dodd, Ranking Member Shelby, and the distinguished members of this Committee, we have a shared opportunity to act swiftly, decisively, and wisely, to help American families through these trying economic times.

Appendix A

Proposal Team

- **David Abromowitz**- Partner, Goulston & Storrs and Senior Fellow, CAP. Abromowitz is a past chair and founding member of both the Lawyers' Clearinghouse on Affordable Housing and Homelessness and of the American Bar Association's Forum Committee on Affordable Housing and Community Development. 25 years experience in housing transactions and policy.

- **Andrew Jakabovics**- Associate Director for the Economic Mobility Team, CAP. Jakabovics holds a B.A. in Urban Studies from Columbia University and an Masters of City Planning from MIT, where he is currently pursuing his doctorate in the Department of Urban Studies and Planning.

- **Michael Barr**- Professor of Law, University of Michigan Law School and Senior Fellow, CAP. Barr previously served as Treasury Secretary Robert E. Rubin's Special Assistant and as Deputy Assistant Secretary of the Treasury for Community Development Policy. Barr conducts large-scale empirical research regarding low- and moderate-income households, including as the Principal Investigator for the Detroit Area Household Financial Services Study at the Survey Research Center of the University of Michigan, and as a key researcher for the FDIC's study of bank services for LMI households.

- **Ellen Seidman**- Director, Financial Services and Education Project, Asset Building Program, New America Foundation and EVP, National Policy and Partnership Development, ShoreBank Corporation. From 1997 to 2001, Seidman was Director of the U.S Treasury Department's Office of Thrift Supervision and served as Special Assistant for Economic Policy to President Clinton. She has also held senior positions at Fannie Mae, the United States Treasury Department, and the United States Department of Transportation.

- **Laura Tyson**- Professor of Business Administration and Economics, Haas School of Business, University of California at Berkeley and Former Dean, London Business School and Haas School of Business. Dr. Tyson served in the Clinton administration and was the Chair of The Council of Economic Advisors between 1993 and 1995, and she served as the President's National Economic Adviser between 1995 and 1996.

- **Susan Wachter**- Professor of Financial Management; Professor of Real Estate, Finance and City and Regional Planning, Wharton School of Business, University of Pennsylvania. Wachter has held many corporate and public sector leadership positions including; Academic Fellow, Urban Land Institute, 2003-2004; Advisory Board for Regulatory Research, National Association of Homebuilders, 2005-2006; Board of Directors, American Real Estate and Urban Economics

Association, 2003-2006; and Blue Ribbon Committee on Housing Finance, 2005-2006

- **Sarah Rosen Wartell**- Executive Vice President, CAP. During the Clinton Administration, Wartell served as Deputy Assistant to the President for Economic Policy and Deputy Director of the National Economic Council. Prior to serving at the White House, Sarah was a Deputy Assistant Secretary at the Federal Housing Administration in the Department of Housing and Urban Development.

Testimony of

Alex J. Pollock
Resident Fellow
American Enterprise Institute

To the Committee on Banking, Housing and Urban Affairs

United States Senate

Hearing on Foreclosure Prevention and Neighborhood Preservation

January 31, 2008

Refinancing the Mortgage Bust

Mr. Chairman, Ranking Member Shelby, and members of the Committee, thank you for the opportunity to be here today. I am Alex Pollock, a Resident Fellow at the American Enterprise Institute, and these are my personal views. Before joining AEI, I spent 35 years in banking, including twelve years as President and CEO of the Federal Home Loan Bank of Chicago. I am a Past President of the International Union for Housing Finance and a director of three companies in financial businesses.

In my career I have experienced many credit crises, such as the credit crunch of 1969; the real estate investment trust collapse of 1975; the oil, commercial real estate, and Less-Developed Country loan crises, as well as the savings and loan collapse, of the 1980s; the debt panics of the 1990s; up to the current and severe housing and mortgage bust, which continues its panicky downward course, with the risk of a major downside overshoot.

Context

The bust has followed inevitably, as the night follows the day, the great housing and mortgage bubble of the new 21st century. This time we apparently had the greatest house price inflation in American history, accompanied by the unsustainable expansion of

subprime credit, which both fed the house price increases and seemed to be justified by them. Bubbles are notoriously hard to control, because so many people are making money from them while they last. The price inflation stimulated the lenders, the borrowers, the mortgage brokers, the homebuilders, the realtors, the investors, the bond salesmen, the CDO designers, the speculators, the bond insurers, and the flippers. The value of residential real estate about doubled between 1999 and 2006, increasing by $10 trillion. As Walter Bagehot so rightly observed in 1873:

> "All people are most credulous when they are most happy; and when much money has just been made, when some people are really making it, when most people think they are making it, there is a happy opportunity for ingenious mendacity. Almost everything will be believed for a little while."

Bagehot's description certainly fits the developments of the subprime mortgage market.

To help encourage more moderate and rational housing finance behavior in the future, I believe an essential long term reform is to insure clear and straightforward disclosure to borrowers of what mortgage loans really mean to them and to their household income. I have proposed a one-page disclosure form, "Basic Facts About Your Mortgage Loan," to achieve this, and would like to thank Senator Schumer for introducing S. 2296 with the same goal. I hope its provisions will be included in any mortgage legislation adopted by the Committee. It will mean fewer foreclosures in the next cycle.

As for this cycle, our recent bubble and the ongoing bust display all the classic patterns of recurring credit overexpansions and their painful aftermaths. Since this time the upside overshoot was so large, a correction is required, unavoidable and, as shown by many statistics we all know only too well, under way, but we should work to avoid a needlessly destructive self-reinforcing downward spiral.

It is evident that the current excess supply of houses, with the additional selling pressure from foreclosed properties, plus sharp curtailment of credit and reduced demand for

houses, means a trend of falling house prices. Informed forecasts suggest a national average drop of perhaps 15% over two or three years. The magnitude of the drop is uncertain, but the direction is certain. Unfortunately, falling house prices trigger higher mortgage defaults, as the house comes to be worth less than the amount owed. This is especially true when loans were made with small or no down payments, as they were, or were made to speculative buyers, as many were. Defaults are still rising in subprime mortgages, and rising in the Alt-A and prime sectors. As option payment mortgages reach their maximum negative amortization, they will join the parade. The expectations of house price appreciation have become the reality of house price depreciation, so defaults and foreclosures rise, which tends to reinforce the price declines.

We face the possibility of a self-reinforcing downward spiral of defaults, losses, credit contraction, falling house prices, foreclosures, greater losses, more credit contraction, further falls in prices, more foreclosures or what Chairman Bernanke has called a "financial accelerator." To use a different term, the risk of a "debt deflation" in so large and important a sector as housing-mortgage finance, needs to be addressed.

At a recent discussion of the mortgage bust, a senior economist from an international institution intoned, "What we have learned from this crisis is the importance of liquidity risk." "Yes," I replied, "that's what we learn from every crisis." Indeed, the tendency of financial markets to re-learn the same lessons over time is remarkable. Can we learn from the history of mortgage crises? Yes.

The Home Owners' Loan Corporation

A central lesson is that temporary interventions to ameliorate the probable overshoot of a downward cycle is a reasonable project with much historical precedent. A particularly suggestive analogy to our present foreclosure issues is presented by the history of the Home Owners' Loan Corporation ("HOLC"), which was very useful in addressing the massive mortgage collapse and foreclosure crisis of the 1930s. This was preceded by the overconfident mortgage lending and borrowing of the 1920s, which featured interest-only

loans, balloon payments, frequent second mortgages, the assumption of rising house prices and the firm belief in the availability of the next "refi". Sound familiar? Then came the defaults, foreclosures, and debt deflation. I believe the lessons of HOLC are again relevant and might be applied today.

HOLC was created by Section 4 of the Home Owners' Loan Act of 1933, which took only three and a half pages of text. It was from the beginning understood as a temporary, emergency intervention to provide refinancing and liquidity based on the government's credit, which would be withdrawn as normal market functioning returned.

The fundamental idea was that for three years (and only for three years) HOLC was to acquire defaulted residential mortgages from lenders and investors in voluntary transactions, thereby to avoid foreclosure and avoid adding properties to already overburdened markets, and then refinance the mortgages on more favorable and sustainable terms. The lender was relieved of a defaulted, non-earning asset, but often took a loss on the principal of the original mortgage, receiving less than its par value. This realization of loss of principal by the lender was an essential element of the reliquification program—as it should be today. It was, and would be, realization of a loss which, economically speaking, has already happened, but without the additional costs for all concerned of foreclosure. This was a refinancing, not just a modification of the loan.

The goals of the program were to:

- "Protect the small homeowner from foreclosure"
- "Relieve him of part of the burden of excessive interest and principal payments incurred during the period of higher values and higher earning power"
- "Declare that it was a national policy to protect home ownership"
- "Put the least possible charge on the federal Treasury"

- "Avoid injustice to the investor."

A pretty good list, I think.

HOLC's new loan to the refinanced borrower was limited to 80% of its appraisal of the value of the property, with a maximum of $14,000 in 1933 dollars. With an 80% loan, therefore, the maximum house price would be $17,500. Adjusting this by the Consumer Price Index would result in a current house price of about $270,000. Using the Census Bureau's change in median house prices since 1940 would suggest a current equivalent of approximately $1 million—so a HOLC analogy could be imagined to be able to operate today even with California house prices.

The act set the interest rate on the new mortgages to be made by HOLC to refinance the old ones it acquired at not more than 5%. The spread between this mortgage yield and the cost of HOLC bonds over time generated an average spread of about 2.5%. With current long Treasury rates of about 4%, an equivalent spread would imply a lending rate of about 6.5%.

HOLC was a government corporation, whose debt securities were government obligations, like Ginnie Mae today. It had a government board of directors. The Treasury was authorized to invest $200 million in HOLC stock. How much was $200 million is 1933? If simply adjusted to current dollars by the Consumer Price Index, it would be the equivalent of about $3 billion now. If adjusted to be proportional to GDP per capita, $20 billion. As a proportion of GDP, it would be about $46 billion.

The act originally authorized HOLC to issue $2 billion in bonds, or ten times its capital. Using the same three adjustment factors, this would be the equivalent of about $30 billion, $200 billion, or $468 billion today.

During its life, HOLC made more than one million loans to refinance troubled mortgages, something more than half of the loan applications made to it, which represented about 20% of all the mortgages in the country. By 1937, it owned almost 14% of the dollar value of mortgage loans outstanding. This was a remarkable scale of operations. Today, 20% of all mortgages would be about 10 million loans, and 14% of outstanding mortgages would be about $1.4 trillion—approximately the total of all subprime loans. We would not need this scale of operations, since our mortgage bust, while very serious, does not approach the collapse of the 1930s.

HOLC tried to be as accommodating as possible with its borrowers, and any such organization would have to control the servicing of its loans to carry out its function. As an at-risk lender, there will nonetheless inevitably be re-defaults and credit losses. HOLC ended up itself foreclosing on about 200,000, or 20%, of its loans. Since all these loans started out in default and close to foreclosure, this seems to me a quite respectable performance.

An essential provision of the Home Owners' Loan Act was its unambiguous direction that the directors "shall proceed to liquidate the Corporation when its purposes have been accomplished, and shall pay any surplus or accumulated funds into the Treasury."

In 1951, they did, returning an accumulated surplus of $14 million. In other words, they about broke even. A goal of a modest profit or breaking even seems appropriate for such an entity.

The principal historian of HOLC, C. Lowell Harriss, attributed much of its successful operations to the leadership of its Chairman, John H. Fahey, further observing that Fahey "consistently worked to liquidate the HOLC rather than to perpetuate or expand its power." Fahey seems to have been a strong personality, who was said to have dismissed 236 lawyers from HOLC for incompetence and to have believed that the ideal business interview was "4 ½ minutes for business and 30 seconds for greetings and farewells." Any new version of the HOLC would doubtless need strong leadership to succeed.

Design Issues

If one wished to create an analogous capability to refinance the mortgage bust, a number of design issues naturally arise.

1. Should a new organization be created or should an existing one be expanded? In this context, the FHA, already slated for expansion, is an obvious possibility. The advantage of using an existing organization is infrastructure already in place; a new organization would have the advantage of clarity of purpose and of its temporary nature, with more ready enforcement of the sunset "when its purposes have been accomplished."

2. Should the government guaranty of its obligations be explicit or implied? HOLC's guaranty was explicit; an implied guaranty seems to involve the creation of a GSE, which I would not recommend.

3. Should the organization fund loans on its own balance sheet, like HOLC, or issue guarantees as a securitization conduit, like Ginnie Mae? Perhaps in today's markets, both.

4. I have been told, though I have not personally studied this issue, that sales of troubled residential mortgages face obstacles because of Privacy Act restrictions on what information servicers may share with potential buyers. Any such obstacles would have to be eliminated for the new refinancing organization to function successfully.

5. As in the 1930s, many troubled mortgages also involve second liens. Without foreclosure, the second liens would have to be addressed in some other fashion. HOLC had to deal with second mortgages and always settled out all subordinate liens as part of its new loan.

6. If a new government corporation were formed, it would need a board of directors. One might consider a board of, say, five government officers, with the Treasury Department playing a leading role, representing the 100% shareholder.

Doubtless we will be able to think of many other issues to be considered.

I am pleased, Mr. Chairman, that you have taken an interest in the possibility of creating such a refinancing capability to help address the ongoing mortgage and foreclosure problems so prominently facing us. On the House side, I have also been working with Congressman Mark Kirk along similar lines. At the very least, we can say that the historical HOLC experience is highly suggestive and well worth studying.

Thank you again for the opportunity to be here today.

Testimony of Doris W. Koo
President and Chief Executive Officer
Enterprise Community Partners, Inc.

On Strengthening our Economy:
Foreclosure Prevention and Neighborhood Preservation

Before the Senate Banking Committee
United States Senate
January 31, 2008

Thank you Chairman Dodd, Ranking Member Shelby and distinguished members of the Senate Banking Committee. My name is Doris Koo. I am president and chief executive officer of Enterprise Community Partners. I appreciate the opportunity to share with you our best thinking on how to stabilize an increasing number of communities impacted by the recent wave of foreclosures.

Enterprise is a leading provider of development capital and expertise needed to create decent, affordable homes and rebuild communities. For more than 25 years, Enterprise has pioneered neighborhood solutions through private-public partnerships with community organizations, financial institutions, local governments and others who share our vision. Enterprise has raised and invested $8 billion in equity, grants and loans to support the creation of 225,000 affordable homes, and is currently investing in communities at a rate of $1 billion a year.

Of the approximately 50 million outstanding mortgages in the U.S. today, approximately 10 million are subprime loans. According to the Center for Responsible Lending, one in five subprime loans originated in 2005 and 2006 will end in foreclosure.

The current discourse and the attention from Congress have, understandably and necessarily, focused on assistance to individual homeowners at risk of losing their homes. Enterprise wholeheartedly supports these efforts. But the foreclosure crisis also threatens the health and stability of many low- and moderate-income communities that will face disproportional concentrations of foreclosed properties. Without strategic federal intervention and resource deployment, these foreclosed properties will destabilize communities, erode tax bases, bring down property values of neighboring homes and undermine decades of progress in impacted neighborhoods by furthering a cycle of abandonment and disinvestment.

Enterprise was founded in 1982 by James Rouse, a visionary man who passionately believed that all low-income families should have access to fit and affordable housing as a first step in overcoming poverty. That remains Enterprise's mission to this day. Enterprise is actively addressing the foreclosure crisis by undertaking innovative pilot programs and modeling scalable, sustainable solutions in diverse local markets, helping to stabilize neighborhoods impacted by defaults and foreclosures.

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Impact of Concentrated Foreclosures on Low- and Moderate-Income Neighborhoods
We believe that prevention and other front-end interventions are the most important aspects of a multifaceted approach necessary to help the growing number of troubled borrowers keep their homes. Enterprise commends the Banking Committee's attention to the foreclosure crisis and its work to modernize FHA to provide safe mortgage alternatives to predatory lending, preserve homeownership and provide counseling to troubled borrowers.

But the sad reality is that despite these efforts, many families have already lost or will lose their homes. If the forecast on foreclosure trends materializes – estimates are that one million mortgages will default in the next two years – current disposition channels such as auctions and discounted sales will not suffice, contributing to a mounting stock of vacant properties owned by lenders or investors. The longer these real estate owned properties, known as REOs, sit vacant, the more they will contribute to falling property values and loss of demand from potential owner-occupant homebuyers. Moreover, appraisers now have to include foreclosure sales as comparable neighborhood sales, even if they are only a fraction of the original loan amount.

As home prices decline, investor-speculators step in, often looking for short-term profit with little commitment to or investment in the greater community. Landlord absenteeism and poorly maintained properties result, bringing blight, increased crime, public safety hazards and decreased tax revenues for municipalities. And neighbors who may or may not have been in subprime loans themselves begin to hear they now have "negative equity" in their homes, owing more than the home is now worth, unable to move, sell or use equity responsibly. The Center for Responsible Lending has estimated that 44.5 million homes adjacent to subprime foreclosed properties will lose value, and $223 billion in neighborhood wealth will be lost.

This picture is already a reality in many neighborhoods. The latest foreclosure problem is extraordinary, but it is not necessarily new. The federal government interceded in the 1970s and again in the1980s following the savings and loan crisis, when communities across the country faced rising crime, blight and neighborhood abandonment that accompanied mass-scale foreclosures. The federal government became a landlord overnight, taking over single-family homes and apartment buildings when owners could not afford mortgage payments. *The New York Times* described Brooklyn in the 1970s as filled with "empty, mostly two-family, houses foreclosed by the Federal Housing Administration in the past few years whose tinned-up doors and windows and rickety porches are a depressing legacy of lost hopes."

Today's vacant homes still symbolize lost hope, even though this crisis was created and accelerated by a market shift to subprime loans and predatory lending. Understanding the cause and effects will certainly help prevent future abuse in lending, but litigating and legislating against lending practices alone will not bring back neighborhoods destroyed by foreclosures and abandonment. We believe that the federal government can play a pivotal role today, as it did decades ago, to come up with creative and targeted solutions to help our cities and communities overcome these serious and immediate challenges.

I would like to share with you some ways in which Enterprise is crafting local and national partnerships to model successful neighborhood-based approaches to community stabilization, as well as provide policy recommendations.

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Strategies to Stabilize Distressed Neighborhoods

1. Building on Existing Models
Enterprise has long partnered with HUD to operate Asset Control Area (ACA) programs. Created by Congress in 1998, the ACA program allows FHA to sell at a discount all foreclosed, single-family homes it owns in designated revitalization areas that have high rates of foreclosures or low rates of homeownership. Preferred purchasers – local governments and experienced nonprofit organizations – must agree to buy all foreclosed homes within the designated area and develop a business plan for revitalizing the community, to include goals for increasing homeownership and assuring housing quality. They then rehabilitate and resell the homes to qualified income-eligible, working families.

Enterprise currently directly administers two ACA programs in Los Angeles and Dallas through an entity called Enterprise Home Ownership Partners (EHOP). We also invest in or support ACA programs in Baltimore, Cleveland, Columbus, New York City and Rochester. We are supporting efforts to establish new ACA programs in San Antonio and St. Louis. We believe we can learn important lessons from the ACA model to address the current REO crisis.

The ACA model can provide a vehicle for lenders and investors to transfer or sell, at a deep discount, foreclosed homes in designated areas to qualified, high-capacity nonprofits or to local governments. As it has with FHA foreclosures, this system would help limit losses from future foreclosures, prevent real estate speculation that exacerbates blight and slow neighborhood decline and disinvestment. Through quality restoration of the homes and careful homebuyer education, the Enterprise Home Ownership Partners (EHOP) program successfully utilized community minority contractors and nonprofit counseling partners to turn around several Los Angeles neighborhoods and increased ownership rates. There has been little or no default among the new homeowners during the five years EHOP has operated this program. Enterprise is in initial conversation with some servicers to explore opportunities to implement this model with REO properties in targeted locations.

2. Piloting New Local Solutions
Sometimes, local challenges require larger and more focused solutions. In partnership with the city of Cleveland, Neighborhood Progress, Inc. and the Ohio Housing Finance Agency, Enterprise intends to build upon the strength of the city's community development system to create a $21 million foreclosure respon~~se pilot. Dur~~ing the next three years, the partnership will collaborate in six neighborhoods on comprehensive development plans to mitigate foreclosures, restore housing market confidence, eliminate blight, preserve property values and redevelop vacant properties. The city is dedicating $1.2 million in existing Community Development Block Grant (CDBG) resources for demolition of vacant and functionally obsolete housing, and is contributing another $1.5 million in CDBG for soft-second mortgages to redevelop bank-owned foreclosed properties. Enterprise is collaborating with six local community development organizations to manage and raise the balance of the capital. As a result of this pilot effort, 300 homeowners will keep their homes, 150 vacant properties will be redeveloped as affordable ownership or rental homes, and 300 additional blighted properties will be demolished, with the land held as open space or for future development.

In Columbus, Enterprise has invested New Markets Tax Credits (NMTC) with the Columbus Housing Partnership (CHP), a local high-capacity nonprofit development organization. This

investment will enable CHP to purchase, rehabilitate and sell 737 foreclosed homes in targeted communities through its ACA program. A $9.5 million NMTC investment will leverage an investment of $84 million in total development costs, including city and county CDBG, housing trust fund dollars and private sector capital. CHP is acquiring properties through the city of Columbus land bank, discounted REO sales from lenders, and from real estate auctions. This is a new, innovative use of the NMTC program, which Congress authorized in 2000 to stimulate community and economic development in qualifying low-income areas.

3. Exploring New Financing Mechanisms

In the past three years, Enterprise has successfully launched sizable acquisition funds across the country, including in Atlanta, Louisiana and New York City, to provide capital to affordable housing developers to quickly acquire properties to preserve affordable housing and stabilize communities. We are currently exploring opportunities to apply this approach to assist municipalities and states as they work to gain control of vacant foreclosed properties for demolition, land banking, rehabilitation or resale. In Ohio, Enterprise is discussing creation of a state and county land bank with state and local officials. Enterprise would work with national partners to structure the financing vehicles and maximize public subsidies by leveraging private sector investment.

Additionally, we are in early discussions with other partners to create special financing tools for gaining control of vacant foreclosed properties in several targeted states. Senators Kerry and Smith recently introduced S. 2517, legislation that would temporarily allow state housing finance agencies to broaden their tax-exempt bond programs to include mortgage refinancing to provide an important role for state and local housing agencies. We support this approach as well as the Center for American Progress' Saving America's Family Equity (SAFE) proposal to buy existing mortgage pools at a discount and resell them to government-sponsored enterprises (GSEs) and/or FHA lenders who would refinance troubled owners into affordable, fixed-rate loans.

Neighborhood Stabilization Fund in Economic Stimulus Package

Economic stimulus funds must move quickly to local markets where housing activity is grinding to a halt, where non-subprime homeowners are being trapped by negative equity and vacancies are contributing to rapid neighborhood decline. In many markets, REO stock is being sold at auction and bought by speculators or investors whose intentions may not be in the best interest of the community. Providing a mechanism for proven and effective stewards of affordable housing to buy homes in these neighborhoods as part of a stabilization strategy is smart and responsible policy. Targeting stimulus funds into housing markets has both short- and long-term public benefit, and should be included as a complement to taxpayer-based assistance in the stimulus package and the proposals currently before the Senate Finance Committee.

As an immediate step to stave off additional community distress caused by the mortgage foreclosure epidemic and growing numbers of REO-foreclosed properties, we join the National Foreclosure Prevention and Neighborhood Stabilization Task Force in calling on Congress to authorize flexible block grant resources as part of the economic stimulus package that can be quickly deployed to the hardest hit states and localities. We support the creation of a Neighborhood Stabilization Fund to provide immediate and flexible capital to remove troubled properties from third-party investors, servicers and lenders and help place these properties in the hands of local agencies, nonprofit entities, and responsible entrepreneurs whose mission and interests are to preserve neighborhood

viability. A more detailed Neighborhood Stabilization Fund proposal is outlined in a paper supported by the Center for American Progress and Enterprise.

Hard-hit low- and moderate-income neighborhoods will only be stabilized when responsible organizations can access capital to put vacant, foreclosed properties in productive use, turning a community liability into a community asset. The ability of qualified community-based nonprofits, local governments, quasi-governmental land banks, housing authorities, CDFIs and regional or national nonprofit intermediaries to acquire REO-foreclosed homes through discounted bulk sales or donations must be encouraged and enhanced.

There is no lack of demand for decent, affordable housing. Foreclosure-impacted neighborhoods need public capital to reinvigorate responsible private investment – whether this investment is a result of individuals buying homes once again, lenders making prime loans or responsible entities holding and leasing the properties until markets improve. A Neighborhood Stabilization Fund should provide funds to acquire, repair, resell and, where necessary, temporarily lease foreclosed, vacant homes. Each local fund should provide some combination of start-up capital for land banks to hold foreclosed properties for redevelopment, construction loans, affordable second mortgage loans that can leverage prime first mortgages, loan loss reserves and funds for local government to demolish abandoned, blighted structures in targeted redevelopment areas. Whatever the methods, the ultimate goal should be for owner-occupants to move back to the neighborhoods hardest hit with foreclosures.

A $10 billion investment in a Neighborhood Stabilization Fund, one that could stream through an existing source such as the Community Development Block Grant program, will not only spur reinvestment in areas impacted by foreclosures but result in significant national economic benefits as well. Using construction activity multipliers developed by Texas A&M University and the National Association of Home Builders, we estimate that a $10 billion investment will generate at least $25 billion in direct and "ripple effect" economic activity nationwide, employ 80,000 people, generate more than $2 billion in one-time revenue for all levels of government and restore nearly $150 million per year in local government real estate tax collections.

Grants or loans provided through a Neighborhood Stabilization Fund would leverage other development finance resources, including tax and accounting incentives to investors to sell the loans or swap them for subordinated securities from nonprofit organizations or other forms of risk participation. Further leverage could derive from Community Development Financial Institution interim financing as well as funding for qualified nonprofits to acquire and redevelop the properties.

Once acquired, homes would be rehabilitated and reoccupied without delay by pre-qualified low- and moderate-income homeowners using affordable and appropriate fixed-rate mortgage products. In order to promote long-term sustainability of these properties, the rehabilitation of these homes must meet HUD minimum quality standards or local building codes, whichever are more stringent. Where stagnant market conditions preclude homeownership as a viable option, homes could be offered for lease-purchase. Where no homebuyer is immediately available (e.g., within three months of acquisition), nonprofit owners of these properties could affordably rent homes to income-eligible households, with preference for rent-to-own agreements. A comprehensive neighborhood stabilization policy should include providing affordable rental housing opportunities in markets

where homeownership is less viable. In an effort to ensure that these funds are targeted to families of greatest need, homes should be sold or rented with a preference for households at or below 120 percent of area median income.

To ensure success, Congress must provide general authority to the HUD Secretary to waive regulations that can make deployment of funds time-consuming and cumbersome, such as local match and environmental review requirements. The Fund should target defined areas of eligibility, which should include low- and moderate-income census tracts; or areas that have high concentrations of foreclosures or high rates of loan defaults; or areas with concentrations of high cost loans.

Long-term preservation of housing affordability is critical. Local stakeholders could resell homes as part of a community land trust or other shared equity arrangement. When a home is resold, the public resource investment should remain tied to the home or proceeds should be reinvested in accordance to a community revitalization plan.

Additional Policy Recommendations

Expand the New Markets Tax Credit
The highly successful $16 billion New Markets Tax Credit program is an innovative financial tool providing private sector capital to qualified Community Development Entities (CDEs) for community revitalization in low-income communities across the nation. The Treasury Secretary should consider prioritization of NMTC applications in 2008 that include loans to or investments in businesses and projects located in low-income areas impacted by large concentrations of foreclosures. Since the program expires at the end of this year, Congress should certainly authorize a long-term extension.

Maximize CDFI Resources
Congress should authorize a special allocation of Community Development Financial Institution (CDFI) grants and loan funds to local CDFI entities to facilitate acquisition and rehabilitation of foreclosure properties. Congress should also modify the CDFI Bank Enterprise Award program, targeting funds to FDIC-regulated financial institutions' activities that specifically address foreclosure prevention and mitigation as well as REO disposition and community stabilization.

Utilize CRA Requirements
Congress should consider making REO property disposition an eligible activity toward banks' responsibilities under the Community Reinvestment Act. Banks should receive CRA credit for donation of real estate to a qualified nonprofit organization or state or local agency that will restore foreclosed and vacant properties to productive use.

Enact a National Housing Trust Fund
The Senate should proactively advance passage of S. 2523, the National Affordable Housing Trust Fund Act of 2007. A national housing trust fund is a critically needed tool to help stabilize neighborhoods, bringing off-budget resources to the production, preservation and rehabilitation of housing that is affordable to low-income households.

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Expand the Asset Control Area Program
The ACA program could be expanded to new locations where it can help turn FHA foreclosed homes back to productive use and supplement Neighborhood Stabilization Fund activities. Moreover, the cities with existing ACA programs generally have capacity to expand their operations and could purchase non-FHA foreclosed homes within existing or expanded revitalization areas as part of a broader neighborhood revitalization strategy.

Leveraging Resources to Ensure Community Stability
By leveraging the capacity of local governments and highly capable nonprofit organizations as well as proven programs and models – in this case, Community Development Block Grants, the ACA program and New Markets Tax Credits – we will stem the tide of foreclosures that threatens the stability and viability of neighborhoods nationwide. Congress can ensure that existing federal resources are put to the best possible and most efficient use. Congress can also lead new approaches and support creative innovations. Enterprise commends this Committee's recognition that the foreclosure crisis must be addressed in this economic stimulus package if we are to truly move toward solutions for individual families, whole communities and our country at large.

A recent study conducted by the Case Western Reserve University in Cleveland perhaps says it best: "It is unlikely that there will be sufficient buyers in the immediate future, either homeowners or investors in rental properties, to assure that these homes are reoccupied by families. Given the sharp decrease in values, there is the threat that the supply of affordable housing will be lost unless the market is supplemented by activities of nonprofit or government organizations who can acquire and maintain some of this housing stock that is stuck in transition."

We need to employ the best skills of all sectors – public, private and nonprofit – to ensure that our neighborhoods are stable, productive and real communities of opportunity for all families. Thank you.

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RESPONSE TO WRITTEN QUESTIONS OF SENATOR BENNETT FROM SHEILA C. BAIR

Q.1. Do property taxes affect mortgage default and foreclosure rates?

A.1. There is limited evidence directly linking property taxes to mortgage default and foreclosure rates. Also, it is uncertain what impact property taxes will have in the current environment, in which many loans reflect high debt-to-income (DTI) and low loan-to-value (LTV) ratios.

The limited evidence suggests that property taxes are one of many contributing factors to mortgage default and foreclosure rates during periods of high home price appreciation. However, property taxes appear to have less of an impact than other factors.

There are very few research studies that discuss the impact of property taxes on mortgage default and foreclosure rates. The conclusion from the few studies that exist is that property taxes alone do not contribute to default under ordinary market conditions. However, during periods of high home price appreciation, the resulting increase in property taxes may strain marginally-solvent homeowners and may contribute to mortgage default and foreclosure rates.

A December 2007 study from the Federal Reserve Bank of Boston focuses on home price appreciation and concludes that the subsequent increase in property taxes may contribute to foreclosure. However, this study has only one mention of tax delinquency as a contributing factor. (Kristopher Gerardi, Adam Hale Shapiro, and Paul S. Willen, "Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures," Federal Reserve of Boston Working Papers 07–015, December 3, 2007.)

A December 2007 report by the Federal Reserve Bank of Chicago evaluates potential factors influencing state-level differences in foreclosure rates. This report finds that property taxes do not contribute to foreclosure rates, after controlling for market conditions. (Lesllie McGranahan, "The Determinants of State Foreclosure Rates: Investigating the Case of Indiana," Federal Reserve Bank of Chicago ProfitWise News & Views, December 2007.)

Two additional reports briefly mention property taxes in the context of overall home ownership costs. They conclude that excessive homeownership costs may trigger default. (John Tatom, Why is the Foreclosure Rate So High in Indiana?, Networks Financial Institute at Indiana State University, NFI Report 2001–NFI–04, August 2007; and Christopher Herbert, The Role of Trigger Events in Ending Homeownership Spells: A Literature Review and Suggestions for Further Research, Abt Associates, Inc., prepared for U.S. Department of Housing and Urban Development, February 12, 2004.)

A dated study from 1992 finds that tax assessment rates in New York City were a major determinant in the widespread abandonment of residential buildings in the city between 1970 and 1984. (David Arsen, Property Tax Assessment Rates and Residential Abandonment: Policy for New York City, American Journal of Economics and Sociology, vol. 51, no. 3, July 1992, pp. 361–377.)

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM SHEILA C. BAIR

Q.1. Do you believe the housing crisis is going to spread further into other finance industries? Credit cards, Student loans, Auto finance, etc. . . . ?

A.1. Consumer loan performance peaked in first quarter 2006 due to generally favorable economic conditions, including factors such as strong job growth and strength in the housing sector. Since then, broader economic and financial conditions have weakened causing delinquency rates and the dollar amount of credit outstanding to increase on most types of consumer loans, such as credit card debt, auto loans, and home equity lines of credit.

Data from FDIC-insured institutions show that the noncurrent rate on credit card debt increased from 1.81 percent in second quarter 2007 to 2.22 percent in the fourth quarter. The net charge-off ratio increased only slightly from 4.03 percent to 4.08 percent, while the dollar amount of credit card debt outstanding increased from $374.0 billion to $422.5 billion. For other types of consumer loans, the noncurrent rate rose from 0.75 percent in second quarter 2007 to 1.01 percent in the fourth quarter. The net charge off ratio increased from 1.31 percent to 1.89 percent, and the dollar amount outstanding increased from $552.8 billion to $573.3 billion. For home equity lines of credit (HELOC) at FDIC-insured institutions, the noncurrent rate increased from 0.50 percent in second quarter 2007 to 0.86 percent in the fourth quarter, and the net charge-off ratio nearly tripled from 0.31 percent to 0.85 percent. The dollar amount of HELOCs outstanding increased from $576.7 billion to $607.4 billion.

The FDIC does not maintain separate data on auto loans or student loans. However, the latest Consumer Credit Delinquency Bulletin from the American Bankers Association shows that delinquencies on auto loans obtained directly from banks increased from 1.69 percent in June 2007 to 1.81 percent in September, and that delinquencies on student loans obtained directly from banks, which may be through a federally guaranteed program, increased from 4.73 percent to 5.30 percent over the same period.

FDIC analysts have evaluated regional differences between delinquencies in mortgage debt and credit card debt. Using data on mortgage and credit card delinquencies at the metropolitan statistical area (MSA) level from third quarter 2005 through third quarter 2007, FDIC analysts have found a high correlation between increases in mortgage delinquencies and increases in credit card delinquencies.

Although the credit distress that is evident in subprime: and Alt–A mortgage portfolios is not affecting every U.S. household, there is no question that this is one of the factors helping to push consumer loan delinquencies upward. We expect that problems in the housing sector will continue to adversely affect consumer loan performance in the near future. How much of an increase we see in problem consumer loans will continue to depend on a wider range of economic factors, including unemployment, wage growth and energy prices.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM MICHAEL S. BARR

Q.1. The Home Owership Preservation Corporation that is being discussed sounds like a novel approach at prevention. However I have questions about the auction process that has Treasury financing the purchase of delinquent mortgages in bulk by issuing securities and then selling them off via an auction process to be shifted into more secure loans.

1. What do you anticipate will be the appetite for the auctioned off loans in the market?
2. Will $10–$20 billion of start up capital be sufficient or will the cost to the Treasury be determined by the success of the auction process?
3. It took almost twenty years to pay off a similar corporation of this nature that was formed in response to the Great Depression—how long do you think a new corporation will need to be in existence? And when would it return its investment in full?
4. What type of loans do you see as ideal to be purchased and modified?
5. Please describe the process of sorting out the deserving loans vs. speculators who may have made a bad investment?

A.1.

INTRODUCTION

Legislation passed by the Senate Banking Committee providing for a Federal Reserve auction to permit bulk sales of loan pools to private sector participants and new authorities to FHA to insure restructured mortgages would provide a key to broad scale restructuring of troubled home mortgages and the restoration of stability to mortgage markets. For more than a year, financial institutions and the complex legal entities that hold the bulk of troubled subprime and Alt-A mortgages have failed to slow the pace of foreclosures—despite exhortation by the Bush administration for mortgage servicers, lenders, and investors to provide voluntary relief. Foreclosure action was taken on almost one million properties in the second half of 2007, with more in the fourth quarter of last year than in the previous quarter, notwithstanding the voluntary efforts by the HOPE NOW alliance to curtail foreclosures. Divided ownership, conflicts of interest, and the tax consequences of mortgage restructuring further complicate the process.

The crisis in confidence and liquidity coupled with escalating foreclosures are likely to drive over-corrective declines in home and asset prices. Only by removing the sick assets and restructuring them into healthier assets can the effects be contained.

The Senate Banking Committee legislation is designed to solve two problems. *First, it would facilitate the refinancing of millions of mortgage loans in a timely manner, to avoid unnecessary defaults, foreclosure and more severe home price declines.* FHA insurance would be available for the new loans to encourage private lenders to act.

At the same time, *the legislation would help to restore liquidity and stability to the capital markets.* A Federal Reserve-organized auction would permit the private sector quickly to reprice existing

mortgage pools and restore financial stability. Existing pools of troubled loans would be swapped for cash and Treasury securities, at a steep, auction-determined discount. Current investors will take a haircut, exchanging their uncertain and declining-value assets for the liquidity and reduced market risk of Treasury securities or cash. Purchasers would have bought at a discount, and eligible loans could be refinanced with FHA insurance.

Currently many subprime mortgages are serviced on behalf of investors in securitization trusts whose interests are not identical. The servicers/trustees' unclear obligations to the investors, along with certain provisions of the Pooling and Servicing Agreements (PSAs), make it difficult for servicers to make beneficial modifications to at-risk mortgages and to prevent unnecessary foreclosures, and nearly impossible to sell such mortgages. A policy that encouraged the trusts, on a voluntary basis, to sell the loan or a pool of loans to a new owner, without the complex duties to various investors, would make it far more likely that beneficial modifications occurred at a rapid pace, especially if accompanied by policies providing federal credit enhancement for appropriate modified loans.

Unfortunately, provisions of the PSAs may preclude the servicer from selling individual mortgages or pools of mortgages to new holders in many circumstances when such a sale would be beneficial—both to investors and to homeowners. This problem can be readily addressed, however, through modification of the tax code governing Real Estate Mortgage Investment Conduits (REMICs). REMIC provisions can be enacted to make continued tax benefits contingent on PSA modifications that would permit servicers to sell loans under the program when it would be beneficial to the trusts. Modifications to REMIC would facilitate the sale of loans and/or loan pools to new owners and help to stabilize housing markets.

THE SENATE LEGISLATION LOAN PLAN WITH AN AUCTION: HOW IT WOULD WORK

Transfer, triage, and restructure at-risk loans

The overarching goal is to transfer, efficiently and transparently, large numbers of existing loans from the current holders of the mortgages, stymied by conflicting interests, to new owners, who will, as needed to avoid unnecessary foreclosures on owner-occupants, refinance them on affordable and responsible terms.

The auction and transfer

- The Federal Reserve would organize auctions, through which existing loans could be efficiently sold in bulk to FHA lenders. The government would not purchase any loans. The loans would be sold and bought by market participants.
- The auction would determine the price the new lenders would pay (with assurance that loans meeting certain criteria would be eligible for credit enhancement) and the price at which the current holders would sell, establishing a market price.
- The "haircut" will ensure there is no bailout of the financial institutions and existing investors, many of whom uncritically and irresponsibly created the bubble.

• Servicers could receive cash or Treasury bonds for the loans, allowing them to mimic, at a market-determined discount, the income stream anticipated by investors for a loan pool.

• Investors would take a hit, trading a reduction in asset value and yield. However, the widespread swap of now-illiquid pools of mortgage-backed securities for liquid Treasuries or cash could alleviate the credit crisis that has spread beyond housing-related securities.

• The resulting transfer also will help to unfreeze the capital markets. Current investors will exchange the mortgage-backed securities they hold, whose value is uncertain, for the liquidity and reduced market risk of Treasury securities or cash. Restoration of liquidity and transparency will help to restore financial stability to credit markets.

• When the auction-determined price for loan pools gets within a predetermined margin to the face value of the loan, the auction program will automatically shut off because the close-to-par pricing will indicate that it is no longer needed.

Portfolio triage

• Under program rules, purchasers of the pools of mortgages would refinance eligible loans for owner-occupants into new, FHA-backed loans.

• Loans that were currently performing and not at imminent risk would remain intact.

• Loans that would be unsustainable even if restructured would be foreclosed, or otherwise terminated, under program rules designed to prevent unnecessary adverse impacts.

Loan restructuring

• Responsible originators working with the Federal Housing Administration would restructure loans, when restructuring would reduce the likelihood of default, foreclosure, and liquidation.

• Only loans on owner-occupied homes, with currently unaffordable loans, would be eligible for refinance. Speculators would be excluded.

• Most of the refinanced loans would take the form of new fixed-rate 30-year mortgages underwritten to 90% of current home value.

• New loans would be originated with sound, individualized underwriting, based on the current value of the property and real income verification.

• The legislation provides for strict anti-abuse rules.

• The Senate legislation provides for adequate funding of the loan restructuring whether conducted through auctions or on an individualized basis. Funds for the program come from the GSEs as well as loan fees from lenders and borrowers. No taxpayer funds would be used for credit enhancements in the loan restructuring.

The specialized loan program will not be needed once stability is restored to the markets and the legislation provides for a cut-off of new authority in 2011.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TESTER FROM ROBERT K. STEEL

Q.1. How far into the housing crisis are we at this point? When do you believe foreclosure rates will reach their apex?

A.1. The housing correction began in early 2006, and the housing sector is likely to remain weak well into 2008. Inventories of unsold new and existing homes are elevated and look to remain high through the year. This will weigh on both housing prices and construction going forward. Some regions that experienced the highest house price increases during the boom are now seeing substantial home price depreciation. Housing starts overall are down more than 50 percent from their peak in early 2006. The number of permits for single-family homes remains lower than housing starts, pointing to continued future weakness in residential investment. Residential construction subtracted nearly a percentage point from GDP growth in both 2006 and 2007, and we expect it to remain a drag on growth into 2008.

The housing market downturn and broader economic weakness have contributed to an increase in mortgage delinquencies and foreclosures. Through Q3 of last year, we were on track for around a million and a half foreclosures started in 2007, however, many of these will not end up sold at a foreclosure auction or as a lender-owned property. It is unclear when foreclosures will peak, as that will depend on regional and overall economic conditions going forward. We expect the foreclosure rate to remain elevated above its historical average through 2008 and into 2009.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Statement of Thomas Bledsoe
President and CEO of The Housing Partnership Network

On Strengthening the Economy: Foreclosure Prevention and Neighborhood Preservation

The Senate Committee on Banking, Housing and Urban Affairs

Chairman Dodd, Ranking Member Shelby and distinguished members of the Committee.

Thank you very much for the opportunity to present the Housing Partnership Network's perspective on Strengthening the Economy: Foreclosure Prevention and Neighborhood Preservation, and thank you for your leadership on this critical issue that threatens to wreak havoc upon neighborhoods across our nation.

The Housing Partnership Network (the Network) is a peer network and business alliance of 94 of the nation's top-performing nonprofit affordable housing developers, owners, lenders, and housing counseling organizations (see list below). Our mission is to build affordable homes, better futures and vibrant communities for low- and moderate-income people through partnerships with our member organizations, the private sector, government, and philanthropic institutions. The Network helps these strong, accomplished organizations to do more. Through our unique, member-driven model, top performing nonprofits share knowledge and innovation, pool resources to access the capital markets more efficiently, and shape policy that reflects and enhances their practice.

The Network is a funding intermediary for the federal housing counseling program. Since 1995, we have provided more than $16 million in grants to 40 members, who have counseled 400,000 lower-income families—helping 90,000 buy or retain homes. We have also sponsored related initiatives in foreclosure prevention, single-family mortgage brokering, and technology. Our counseling program has broad geographic coverage, reaching most of the country's major urban centers. By far the most significant challenge to service provision that Network members face is the growing escalation of the sub prime market fallout and national foreclosure crisis. The dramatic increase in foreclosures nationwide has significantly impacted all Network affiliates. The prevalence of sub prime and predatory lending in recent years has resulted in hundreds of thousands of households throughout the country with delinquent or foreclosed on mortgages. In addition, as local economies struggle, many homeowners are struggling to meet mortgage obligations because of income or job loss. Network affiliates, including organizations that perform counseling services as well as those that are developers and owners in the multi- and single-family markets in their communities are seeing the impact of this dramatic trend first hand.

The Network has been an active member of the HOPE NOW alliance and we applaud Secretary Paulson and the Treasury Department's efforts to bring together many of the participants in this crisis, as well as their ability to help broker some effective responses that will assist struggling homeowners that find themselves trapped in a tumbling housing market with spiraling mortgage payments. But as the Chairman and the Committee have identified, there is still much to be done.

The testimony offered by Doris Koo of Enterprise Community Partners describes well the conditions that our members see across America, and the Strategies she lays out are thoughtful responses that we support and recommend to the Committee.

We would like to expand on the testimony presented and offer a few additional comments and suggestions on this subject.

Foreclosed Properties and Neighborhood Preservation

The resources proposed to be distributed to states and localities through the infusion of CDBG dollars is desperately needed to deal with the looming foreclosure crisis. However, there is an element to this problem that we believe needs additional consideration. All of the servicers, many of the originator/lenders and all of the investors/owners of the pools are national organizations. A local approach is critical, but by itself is insufficient. We believe that a local/national approach is the best way to manage the acquisition, operation, rehabilitation and the eventual resale of homes that have been foreclosed upon.

The current and proposed funding mechanisms do not allow for an efficient local/national approach to this problem. Each state or local government will likely devise a unique response to the foreclosure problem in their communities, while myriad local government, private and mission-driven organizations will work independently of each other to seek resources and respond to the crisis.

The Network believes that Congress should, in subsequent legislative efforts, make some portion, perhaps 25%, of the funding in this arena available nationally through a swift competitive process, that would allow national mission-driven intermediaries to apply for resources that would allow us, working with our local members, to deal directly with the national servicers and investors in these mortgage pools to acquire, manage and return these foreclosed homes to productive use and help protect the neighborhoods in which they are located. We recommend a national competitive process managed by the Department of Treasury through CDFI group managed in a compressed time frame. The resources should be available for both the coordinating role and for the acquisition and holding costs of the REO inventory. The eventual sales of these homes would be facilitated by a comprehensive approach that emphasizes pre-purchase counseling, to reduce the risk of the recurring cycle of defaults.

By linking these cities and organizations together into a coordinated national initiative, the opportunity exists to create an effective, community based strategy to revitalize and sell properties at a scale and approach that is commensurate with the problem. The Network's proposal would allow for the coordination of the program at a national scale, providing resources and technical assistance for each community to develop and carry out a locally tailored strategy to revitalize foreclosed and distressed properties. Working

closely with governments and other key partners, the lead local nonprofit organization will develop a comprehensive plan that addresses property management, acquisition and rehabilitation, construction and end loan financing, marketing and homeownership counseling.

Fee for Service & Sustainability

Nationwide, the dramatic escalation of foreclosures has doubled the demand for loss mitigation counseling among Housing Partnership Network members. Members face capacity shortages to handle this volume, let alone the increased demand that will come as the foreclosure crisis deepens. While the recent federal appropriation for foreclosure mitigation counseling infuses much-needed resources to Network member communities, this is a one-time investment of funds that will expire on December 31, 2008. With experts recognizing this as at least a two to three year crisis (with continuing impact of foreclosures further into the future), the appropriation is not structured to sustain an effective response for the length of this crisis or over the long term. A sustainable business model that allows housing counselors to respond effectively to demand for foreclosure counseling must include a fee-for-service mechanism for counseling paid for by the mortgage servicing industry, which benefits most when foreclosure is avoided, as noted by the FDIC Chair Sheila Bair's testimony.

The Housing Partnership Network is an active member of the HOPE NOW Alliance. At present the HOPE Hotline is reimbursed at a rate of $100 for telephonic counseling sessions. While this is an important first step, the $100 reimbursement does not cover the actual costs of either telephone or face to face counseling and will not be sustainable in the long run. Recognizing that the $100 fee is inadequate to support high quality foreclosure intervention counseling, the HOPE NOW Alliance has developed a revised fee-for-service model that supports the cost of counseling at two distinct levels of service. Level One service, which is typically conducted via telephone, will be compensated at $150 per intervention for borrowers referred to participating servicers with the intake, authorization, and action plan complete. Housing counseling agencies will be compensated at $350 for more intensive counseling, in which borrowers are referred to participating servicers with a complete counseling packet, including intake, authorization, action plan, budget analysis, hardship letter, and supporting documentation complete. Adopting this consistent fee for service model will be critical to support the foreclosure mitigation efforts of nonprofit housing counseling agencies.

Given their trusted position and strong track records in the communities they serve, nonprofit housing counseling agencies play an essential role in helping borrowers avoid foreclosure and protect their homes. Counseling agencies are more likely to establish early contact with at risk borrowers, and through intensive one-to-one counseling sessions are able to deliver highly prepared borrowers to servicers. Nonprofit counseling agencies are doing this work, and a sustainable fee for service mechanism will allow them to help an even greater number of homeowners avoid foreclosure and remain in their homes.

Thank you again for your consideration. The members and staff of the Housing Partnership Network stand ready to assist the Committee and the nation in resolving this crisis.

The Housing Partnership Network
Membership and Chief Executive List

1260 Housing Development Corporation	Philadelphia	PA	Walter Kubiak
ACTION-Housing	Pittsburgh	PA	Lawrence Swanson
Aeon	Minneapolis	MN	Alan Arthur
Affordable Housing Partnership	Albany	NY	Susan Cotner
AHC, Inc.	Arlington	VA	Walter Webdale
Atlanta Neighborhood Development Partnership	Atlanta,	GA	John O'Callaghan
BRIDGE Housing Corporation	San Francisco	CA	Carol Galante
Caleb Foundation	Swampscott	MA	Warren Sawyer
Century Housing Corporation	Culver City	CA	Ronald Griffith
Chicanos Por La Causa	Phoenix	AZ	Pete Garcia
Cleveland Housing Network	Cleveland	OH	Robert Curry
Columbus Housing Partnership	Columbus	OH	Amy Klaben
Common Ground Community	New York	NY	Rosanne Haggerty
CommonBond Communities	St. Paul	MN	Paul Fate
Community Action Project of Tulsa County	Tulsa	OK	Steven Dow
CDC of Brownsville	Brownsville	TX	Don Currie
Community Development Corporation of Utah	Salt Lake City	UT	Darin Brush
Community Housing Initiatives	Spencer	IA	Douglas LaBounty
Community Housing Partners Corporation	Christiansburg	VA	Janaka Casper
Community Preservation and Development Corp.	Washington	DC	J. Michael Pitchford
Community Preservation Corporation	New York	NY	Michael Lappin
Community Reinvestment Fund	Minneapolis	MN	Frank Altman
Community Services of Arizona	Chandler	AZ	Brian Swanton
Dallas City Homes	Dallas	TX	Karen Crosby
Eden Housing	Hayward	CA	Linda Mandolini
Enterprise Corporation of the Delta	Jackson	MS	William Bynum
Family Housing Fund	Minneapolis	MN	Thomas Fulton
Foundation Communities	Austin	TX	Walter Moreau
Great Lakes Capital Fund	Lansing	MI	Mark McDaniel
Greater Metropolitan Housing Corporation	Minneapolis	MN	Carolyn Olson
Greater Miami Neighborhoods	Miami	FL	Russell Sibley
Greater Rochester Housing Partnership	Rochester	NY	Jean Lowe
Gulf Coast Housing Partnership	New Orleans	LA	Kathy Laborde
HAP, Inc.	Springfield	MA	Peter Gagliardi
Hispanic Housing Development Corporation	Chicago	IL	Paul Roldan
Homes for America	Annapolis	MD	Nancy Rase
Housing Assistance Corporation	Hyannis	MA	Frederic Presbrey
Housing Development Corporation of Lancaster	Lancaster	PA	Michael Carper
Housing Development Fund	Stamford	CT	Joan Carty
Housing Partnership, The	Charlotte	NC	Patricia Garrett
Housing Partnership, Inc.	Louisville	KY	F. Lynn Luallen
Housing Partnership Development Corporation	New York	NY	Daniel Martin
Housing Partnership of Northeast Florida	Jacksonville	FL	Carolyn Ettlinger
IFF	Chicago	IL	Trinita Logue
Indianapolis Neighborhood Housing Partnership	Indianapolis	IN	Moira Carlstedt
Interfaith Housing Alliance	Frederick	MD	James Upchurch

LINC Housing Corporation	Long Beach	CA	Hunter Johnson
Long Island Housing Partnership	Hauppauge	NY	Peter Elkowitz
Low Income Investment Fund	San Francisco	CA	Nancy Andrews
Massachusetts Housing Investment Corporation	Boston	MA	Joseph Flatley
Mercy Housing	Denver	CO	Lillian Murphy
Metro Housing Partnership	Flint	MI	Ravi Yalamanchi
Metropolitan Boston Housing Partnership	Boston	MA	Chris Norris
Mid-Peninsula Housing Coalition	Foster City	CA	Fran Wagstaff
Minnesota Home Ownership Center	South St. Paul	MN	Julie Gugin
Mississippi Housing Partnership	Jackson	MS	Timothy Collins
Montgomery Housing Partnership	Silver Spring	MD	Robert Goldman
National Affordable Housing Trust	Columbus	OH	James Bowman
National Church Residences	Columbus	OH	Thomas Slemmer
National Community Renaissance	Rancho Cucamonga	CA	Rebecca Clark
NCB Capital Impact	Arlington	VA	Terry Simonette
Neighborhood Housing Services of Chicago	Chicago	IL	Bruce Gottschall
Neighborhood Housing Services of NYC	New York	NY	Sarah Gerecke
Nevada HAND	Las Vegas	NV	Michael Mullin
New Community Corporation	Newark	NJ	William Linder
New Orleans NDF	New Orleans	LA	Rosalind Peychaud
New York Mortgage Coalition	New York	NY	Cecilia Fucuy
North Carolina Community Dev. Initiative	Raleigh	NC	Abdul Sm Rasheed
Ohio Capital Corporation for Housing	Columbus	OH	Hal Keller
Omni Development Corporation	Providence	RI	Joseph Caffey
Phipps Houses Group	New York	NY	Adam Weinstein
Planning Office for Urban Affairs	Boston	MA	Lisa Alberghini
Preservation of Affordable Housing	Boston	MA	Amy Anthony
Progressive Redevelopment, Inc.	Decatur	GA	Bruce Gunther
Project for Pride in Living	Minneapolis	MN	Steven Cramer
Raza Development Fund	Phoenix	AZ	Tom Espinoza
REACH Community Development	Portland	OR	Dee Walsh
Reinvestment Fund, The	Philadelphia	PA	Jeremy Nowak
Religious Coalition for Community Renewal	Charleston	WV	Sandra Hamlin
Rocky Mountain Mutual Housing Association	Denver	CO	Douglas Smith
Rural Community Assistance Corporation	West Sacramento	CA	Stan Keasling
San Antonio Alternative Housing Corporation	San Antonio	TX	Rod Radle
San Antonio Housing Trust Foundation	San Antonio	TX	John Kenny
Santa Fe Community Housing Trust	Santa Fe	NM	Sharron Welsh
Settlement Housing Fund	New York	NY	Carol Lamberg
Sioux Empire Housing Partnership	Sioux Falls	SD	Jim Schmidt
South County Housing	Gilroy	CA	Dennis Lalor
South Shore Housing	Kingston	MA	Stephen Dubuque
Southwest Minnesota Housing Partnership	Slayton	MN	Rick Goodemann
St. Ambrose Housing Aid Center	Baltimore	MD	Vincent Quayle
Tarrant County Housing Partnership	Forth Worth	TX	Donna Van Ness
Wesley Housing Corporation of Memphis	Memphis	TN	Larry Kaler
Wesley Housing Development Corporation	Alexandria	VA	Shelley Murphy
Wisconsin Partnership for Housing Development	Madison	WI	William Perkins

Statement by

Douglas Duncan, Ph.D.

Senior Vice President and Chief Economist

Mortgage Bankers Association

For the Record of the

Committee on Banking, Housing and Urban Affairs

United States Senate

January, 31 2008

Hearing on

"Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation"

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to submit a statement for the record for the Banking Committee hearing entitled, "Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation." My name is Douglas G. Duncan, Chief Economist and Senior Vice President of Research and Business Development at the Mortgage Bankers Association (MBA).[1] I am presenting MBA's perspective on the current market, how we can continue to work together to stabilize it, help borrowers in trouble and prevent some of the current problems from occurring again.

Almost one year ago, I came before this committee and discussed the state of the housing market. My testimony focused on how the market was performing and discussed the kinds of loans American borrowers were choosing, how they worked and how market innovation led to increased rates of homeownership. Today, the markets have changed significantly. In a little over a year, we have gone from a market of relatively loose credit, to one where credit is severely constrained. We have, in effect, a mortgage market that is going through a once-in-a-generation transformation. The mortgage market already looks very different from one year ago and it will look different one year from now.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2500 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

What has not changed is mortgage bankers' commitment to provide adequate credit opportunities to increase home ownership and quality rental housing. And when people find themselves in difficulty, lenders and servicers continue to work with them to find a successful outcome, whether through re-payment plans, forbearance, debt forgiveness, loan modifications or other loss mitigation options. There are some people we are not able to help, but it is important to understand that foreclosure is always a last option for our members. It is extremely expensive and represents, ultimately, a failure of our industry to help a homeowner achieve the American Dream.

We continue to believe transparency in the mortgage process needs to be improved to help borrowers understand, shop for and choose the loan to best meet their needs. We also believe a uniform national mortgage consumer protection standard for all homebuyers will simplify the process for borrowers and protect them, facilitate better enforcement against predatory practices and assist the smooth flow of global capital into the mortgage market.

Since last February, it has become clear that industry participants and policy makers needed to respond to the credit crunch and market conditions. In December, Congress passed important legislation extending the mortgage insurance deduction and providing tax relief for forgiven mortgage debt. Also last year, the Federal Housing Administration (FHA) launched the *FHASecure* program to help borrowers, who have made their payments before a rate reset, refinance into a FHA-insured loan. The mortgage industry too has clearly responded. In just the last few months, we have seen hundreds of thousands of borrowers helped through loan modifications, repayment plans and other workout options. Obviously, our goal is to help every

borrower possible, and the industry remains encouraged by how far we have come in a short period of time. Lenders and servicers have made huge strides to increase their capacity to help borrowers and these efforts must continue. We are just now starting to see the results of this stepped up capacity and other industry and government efforts.

Last fall, U.S. Treasury Secretary Henry Paulson and Department of Housing and Urban Development (HUD) Secretary Alphonso Jackson helped the industry form the HOPE NOW Alliance (HOPE NOW), which is actively assisting hundreds of thousands of borrowers struggling to make their mortgage payments through counseling and other outreach efforts. In addition, HOPE NOW has endorsed an American Securitization Forum (ASF) framework that could freeze interest rates for hundreds of thousands of subprime short-term adjustable rate mortgage (ARM) borrowers at their current rates for an additional five years. Modifications under the ASF framework should begin soon and will increase the number of borrowers who are receiving assistance. Add this to the over 370,000 borrowers who servicers assisted in getting a repayment plan or loan modification during the second half of 2007, and we are headed in the right direction. Much still lies ahead of us, but efforts to help borrowers are in place and working.

Fiscal and monetary policy must also respond to the current weakness in the overall economy. Any Congressional action should be with an eye towards increasing liquidity in the mortgage market and increase borrowers' financing choices. Further, Congress should make clear what the rules of the game are, so the current market upheaval is not exacerbated by a rapid change in regulation. These include passage of a uniform national mortgage lending standard, GSE reform

and FHA Modernization. In order for the market to change course, certainty must be realized by consumers, lenders and investors. With the possibility of major investor liability still on the horizon, secondary market participants and mortgage lenders will remain apprehensive of lending to all but borrowers with perfect credit. The longer these fears remain, the longer our housing market will take to rebound.

Current Market Conditions

Fundamentally, the demand for housing is driven by household formation and jobs creation. The single most important step Congress can take to support the housing market is to encourage long-term economic growth through sound fiscal and tax policy. Members of Congress should also recognize that housing and mortgage delinquencies react to economic conditions and are not a key driver of those conditions. States such as Ohio and Michigan have seen an exodus of jobs and population, stranding a significant amount of housing stock and lowering home prices in the region. States such as California, Florida, Arizona and Nevada saw speculative home construction that far outpaced the rate of household growth, causing home prices to retreat to levels of about two years ago. As long as economic growth continues, these Sunbelt states should be able to grow out of their problems. Other sections of the country face more long-term and intractable problems.

Overview of Industry Efforts to Help Borrowers

In my February 2007 testimony, I discussed at length the many different ways mortgage servicers work with homeowners in the loss mitigation process. Loss mitigation can take many different forms, all of which are aimed at one thing: getting the borrower through their financial

problems and able to sustain a loan. Whether through forbearance, a repayment plan, a loan modification or other tools, the goal is to help borrowers remain in their homes. Historically, the number one cause of delinquencies and foreclosures is job-related. As discussed earlier, this is currently evident in the Midwest, which has lost a significant number of manufacturing jobs.

However, in the last year, delinquency and foreclosure rates have increased due to upward rate adjustments on adjustable rate mortgages (ARMs) combined with falling home prices. With the recent decline in interest rates more homeowners are receiving favorable mortgage rates, either through lessening the burden on ARM adjustments or re-finance opportunities. However, housing price declines make it harder for borrowers to qualify for certain mortgages, such as a loan taken out with a 20 percent down payment (80 percent loan-to-value), for example, may now be a 90 percent LTV loan due to a 10 percent house price decrease.

Historically, delinquency rates tend to peak in the first three to five years after origination. Because more than half of outstanding loans are less than five years old, it stands to reason that delinquency and foreclosure rates would be increasing at this time under normal circumstances. However, these are not normal circumstances. We are facing an unprecedented overhang in the supply of homes, driving down prices in a number of markets. The overbuilding of homes in markets in California, Florida, Arizona and Nevada has driven down prices from unsustainable levels and has directly led to the foreclosure problems in those states. In Michigan and Ohio, the dramatic loss of jobs and general demographic trends have led to vacant houses with too few

potential buyers who can qualify for a loan. The economies of these states are clearly at the root of the housing crisis.

Given increased delinquency and foreclosure rates, lenders are taking significant action to help borrowers. Most of these options were discussed at length in my February testimony, but bear repeating since there has been concern that servicers are not doing enough to help borrowers.

It makes good economic sense for mortgage servicers to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are very costly to the servicer, who must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, significant staff resources must be employed to contact the borrower, assess the situation, work on repayment plans, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance plans are generally the first tool servicers employ to help borrowers. Servicers allow mortgagors to miss a payment, with the explicit understanding the payment(s) will be made up some time soon. If the situation is more involved than a short- term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended time frame.

Loan modifications are the next level of loss mitigation options. A loan modification is a change in the underlying loan document. It might extend the course of the loan, change the rate, change

repayment terms or make other alterations. The changes to the loan, however, are permanent and represent a new contractual obligation for the borrower. Similarly, a servicer may, depending on the agreement the servicer has with the ultimate investor, attempt to completely refinance the delinquent borrower into a new loan.

Servicers, however, can only help borrowers who want to be helped. Borrowers must respond to servicers notices and phone calls. At some point, the servicer has to assume the property is abandoned or the homeowner has no intention of paying off the obligation. This is why the most important thing lawmakers can do is to use the ability to influence the media to get the word out that if borrowers are in trouble they should reach out to their servicer. Servicers are also actively reaching out to borrowers. As part of the HOPE NOW Alliance, servicers sent letters to almost 500,000 at-risk borrowers encouraging them to contact their servicer or a HOPE NOW representative. In addition, mailing of another round of letters began last week, bringing the total to more than 700,000. It is human nature not to want to reach out to the company to which you are indebted. We understand that. If people do not want to call lenders, they should reach out to a housing counselor, a minister, or call 1-888-995 HOPE.

Last week, through MBA's financial assistance, 38 Mayors who were in Washington created public service announcements for their local media markets urging borrowers to do the same thing. We can not stress this enough: the longer it takes for a borrower to reach out to their servicer, the fewer options available to help.

A Snapshot of What the Industry is Doing to Help: 3rd Quarter of 2007

Recently, MBA authored an empirical report on how servicers helped borrowers at a particular point in time, the third quarter of 2007. As indicated earlier, this was before the HOPE NOW initiative got off the ground, so it gives a good sense of servicers' traditional ability to help, while also setting a "floor" from which the industry can be judged moving forward. Attached to this testimony is the paper, "*An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and other Loss Mitigation Activities in the Third Quarter of 2007*," from which several important facts should be highlighted.

During the third quarter of last year, mortgage servicers helped about 183,000 borrowers through repayment plans. They modified the rates or terms on about 54,000 more loans: 13,000 of which were subprime ARM loans, 15,000 subprime fixed rate loans, 4,000 prime ARM loans and 21,000 prime fixed-rate loans. As you can see from these numbers, the industry helped over 230,000 borrowers during the third quarter. More importantly, HOPE NOW has reported that over 250,000 borrowers received repayment plans, another 120,000 received loan modifications for the second half of 2007, and servicers were modifying subprime loans during the fourth quarter at triple the rate of the third quarter.

Misleading Reports Fuel Public Concern

The paper also discussed something known in our industry as the "Moody's 1% Number." In September 2007, Moody's released a study suggesting the mortgage industry had only assisted 1 percent of the people who needed help. A later report then stated it was 3.5 percent. Despite the fact that in its December report Moody's went to great lengths to put the numbers into the right

context, others continue to look at the number of loan modifications solely in terms of loans outstanding. The problem with this type of analysis is that it uses the wrong measures to accurately judge the situation. In the Moody's "*US Subprime Market Update: November 2007,*" from which the 3.5 percent is cited, states "a meaningful barometer of the extent to which servicers are undertaking loss mitigation activity was 24%."

Another problem with the initial Moody's analysis, but since addressed in the later report, is that it used as the denominator the complete universe of subprime ARMs whose rates are resetting in a particular period. Only a limited number of borrowers with subprime ARMs can be helped or need to be helped. In the third quarter of 2007, according to MBA's National Delinquency Survey, approximately 70 percent of subprime ARM borrowers were paying on time, although this percentage will continue to fall as a number of subprime ARM borrowers refinance into other loans and the number of subprime ARM loans outstanding continues to fall. Many borrowers refinance prior to the rate reset, and many others default before the rate reset for reasons completely unrelated to the rate reset.

A more appropriate measure is not to look at the numbers of borrowers assisted relative to the number of borrowers who go into foreclosure, but the total number of borrowers helped versus the total number of borrowers who need help. Looking at the foreclosure number by itself is not a good measure because a number of borrowers facing foreclosure cannot be helped by a payment modification plan. Among these are investors, and people who default despite a previous loan modification or repayment plan.

Various groups have used the 3.5 percent figure as a political rally cry. If the 24 percent number is used and then the number of speculator/investment property loans is deducted from the total, you will see a much larger number of borrowers were helped during the specific period. This does not exclude those borrowers who have not been able to comply with their current repayment plans or who have not responded to servicers' efforts to assist them.

Why All Borrows Can't be Helped

The last group is investors, for whom help is not available. During the housing boom of the last several years, there were a lot of speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means that you do not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are turning away from their properties and defaulting. In the third quarter of 2007, 18 percent of foreclosure actions started were on non-owner occupied properties. Foreclosure starts for the same period for Arizona, Florida, Nevada and Ohio were at 22 percent for non-owner occupied properties. When assessing the magnitude of the assistance being given to borrowers, it is critical that Congress exclude those loans from assistance calculations because the incentives for some investors to continue to pay their loans will not be influenced by a rate freeze, particularly in states like California and Florida. In fact, including them in the freeze will distort investment incentives and increase the likelihood that we will see such excess in the future.

Conclusion

As Congress continues its examination of the current situation in the housing market and our economy, there are a few things that you should consider. Were there loans made that probably should not have been made? Yes, there is no question bad loans were made and there were bad actors taking advantage of a robust housing market. Several key points should be highlighted as we all look to turn this current situation around. In the short term, the most important thing Congress, industry and consumer groups can do is to help those borrowers who are currently in trouble and occupying the home for which they have a loan. The industry has greatly increased its capacity and we are starting to see those results. We must also realize that not all of those loans facing rate resets deserve a workout. We saw a lot of investor and speculator activity and most of those loans should not be used to minimize the good work we are doing to help deserving borrowers. Finally, as an economist, all policy decisions lawmakers might consider over the course of this year and beyond, must take into account what the essential factors are for a healthy and vibrant market.

First, innovation. Whether it's the housing markets or technology, the ability to innovate without over restrictive and prescriptive regulation is one a necessity for a better America. Second is confidence. Right now, we are seeing a lack of borrower, industry and investor confidence. The more policy makers discuss options that would inject additional risk into the market; confidence will remain on the sidelines. It is vital that policy discussions focus on ways to bring confidence back. We need the liquidity that investors bring to market. As the liquidity returns, many borrowers will begin to see their access to credit return. The industry has learned from its mistakes and investors have learned from their mistakes. This can be seen in the types of loans

being made today. We are all focusing our efforts to help borrowers and stabilize our economy. Congress must now carefully consider how it addresses ways to facilitate innovation and bring confidence back into the market.

FOR IMMEDIATE RELEASE
January 30, 2008

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Interest Rate Reductions Good for the Economy But Unresolved Foreclosure Crisis is Root of Problem

NCRC Proposes Public Private Partnership to End Foreclosure Crisis

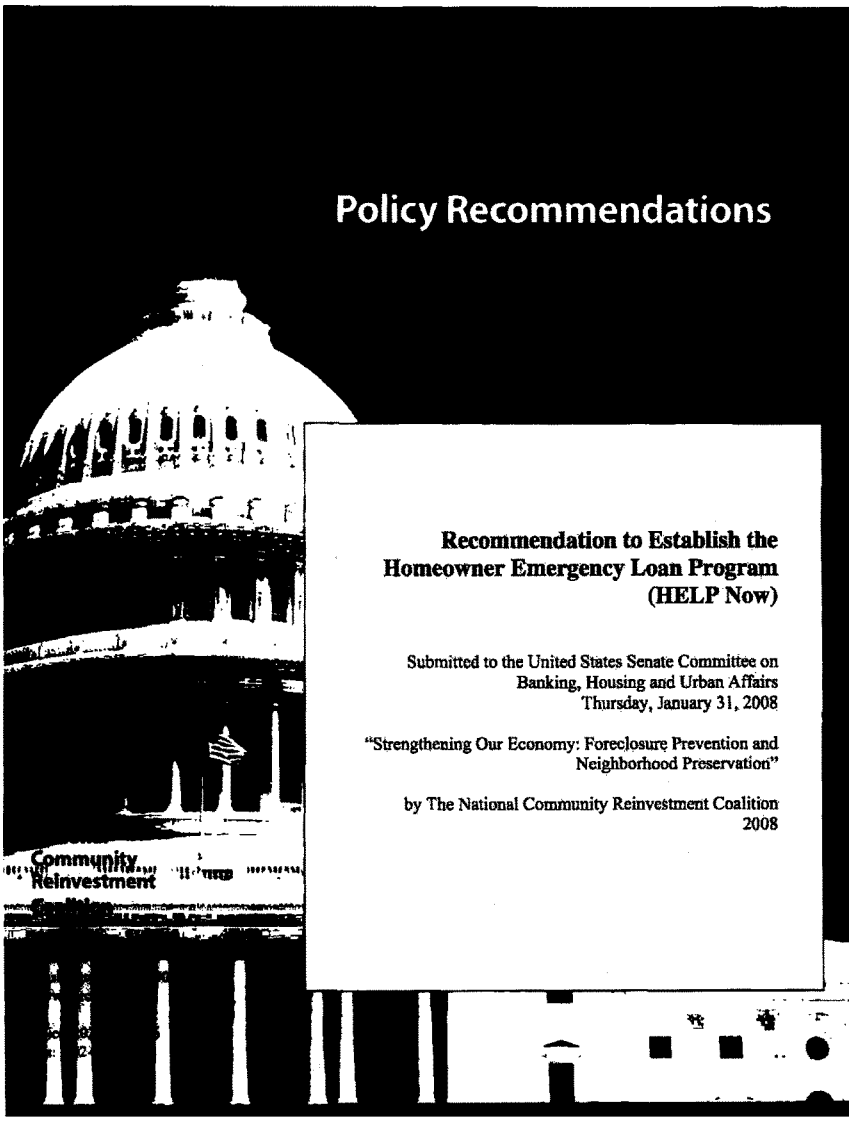
Washington, DC –today's interest rate adjustments by the Federal Reserve will have little immediate impact on the growing financial trauma caused by the foreclosure crisis. Lowered interest rates may benefit new home borrowers and some prime market consumers. But for the millions of borrowers facing foreclosure, interest rate reductions will not improve their circumstances.

In fact, no remedy currently in place is of the scale to seriously tackle the foreclosure crisis. For this reason the National Community Reinvestment Coalition (NCRC) has proposed an initiative that would help put the mortgage finance market, and the economy, back on its moorings. The Homeowners Emergency Loan Program (HELP Now), developed by NCRC, is a pragmatic plan that will have an immediate and widereaching impact on the foreclosure crisis.

"It's time to stop fiddling around the edges of this crisis and implement comprehensive solutions," said John Taylor, NCRC's President & CEO. "This is not a bailout," said Taylor, "It's a public private partnership that shares the burden for ending the foreclosure crisis."

HELP Now would use federal funds to purchase securitized loan pools at a discount, ensuring that the burden for solving the crisis is shared by market players. Once held by the government, problematic loans would be modified or refinanced into 30-year fixed mortgages by private financial institutions, keeping the government out of the refinancing business. To get help to homeowners quickly, the program relies on existing federal agencies.

A critical provision of the proposal requires that the refinance be written according to the borrowers ability to pay. The program would also require the loan to be made according to an accurate appraisal of the current value of the home. The government would not absorb the full difference between those two values, but rather a second lien (or "soft second") would be placed on the property to make up a portion of the cost of meeting the



Recommendation to Establish the Homeowner Emergency Loan Program (HELP Now)

Submitted to the United States Senate Committee on Banking, Housing and Urban Affairs
Thursday, January 31, 2008

"Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation"

by The National Community Reinvestment Coalition
2008

Recommendation to Establish the Homeowner Emergency Loan Program (HELP Now)

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About NCRC

The National Community Reinvestment Coalition (NCRC) is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation

Current Efforts Inadequate to Stem Foreclosure Crisis

The most recent available data reinforces the reality that the home mortgage crisis continues to grow. And despite the best efforts of the home mortgage finance industry, voluntary measures to stem the crisis are failing to respond adequately to the scale of the problems. According to Moody's Investors Service, only 3.5 percent of loans scheduled for interest rate resets in the first nine months of 2007 were modified. Yet even if the numbers were higher, the remedies being offered are not working. Current industry workouts and payment plans do not move families into long-term affordable mortgages. Rather, they shift the problems into the future. And, the unsuccessful results of this shifting are clear: according to the Mortgage Bankers Association, fully 40 percent of subprime adjustable rate mortgages (ARMs) that went into foreclosure in the third quarter of 2007 were loans that had previously experienced a modification or repayment plan.

The FHASecure program, introduced in August of 2007, provides additional flexibilities in FHA underwriting guidelines that open the door to refinancing for borrowers who have good credit histories but cannot afford higher mortgage payments due to a loan reset. This program does provide a long-term affordable mortgage solution for borrowers who qualify. But FHASecure lacks the capacity to address the full panoply of problem loans outstanding. According to a January 28, 2008 Reuters article, the American Securitization Forum estimates that FHASecure will assist roughly 44,000 subprime borrowers in its current form. As a result, while an important part of the solution, it is inadequate as the total remedy. Finally, neither FHASecure nor voluntary industry efforts address homeowners who have been foreclosed upon due to unfair and deceptive practices. Likewise, neither program addresses the mounting REO properties that are concentrated and growing in communities across the nation. A broader solution is required to stabilize families in their homes and return confidence to the housing markets and the economy.

Broader Solution Needed: Homeowners Emergency Loan Program (HELP Now)
When faced with a major foreclosure crisis resulting from the economic turmoil of the Great Depression, the federal government responded with a new housing finance agency, The Home Owners Loan Corporation (HOLC). A similar entity, the Resolution Trust Corporation (RTC), was established in the 1980s to aid in the clean-up of the failing savings and loan industry. Although these institutions fulfill their missions, waiting to approve, fund, staff and create programs for a new agency could take more than a year to accomplish. The immediacy of the foreclosure crisis does not allow that luxury of time.

Create a Program, Not an Agency
The National Community Reinvestment Coalition is developing a comprehensive proposal to respond to the foreclosure crisis. NCRC proposes to build on the HOLC model, but rely on existing institutions such as the US Department of the Treasury, FHA, Fannie Mae, Freddie Mac, or the Federal Home Loan Banks to purchase outstanding loans, provide financing or insure loans. By avoiding the added time that would be required to create and staff a new agency, this model could potentially become operational immediately. The proposal recommends the creation of a two-year recoverable loan program, the Homeowners Emergency Loan Program (HELP Now).

Under the program, the federal government would offer to purchase, at a discount, loans held in securitized pools. Discounting the purchase of loan pools would strike a balance between assisting homeowners and ensuring that lenders, servicers, and securitizers are not rewarded for financing and servicing predatory loans. Once held in portfolio by the federal government, the loans could be modified in a meaningful way to create long-term affordability, or refinanced.

Use the Private Markets to Refinance Loans
Borrowers requiring refinancing would be allowed to refinance their loans through private lenders based on standardized underwriting criteria that would include consideration of a borrower's ability to repay the loan. Loans would be underwritten by lenders to be eligible for securitization by the Government Sponsored Enterprises. In addition to being affordable, fixed rate, self amortizing mortgage products, refinanced loans would have their initial principal balance adjusted to reflect current appraised home values.

Government is Paid Back
The discounted value of the home would be reflected in a lien (in the form of a soft second). This lien would be recaptured by the government when the asset is sold (assuming adequate equity growth and the property is held for at least five years) or if the property is refinanced. There would be no repayment obligation by homeowners in excess of that which could be captured by appreciation. Losses would be borne by the federal government, but would be minimal relative to failing to end the foreclosure crisis.

NonProfits Act as Trusted Advisors
Studies have shown consumers to be wary of contacting their loan servicers to request loan modifications or other advice. Given the substantial level of predatory lending in the market, and growing concerns over fraud, their fears are neither surprising nor irrational. Nonprofit intermediaries that have expertise as home loan counselors, mortgage advisors, and lenders, would be funded to contact and assist borrowers to secure loan modifications or refinance. Nonprofit intermediaries could also act as mortgage advisors to ensure that borrowers recieve the best possible loans given the borrower's financial circumstances.

Assist Borrowers Who Have Lost Their Homes

The final piece of the proposal would empower HUD with expanded authority and resources to develop a plan, working with nonprofit community development organizations, to address foreclosed and vacant and abandoned properties. Consumers who have lost their homes due to foreclosure would be provided a right of first refusal to repurchase their homes based on the new HELP Now program guidelines. Properties that are not suitable for repurchase or where former homeowners are no longer interested in or eligible to buy back the properties would be transferred to the HELP Now initiative's REO program. The focus of HUD's HELP Now REO property efforts would be to ensure that properties are returned to productive *and affordable* use as quickly as possible. HUD might rely on or borrow from major successful initiatives such as the City of Chicago's *Troubled Building Initiative,*[1] or institutions such as Smart Growth America,[2] with expertise in the field.

A Win-Win for Families, the Housing Finance Industry and the Markets

The NCRC proposal addresses the single most challenging hurdle that all previous initiatives have faced, which is the inability to restructure or refinance loans held in securitized pools. By purchasing those loans, servicers can offer meaningful modifications that create long-term homeownership affordability. Lenders can offer refinancing options that meet the borrower's ability to repay loans based on the current and realistic value of properties. And families who have lost their homes to foreclosure can recover that loss. By including soft seconds in subsidized loan agreements, the government is paid back a substantial share of its upfront investment.

This broad-based plan not only addresses the most significant challenges facing the housing industry related to the foreclosure crisis, but also ensures that the private markets play the lead role in stabilizing families in their homes. HELP Now would provide a needed stimulus to the housing market that should contribute significantly to the ailing economy. Finally, HELP Now is not a bailout. It is a public private partnership that shares the burden for ending the foreclosure crisis.

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[1] Since 2003, the Troubled Buildings Initiative, part of the city of Chicago's department of Housing, compels landlords to maintain safe and drug-free environments for City residents. Primary areas of concern include neighborhood gang and drug activity, disconnection of utilities that place residents at risk, and lack of maintenance or repairs that creates dangerous conditions for residents. The city partners with non-profit organizations to reclaim foreclosed, vacant and abandoned properties to strengthen city blocks and neighborhoods. In the first three years of the program, over 2,500 units were rehabilitated or repaired.
(City of Chicago website. 2008)

[2] The National Vacant Properties campaign is a joint partnership between Smart Growth America, LISC and the Metropolitan Institute at Virginia Tech. The goal of this campaign is to help communities prevent abandonment, reclaim vacant properties, and once again become vital places to live. The campaign builds a national network of leaders and experts; provides tools to communities; raises awareness through communications; and provides technical assistance and training. The National Vacant Properties Campaign has worked with nonprofits, elected officials and residents in 14 states. *(National Vacant Properties Campaign Website. 2008)*

Testimony of Jane DeMarines, Executive Director
National Alliance of Community Economic Development Associations
Washington, DC * January 31, 2008
Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation
US Senate Committee on Banking, Housing, and Urban Affairs

The National Alliance of Community Economic Development Associations (NACEDA) appreciates this opportunity to provide written comments for today's hearing on economic stimulus, foreclosure prevention and neighborhood preservation. We applaud Chairman Dodd, Ranking Member Shelby and all members of the Committee for their important work in this area.

Through our member state associations, NACEDA represents more than 2,000 community development corporations (CDCs) across the country. In 2005, as an industry total (aggregate) CDCs produced/created: 1.3 million homes (since 1988), 774,000 new jobs and 126 million sq feet of commercial/industrial space, housing for special needs populations and nearly two-thirds of CDCs offer homeownership counseling.

NACEDA is committed to helping transform distressed communities and neighborhoods into healthy ones: good places to live, work and raise families. We work to help our members build strong communities and increase housing and economic opportunities for low-wealth populations. We believe that the Economic Stimulus bill should include provisions to address the growing foreclosure crisis in our country because this crisis is damaging the national economy and devastating some local communities where foreclosures are particularly high. The collapse of housing prices, the increasing vacancy and blight in our neighborhoods, and the reduced spending ability of families on the brink all contribute to this downward cycle. We must stop this trend and reverse it. With federal support, our member CDCs can help to do this.

NACEDA applauds Sen. Dodd's Economic Stimulus proposal to prevent further neighborhood decline caused by foreclosures. We agree that such a stimulus will help prevent a slide into a recession and further damage to communities and the nation as a whole. Anti-foreclosure efforts are key to Sen. Dodd's proposal and are the focus of our testimony today. According to RealtyTrac:

- More than 201,000 foreclosure filings were reported in November 2007 alone, up 68 percent from the year before.
- 1.3 million homes received foreclosure-related warnings in 2007, up from 717,522 in 2006.
- Foreclosure filings rose 75 percent from the previous year to 2.2 million.

Sen. Dodd's proposal calls for $10 billion for CDBG for purchase and rehabilitation of foreclosed properties, which is essential to dealing with a problem of this magnitude. NACEDA believes that any new funding for economic stimulus should be distributed through CDBG jurisdictions and allocated using the same formulas, but Congress needs to ensure that funds are ultimately distributed to community based nonprofits at the local level who are best positioned to acquire, rehab and restore these properties and these neighborhoods. These funds need to be in the hands of those doing the grassroots work and are experts in property disposition and neighborhood stabilization. Importantly, these groups can also work against the displacement of families. As Sen. Dodd noted, foreclosed and abandoned homes are decimating many communities around the country. They lead to a cycle of disinvestment, crime, falling property values and property tax collections, thereby leading to service cuts and further disinvestment. Economic Stimulus funds can help stop this devastating process.

It is important to note that organizations such as LISC, Enterprise and Neighborworks America have a vital role to play as intermediaries in this struggle. These organizations have expertise on these issues and are connected to a broad network of local organizations. Therefore, it may make sense for some funds to flow through these entities to local communities. At the end of the day, the key is to get the bulk

of the funding to community-based nonprofits that have the capacity to deliver quick and substantial results for local communities.

CDCs Should be Involved in Property Disposition

In addition to preventing foreclosures wherever possible, NACEDA believes that when foreclosures are inevitable, provisions should be made **to make sure that those properties are purchased by responsible parties who will maintain them and keep the neighborhood stable.** As 5 million more Americans moved into poverty in the past 6 years and unemployment rates rise, it is more vital than ever that those organizations that have experience working for the public good are involved in these economic stimulus plans.

CDCs could buy **foreclosed properties, protect existing tenants, maintain the properties and ensure their long term use as affordable housing in low-wealth communities.** The affordable housing shortage is at an all-time high. Annually, the country is losing 40,000 units of affordable housing.

Any future economic stimulus legislation should be crafted in such a way that it allows nonprofits and CDCs, who are experts in real estate development in low-income communities, to participate to take advantage of their commitment and expertise in working in low-income communities. In addition, **NACEDA proposes specific measures with regard to real estate and banking be included in any proposed legislation:**

1. Resources for local government to increase code enforcement of foreclosed properties.
2. Resources to state/local jurisdictions to allow nonprofits to acquire, rehab, manage and dispose of foreclosed properties. (This money should be easy to access and flexible.)
3. Encourage/require Fannie Mae, FHA and Freddie Mac to be more risk tolerant when participating in both foreclosure prevention programs and acquisition strategies.

4. Pass a mortgage company Community Reinvestment Act (CRA) at the federal level. CRA grades should take into account how well lenders dispose of foreclosed properties.

NACEDA also supports Sen. Dodd's proposal to create a Federal Homeownership Preservation corporation to purchase outstanding mortgages at discounts, ensuring that those discounts are then passed onto homeowners in the form of new, lower-balance mortgages insured by FHA or backed by the housing government-sponsored enterprises. If and when this corporation is forced to foreclose on a homeowner, it should be required to dispose of the property to responsible owners who will ensure that the property is maintained as well maintained affordable housing.

A Local Example with Potential National Benefits

We concur with our partner organization Neighborhood Progress, Inc. who proposes that on a national level we encourage lender loan workouts and loan re-structuring patterned after a successful model in Ohio: the East Side Organizing Project (ESOP) lender agreements. ESOP's aggressive approach to predatory lending has been nationally recognized for its effectiveness in fighting loan industry abuses, and setting up better loan services in low-income communities.

In 1999, ESOP created the Predatory Lender Action Committee (PLAC), which adopted an aggressive strategy to address the explosive growth of predatory lending in the Cleveland area. This includes: 1) raising community awareness about predatory lending by exposing abusive lenders and their practices; 2) assisting people who have fallen prey to predatory lenders by partnering with a variety of community organizations, government agencies, churches and social service agencies; 3) pushing for increased state and federal government regulation of predatory lenders activities and 4) partnering with reputable banks to increase quality lending in low-income and minority communities.

The loan workouts are comprised of three fundamental aspects:

1) Immediate halt to foreclosure proceedings after the borrower has filled out ESOP paperwork.
2) Access to a top level lender with full authority to make decisions and who can reduce interest rates.
3) A loan repositioning designed to keep the borrower in their homes.

This effort has had an 85% success rate for those who follow through the process and 1,500 homes were saved last year. This model could be an asset to the architects of the proposed Economic Stimulus bill.

Conclusion

NACEDA encourages Congress to pass legislation with strong language that helps eliminate predatory lending practices. By establishing standards, Congress can ensure that homebuyers of all income levels have a chance to seek a fair mortgage. NACEDA appreciates this opportunity to present NACEDA's positions on these important Economic Stimulus issues. We are willing to provide testimony for future hearings. Please contact our headquarters at: (703) 741-0144. Web: http://www.naceda.org/.

NACEDA member organizations:

AR Coalition of Housing and Neighborhood Growth for Empowerment
Association for Neighborhod and Housing Development
Association of Oregon Community Development Organizations
Atlanta Housing Association of Neighborhood-based Developers
California Community Economic Development Association
Community Development Council of Greater Memphis
Community Economic Development Association of Michigan
Community Housing Developers Association of Tennessee
Connecticut Housing Coalition
Florida Association of CDCs
Georgia State Trade Association of Nonprofit Developers
Housing & Community Development Network of New Jersey
Housing Action Illinois
Housing Alliance of Pennsylvania
Housing Network of Rhode Island
Indiana Association for Community Economic Development
Maryland Asset Building Community Development Network
Massachusetts Association of CDCs
Metropolitan Consortium of Community Developers
NC Association of Community Development Corporations
Ohio CDC Association
Philadelphia Association of Community Development Corporation
SC Association of Community Development Corporations
South New Hampshire University School of Community Economic Development
Southern California Association of Non-Profit Housing
Texas Association of Community Development Corporations
The Democracy Collaborative