S. Hrg. 112–318

NEW IDEAS TO ADDRESS THE GLUT OF FORECLOSED PROPERTIES

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

OF THE

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

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXPLORING NEW IDEAS TO ADDRESS THE GLUT OF FORECLOSED PROPERTIES AND MOVING THE NATION'S HOUSING MARKET FORWARD

SEPTEMBER 20, 2011

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

Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

73–179 PDF WASHINGTON : 2012

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) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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C O N T E N T S

TUESDAY, SEPTEMBER 20, 2011

NEW IDEAS TO ADDRESS THE GLUT OF FORECLOSED PROPERTIES

TUESDAY, SEPTEMBER 20, 2011

U.S. SENATE,
SUBCOMMITTEE ON HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee convened at 10:02 a.m. in room 538, Dirksen Senate Office Building, Hon. Robert Menendez, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN ROBERT MENENDEZ

Senator MENENDEZ. This hearing of the Subcommittee on Housing, Transportation, and Community Development is called to order. Thank you all for being here today.

This hearing, the second in a series to explore the best ideas for moving our Nation's housing market forward, will focus on new ideas to address the glut of foreclosed properties.

Last, we looked at refinancing options and heard from Senators Boxer and Isakson about how we can break down some of the costs of barriers to refinancing and also heard from experts on the bill I will be introducing to encourage principal write-downs by allowing both the lender and the borrower to share in the upside of an appreciation of home value.

In my view, we need to do even more to fix the housing market, get the broader economy moving again, and create jobs, as the housing market often anchors the broader economy. Too many families, including those who have never missed a mortgage payment in their lives, are suffering from a housing hangover caused by years of risky behavior in our over-indulgence of the market.

Today, our witnesses will explore the question posed in the Obama administration's request for information about how the Government should dispose of the millions of foreclosed properties that it has or will have on its books within the next few years. These properties are at the GSEs and the FHA, which are half of the foreclosed properties in the country.

Currently, the Government sells these properties one by one, but I would question whether that is always the best policy right now for all areas of the country. Although that policy might make sense in areas where home sales are strong, in areas where home sales are weak, converting those properties to rentals or even looking at other options might make more sense. Continuing to sell foreclosed properties into an already depressed market in some areas leads to further drops in home prices, which hurts other homeowners in the neighborhood. And then there is a need for rental housing right now because many people who lost their homes or who cannot get financing to buy a home now need to rent, and as a result, we have seen rents go up, as well.

One idea that has been widely suggested is selling foreclosed properties in bulk to nonprofits or to investors with a requirement that they be converted into single-family rentals for a certain period of time. There are different views of that and we look forward to the views of the panel on those suggestions. And the witnesses will also explore whether and under what conditions the Government should help finance such sales for conversion into rentals.

We must do all we can to stop the slide in home prices and stabilize neighborhoods by turning millions of vacant foreclosed homes into occupied homes, and that is the focus of the Committee's work.

With that, I am happy to recognize any other Members who wish to make an opening statement. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Mr. Chairman, I simply want to commend you for not just this hearing, but the series of hearings you have undertaken addressing critical issues in the housing market, and I share the same presumption that you have articulated, which is until we get the housing market stabilized and moving forward, the broader economy will not begin to move forward in a sustained and appropriate way. Many of the ideas that we will explore today, I think, are important aspects of getting that market moving.

But I thank you for your leadership and I thank you particularly for accommodating this hearing so we can have a broader participation. Thank you, Mr. Chairman.

Senator MENENDEZ. Senator Merkley.

STATEMENT OF SENATOR JEFF MERKLEY

Senator MERKLEY. I echo the compliment on holding these hearings. The cloud of foreclosures, the five to eight million additional foreclosures is a huge problem for our economy and holding these hearings to try to wrestle with how we can be more aggressive in addressing them, both for the millions of families' success and for our economic success, is so important. Thank you.

Senator MENENDEZ. Thank you.

Well, let me introduce our panel. We have a great panel here to help us go through some of these options.

Allan Dechert is the President of the New Jersey Association of Realtors. He has been a Realtor since 1981, owns Ferguson Dechert Real Estate in beautiful Avalon, New Jersey. Those of you who have not visited should visit Avalon, New Jersey, I assure you. He has served the Realtors in many capacities over the years and the Subcommittee and I are certainly pleased to welcome his Garden State experience here today.

Bob Nielsen is the current Chairman of the National Association of Homebuilders. He currently works in Reno, Nevada, brings over 25 years of industry experience with him. He has also been very active in the affordable housing sphere, contributing to the creation of the Nevada Low-Income Housing Trust Fund, and we look forward to your testimony and thank you for being here.

Chris Krehmeyer is the President and CEO of Beyond Housing, a NeighborWorks Organization in St. Louis, Missouri. He has served in that capacity since 1993 and has led the organization through fivefold growth, adding a nonprofit property management company with Beyond Housing, currently controlling assets worth nearly $50 million, and we appreciate your perspective here today.

Laurie Goodman is a Senior Managing Director at Amherst Securities responsible for research and business development. Before joining the firm in 2008, she was the head of Fixed Income Research at UBS, also worked at CitiGroup, Goldman Sachs, Merrill Lynch, and the Federal Reserve Bank of New York. She has appeared before the Subcommittee before and we are looking forward to her expertise once again. Thank you.

Dr. Stan Humphries is a Chief Economist at Zillow, a home and real estate marketplace that helps homeowners, buyers, renters, and professionals share information about homes, real estate, and mortgages. He oversees the production of housing market metrics and economic research and he has contributed to housing market price algorithms for Zillow. The Subcommittee looks forward to his testimony and thanks you for being here.

So I would ask you all to synthesize your statement in about 5 minutes or so. We will include your entire written statement in the record, and then we will have an opportunity for our Members and you to have a conversation and some questions.

So, Mr. Dechert, we will start with you.

STATEMENT OF ALLAN H. "DUTCH" DECHERT, PRESIDENT, NEW JERSEY ASSOCIATION OF REALTORS

Mr. DECHERT. Thank you. Chairman Menendez, Ranking Member DeMint, and Members of the Committee, thank you for holding this timely hearing on new ideas to address the Nation's continuing mortgage problem.

My name is Allan Dechert and I am the 2011 President of the New Jersey Association of Realtors, and I am proud today to testify on behalf of the more than 1.1 million members of the National Association of Realtors.

The U.S. housing sector is in a precarious state. According to many economists, the market appears to have reached bottom and sales volumes and prices are beginning to stabilize. However, the uncertainty and lack of consumer confidence that has plagued the sector could be reintroduced and impact the absorption rate of bank-owned real estate, which will place downward pressure on prices and jump-start the cycle that has debilitated the housing sector to date.

Realtors appreciate the Administration's attempts over the last two-and-a-half years to keep families in their homes and its recognition that home ownership matters. Those several Federal programs were put in place to keep families in their homes, nearly all have fallen short of their goals.

Realtors believe that another attempt must be made to fix the housing sector if a broad recovery of the overall economy is to occur. In particular, focus should be placed on the large inventory of real estate owned, REO properties, that continues to grow. Realtors recommend that any foreclosure solution must focus on providing mortgage financing to qualified home buyers and investors to prevent increases to the existing REO inventory. Expand pre-foreclosure efforts, including loan modifications and short sales, since foreclosures typically cost more than loan modifications and short sales. And continue the timely and orderly disposition of REO inventory assets, relying on the expertise of local contractors, real estate brokerage firms, and professional property management companies.

NAR supports strong underwriting standards. However, potential home buyers and investors have been discouraged by high fees, unduly tight underwriting standards, and the lack of availability of private mortgage capital. Realtors respectfully request that regulators and lenders reassess their policies in order to increase lending.

In particular, Realtors believe that the Government should temporarily modify some policies governing FHA and the GSEs to encourage investors to step in and absorb some of the REO properties. Two examples of policies to be modified are, one, FHA's Section 203(k) lending program, which HUD should expand to include investors, and remove the limitations on the number of outstanding loans held by an investor.

Since early 2008, NAR has urged the lending industry to take every feasible action to keep families in their homes with a loan modification, or, where it is not possible to avoid foreclosure, a short sale. Realtors recommend that the Government reassess current policies to make sure that as many loan modifications and short sales are approved as possible. This will reduce adding to the ever-increasing glut of REOs. Moreover, repurposing a portion of housing funds designated under TARP to increase borrower participation in loan modification and short sale programs will improve them and reduce the number of mortgages ending in foreclosure. Also, streamlining the short sale process would result in a properly functioning loss mitigation mechanism that prevents additional foreclosures.

Last, in August, the Administration requested advice from market participants on the pooling and disposition of GSE and FHA REO properties inventories, I should say. Though bulk sales may quickly alleviate the critical mass of REO inventory held by the agencies, bulk sales will likely result in larger losses than is necessary. Realtors strongly believe that every effort should be made to incentivize individual versus bulk sales because individual sales maximize recovery of the assets and minimize the impact on housing values.

An option that combines REO disposition with affordable rental is a lease-to-own program. NAR recommends that any lease-to-own solution should first focus on keeping families in their homes, after which the following principles should be considered. Lease-to-own ventures should be privately administered by local investors or local nonprofits that understand the specialized needs and challenges of markets. Use local real estate agents to market the property to ensure visibility. Have clearly defined expectations. Have guidelines in contracts that are specific regarding maintenance, purchaser responsibility, purchase price, and percent of payment allocated toward the down payment. Include condominiums, and minimize detrimental effects on neighborhoods by implementing strict guidelines on the rehabilitation and continued maintenance of properties.

Finally, NAR recommends the creation of an advisory board made up of public and private industry participants. Advisory board members should include Government staff, asset managers, real estate sales professionals, property managers, and others with extensive real estate industry experience. The charge of this board will be to ensure the efficient disposition of Government-owned REO properties in order to minimize taxpayer losses and negative effects on local real estate markets.

In conclusion, every decision that we make today regarding our housing finance system will have a significant impact on the ability of future generations to purchase a home and our Nation's overall economy.

I thank you for this opportunity to present our thoughts. As always, the National Association of Realtors stands ready to work with you and our partners to make the future brighter for all Americans. Thank you.

Senator MENENDEZ. Thank you very much.

Mr. Nielsen.

STATEMENT OF ROBERT NIELSEN, CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOMEBUILDERS

Mr. NIELSEN. Chairman Menendez and Ranking Member DeMint and Members of the Subcommittee, I am pleased to appear before you today on behalf of the National Association of Homebuilders to share our views on how to address the glut of foreclosed homes that are currently on the market. My name is Bob Nielsen. I am the 2011 NAHB Chairman of the Board and a homebuilder from Reno, Nevada.

Home mortgage foreclosures continue to have a significant negative impact on the housing market and contribute to the lag in the Nation's economic recovery. While the majority of foreclosures have been concentrated in a handful of States, no State has avoided the negative effects on prices created by the foreclosures.

Home prices have fallen by a record amount across the country, making consumers hesitant to undertake home purchases and making it more difficult for homeowners to sell their current home in favor of a new residence. Many times, foreclosed or distressed property sales are used as comparable sales in appraisals, which further depresses home values and puts new construction at a disadvantage. The downward spiral in values is also adversely affecting outstanding residential construction loans, as lenders demand equity pay-ins to offset declines in collateral value and making it more difficult for builders to obtain adequate funding to start new projects.

Ultimately, stopping this trend in foreclosures will have benefits beyond the housing industry. Stabilizing home values will improve the balance sheets of financial institutions and will reassure homeowners that their biggest asset will retain its value.

NAHB recently submitted comments in response to a joint request for information, soliciting ideas for strategies on disposing of the substantial inventory of real estate owned properties held by Fannie Mae, Freddie Mac, and FHA. We support the agencies' goal of reducing the REO portfolio in a cost-effective manner, reducing average loan losses to the enterprises and FHA, addressing property repairs and rehabilitation needs, responding to the economic and real estate conditions in specific geographies, and stabilizing neighborhoods and local home values.

While my written statement covers NAHB's specific recommendations in great detail, we believe that it is extremely important for the enterprises and FHA to take a balanced approach in disposing of their large inventories of REO properties to avoid further disruptions to pricing and markets and to limit losses to the enterprises and FHA.

In particular, the enterprises and FHA should avoid bulk sales to large investors that have no stake in the neighborhoods in which these properties are located. Local and small businesses should be the driving force behind the disposition of REO inventory, which will result in the creation of jobs and the stabilization of neighborhoods. Federal Government programs such as FHA Section 203(k) and the Neighborhood Stabilization Program should be modified to allow for-profit investor participants to provide the capacity and the innovation needed to tackle this problem.

Fannie Mae and Freddie Mac programs are also currently biased against investors, as they have very tight limits on the number of homes one individual can finance. These limits must be increased to enable the private sector to partner in an effective REO disposition effort.

Additionally, NAHB suggests that several new programs could be pursued that could contribute to the reduction of the REO inventory, specifically, the creation of an investment fund that would be open to individual investors and a new lease-to-own program geared to all income levels.

It is also essential to return to more balanced credit requirements for home purchasers. Current GSE credit requirements and further discretionary overlays by private lenders are frustrating many creditworthy borrowers who otherwise would make an REO property their home.

And finally, with the current GSE and FHA loan limits set to expire on September 30, I would like to thank the Chairman for his leadership and efforts to extend the higher limits beyond the current deadline. As the Chairman fully understands, allowing the limits to expire would exclude many homes and home buyers from critical Government loan programs, particularly in areas of the country where there is substantial foreclosure inventory.

Thank you again for the opportunity to testify today. I look forward to your questions.

Senator MENENDEZ. Thank you very much, Mr. Nielsen.

Mr. Krehmeyer.

STATEMENT OF CHRIS KREHMEYER, PRESIDENT AND CEO, BEYOND HOUSING

Mr. KREHMEYER. Chairman Menendez, Ranking Member DeMint, and all Committee Members, it is truly my honor to be here to talk about this very serious problem of foreclosures happening all across the country. In addition to my role as being President and CEO of Beyond Housing, I am also on the board of the National NeighborWorks Association and a founding member of Practitioners Leveraging Assets for Community Enhancement, PLACE, trying to unify the voice of our community development field.

Day in and day out, in neighborhoods and communities back in St. Louis, we see this problem day in and day out. My organization touches foreclosures from just about every vantage point, from providing home ownership advisement services on the front side to create sustainable, successful long-term homeowners, to providing foreclosure counseling services to keep families in their home, to buying and rehabbing foreclosed properties, and just created a Community Land Trust as another tool to try to get after the problem.

First and foremost, I think the best way to deal with the problem is keep families in their homes, so I am grateful that the Chairman is proposing principal reductions in a more significant way, because certainly my foreclosure accounting staff has begged us, can we please get more principal reductions to keep families in their homes.

In addition to that, can we convert some of this portfolio to rental properties. My organization owns 340 scattered site single-family homes and we rent them to low-income families and have done so for 30 years. It is possible. It is feasible. It is a challenge. It is not easy. It is a long-term asset accumulation plan. It is not a short-term windfall to put your investment dollars in and try to take them back out. It is about investing in that, not only in that home, but in that community and providing affordable rental opportunities, and certainly, as has been said, there is a great need for affordable housing all across this country. Folks are suffering, and we need to see if we can provide more of those opportunities. We have proven it can be done. It takes significant debt reduction relative to the price points. It takes sound property management and ensures that, again, you have to create that asset that will serve that community well long-term.

Can we create other possibilities, and we think there are opportunities to do some bulk purchases with the GSEs. I have talked to a number of my peers across the country and we think there is a great opportunity to do so, particularly if we design a vehicle that says, can we build on the existing work and really move the needle on getting homes back in productive use.

A partnership model that we proposed leverages many institutions, created by the community development industry in response to the crisis. This includes the National Community Stabilization Trust, which was created by NeighborWorks America and many other enterprises. The NCST provides a function to aggregate REO inventory among servicers and creates a platform for offering this inventory to not-for-profits across the country and simplifying the execution process to transfer these assets.

That particular model can take a number of forms in terms of what it can look like, but here are some of the key elements. GSEs and FHA identify and reserve homes that are located in either Neighborhood Stabilization markets or similar target geographies being worked by not-for-profits. These assets can be made available through a first look clearinghouse of loans to qualified not-for-profits. These assets then are available for acquisition for a short period of time to see if they can be disposed. If not, they will be put back on the marketplace.

Qualified not-for-profits working in the target markets would purchase the assets at a prudent, transparent discount price that considers the balance between the cost of acquisition, rehabilitation, and management and feasible rents to families in these markets. In consideration for these discounted prices, the not-for-profits would execute an agreement to share any gain on sales that would occur with the GSEs or with FHA. Not-for-profits would take title to the property, would rehab the housing stock to an appropriate level, considering the appraised value, and that will improve the longevity and operating costs of the home by including energy efficiency and green improvements within that budget.

To facilitate this rehabilitation, the GSEs and FHA will offer the not-for-profits an opportunity to take out a mortgage as the mortgagor from the GSEs that covers rehabilitation costs of the homes. The mortgage would be assumable by a future buyer of the property. The not-for-profit improves the property and makes them available to a low-income family or moderate-income family. The not-for-profit manages the assets of the rental property and uses the income to cover the mortgage note payment. And at a point of time when the values have stabilized, the not-for-profit makes the property available for sale to families in the community, and once that sale is made available, the not-for-profit again shares that asset appreciation with the GSEs or the FHA.

Gentlemen, you guys know this is a big problem, day in and day out. My organization sees the struggles of what is happening in the community. We need big, bold solutions. Everything we have tried to date on our foreclosure problem, regrettably, has not met with our expectations. I hope we can continue to talk about this topic, and again, come up with some big, bold and aggressive solutions that are harming families in our country.

Thank you very much.

Senator MENENDEZ. Thank you.

Ms. Goodman.

STATEMENT OF LAURIE GOODMAN, SENIOR MANAGING DIRECTOR, AMHERST SECURITIES

Ms. GOODMAN. Mr. Chairman and Members of the Subcommittee, thank you for your invitation to testify today. My name is Laurie Goodman and I am a Senior Managing Director at Amherst Securities, a leading broker dealer specializing in the trading of residential mortgage-backed securities. I am in charge of the strategy and business development efforts for the firm. We perform extensive data-intensive research as part of our efforts to keep ourselves and our customers informed of critical trends in the residential mortgage-backed securities market.

One of the trends we have documented is the very significant supply demand imbalance in the housing market. Distressed loans are moving very slowly through the delinquency foreclosure pipeline. These loans weigh heavily on the residential real estate market and are often referred to as shadow inventory. In addition, many of the borrowers that are not delinquent on their loans have a tainted credit history and/or are seriously underwater, suggesting many more defaults to come. Thus, there are many distressed homes that will need to change hands over the next five to 6 years.

At the same time, mortgages are becoming increasingly difficult to obtain. Overall credit availability is tightening, and the pool of qualified mortgage applicants is shrinking dramatically. A large number of borrowers who are delinquent on their current mortgage and do not have the financial profile to purchase another home are likely to be converted to renters.

Despite this cloud surrounding the mortgage market, we see housing as very affordable by most traditional measures. Given this backdrop, we believe that long-term investors in one- to four-family residential real estate are the key to a housing recovery. They are the only potential buyers of many of the distressed homes that are likely to hit the market over the next five to 6 years. Investors need to be part of the solution to the housing crisis.

At the same time, this represents a good business opportunity for interested investors whose goal would be to rent the distressed homes as the rental market strengthens. Given the large decline in home prices, rental yields are high enough now to attract a limited amount of private capital. With modest governmental action, not assistance, more private capital can be attracted to this market, helping to stabilize home prices, neighborhoods, and communities, and more importantly, ensure that the housing needs of the distressed homeowners and their families are met. In fact, my firm, Amherst Securities, along with several of our partners, has successfully launched such a program.

We would argue that successful governmental action must have four objectives. First, it must be scalable enough to have an impact. Second, it must hold homes off the market for several years to give the market a chance to stabilize. Third, it must place the risks and responsibilities of owning the real estate with financially strong and operationally sound managers. Finally, it needs to maximize the economics for the GSEs and the taxpayers.

We believe these objectives could best be accomplished by allowing for a program in which, one, opportunities were provided for bulk purchases of REO properties as well as non-performing loans, and two, financing was more available to investors.

The difficulty of buying up sizable blocks of distressed properties inhibits large-scale investors from participating in the market. In order to build out a rental organization, which include rental agents and property managers, it is necessary to obtain a critical mass of properties in a given area. Thus, we would strongly urge the FHFA, working with Fannie and Freddie, to bundle together at least 200 properties in a given MSA and conduct an auction on an all or none basis. We believe this would maximize the economics for the GSEs. Bulk sales are the most efficient distribution vehicle and homes that are vacant or occupied by homeowners not paying their mortgage or maintaining their property lose value very, very quickly. In addition, we would suggest imposing the requirement that at least 80 percent of the properties be held for a three-year period.

One very important point. A program that includes nonperforming loans as we as REO properties would be more effective than an REO program alone. Bidding a portfolio of nonperforming loans and REOs would allow for the bundling of a larger group of properties in a given geographic area. In addition, since the borrower is often a suitable tenant for a property, it saves the transactions and emotional costs of a move and may allow the loan to command a higher price as it is being sold with a ready-made renter.

This is not just a theoretical idea to my firm, Amherst Securities. We believe in it and put our own capital to work, purchasing the first block of homes auctioned by Fannie Mae with a tenant in the home.

Conservative financing of 60 to 75 percent of the purchase price would serve to stimulate investor demand and further cushion home price declines. An example will make this clearer. Assume the net distress rental yield was 7 percent. Assume further that an investor was able to obtain financing on 60 percent of the purchase price at a 4.5 percent rate. The return to investors would rise to ten-and-three-quarter percent. We expect conservative investor financing to encourage more investor participation and higher bids from participating investors.

Again, thank you for the opportunity to appear before the Subcommittee. We look forward to working with you on practical solutions that will help ease the housing crisis and promote housing market stability.

Senator MENENDEZ. Thank you.

Dr. Humphries.

STATEMENT OF STAN HUMPHRIES, PH.D., CHIEF ECONOMIST, ZILLOW

Mr. HUMPHRIES. Thank you, Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee for the invitation to speak today. My name is Stan Humphries. I am Chief Economist at Zillow, the leading real estate information marketplace, where I closely follow and report on the state of the housing market.

I would like to preface my statements this morning by noting the perspective from which Zillow approaches analysis of the housing market. We launched our Web site in 2006 with the goal of creating more transparency of real estate information for consumers. As a media-supported business, we have relatively little vested interest in the outcome of this particular debate other than the hope that whatever is decided will best address the needs of consumers, buyers, sellers, and homeowners who have no intention of selling any time soon.

Today, I would like to make three points about the housing market and about how to address foreclosures. The first is, let us not underestimate the ability of the market to fix itself. Second, let us focus on fundamental drivers of the housing market itself, not on symptoms of the housing recession. And third, the first objective of any policy response should be do no harm.

Regarding my first point about the ability of the market to fix itself, yes, there are a large number of foreclosures in the open marketplace right now. The latest estimates put that number at about 4.1 million foreclosures or seriously distressed homes in the marketplace. That cheap, abundant inventory is going to put downward pressure on prices over the near term, and over the long term, it is going to put a firm lid on price appreciation that we should expect over the next few years.

But that dismal side that we spend so much time talking about in the housing market is just one side of the housing market. It is the purchase side. If you look at the other side of the coin, the rental side, that side of the housing market is actually doing quite well. We expect effective rental rates to rise four to 5 percent this year alone, and the rental supply right now is back down to pre-recession levels. So there is a lot of demand in the rental side of the housing market and investors smell a distinct opportunity here. They are—in terms of arbitraging from the distressed purchase side over into the rental side where there is strong demand.

How do we know this is happening? One-third of all home sales nationally right now are going to all-cash buyers, the bulk of whom are investors. True, this process is not always pretty and does take time, but it is a natural market process that is and will slowly heal the market. Unfortunately, economic recovery cannot always happen overnight.

A second point. Many policies addressing foreclosures are simply addressing symptoms, not fundamental drivers of a healthy housing market. I believe the fundamental drivers of the housing economy in the next 2 years can be summed up in two factors, negative equity and unemployment.

Negative equity is very important to the housing market for two reasons. One is on the supply side, it is the key contributor to foreclosures, which increase supply and, therefore, put downward pressure on prices. Negative equity is also a problem on the demand side because it suppresses demand because it traps people in their homes and prevents them from going out and buying new homes. And unfortunately, negative equity is a fairly difficult problem to address through policy means for a variety of reasons which I can go into in questions if it is relevant.

This pains me that this is the fact because the aggregate numbers that I cited about foreclosures and seriously delinquent mortgages mask the tremendous suffering for millions of homeowners. So I wish that there was more of a silver bullet for negative equity, but unfortunately, as you drill down into a lot of responses for how to eliminate negative equity, they become quite problematic, typically because of issues involving moral hazard. We, therefore, expect negative equity to be a problem that will slowly recede over the coming years once normal home value appreciation returns to the marketplace.

Unemployment is a second big factor in the housing market and it is also very critical, of course, to housing for a variety of reasons, and fortunately, it is one that is more easily addressable through policy means. Unemployment and job growth is very important to the housing market for a few reasons. I will just list two, consumer confidence and household formation. The more confident consumers are about their jobs and about the overall economy, the more likely they are to get off the fence and buy homes.

Household formation is also important. We were just reminded last week when the Census Bureau reported that 22 million households in the United States are doubled up. If you want to know where a lot of the housing demand has gone during the housing recession, that represents a lot of it. These are adult children living with their parents in the basement and multiple families living under the same roof. If we want to get those families moved out and into new housing units and, therefore, increase housing demand, we have got to grow jobs. So make no mistake that a plan for unemployment is a plan for housing, as well.

My third and final point is that the objective of Government policies should be to do no harm. For example, one of the ideas that we have been exploring, or, rather, that we in America have been exploring over the past few months more seriously is the idea of the Government getting more involved in some fashion in the rental market as a solution for disposing of its stockpile of REO and foreclosed homes.

I believe that we should tread cautiously in examining proposals like this because, as I already noted, the private sector is already stepping in fairly briskly to do exactly this, to arbitrage from the purchase side over to the rental side where there is strong demand. Allowing the GSEs or FHA to get into the rental market more directly could have a definite chilling effect on private investment in this area, and as I noted, the rental area is an area that is actually performing fairly well and is actually indirectly helping the purchase side, as well, through contributing to demand on the purchase side. I believe we would be naive if we think that we can only address the supply side through these proposals without also affecting the demand side of that proposal.

So, in summary, forces in the housing market are already at play that will ultimately lead to long-term stabilization. Again, it is not always pretty and it may take longer than we would desire, but the likely long-term consequences of policy intervention should be well understood before the Government steps in to help the market along.

Thank you again for the opportunity to address you today and I look forward to answering any questions you might have.

Senator MENENDEZ. Well, thank you all very much for your testimony. There are a few cross-current here and I want to explore them.

The question of the whole issue I heard in your statements, the question of investors being able to purchase groups of properties and there is a countervailing view here. How do—in this step-by-step process that we have right now—how do we move that whole universe of that housing market if we continue on the individual-by-individual sale at the end of the day? Mr. Nielsen or Mr. Dechert.

Mr. NIELSEN. Well, I do not think that is what we are advocating. In fact, what we are advocating is that the financing vehicles that keep folks from going to larger numbers of homes being sold be allowed to go forward. In other words, Fannie Mae and FHA both have limits on the way they finance some of those things. Our guys would be out there buying much greater numbers of homes if they could use those financing mechanisms to purchase them.

So I think I would agree with Ms. Goodman. A lot of what Laurie said, however, we would probably ratchet it down to 50 units as a salable bulk and then maybe up to 200, as she suggested. So I think there is a lot of commonality in what we are all saying here, but I think what we are concerned about is the financing mechanisms need to be loosened up so that our guys can participate.

Senator MENENDEZ. Mm-hmm. And what would you want to see in that respect, the number of individual properties that could be——

Mr. NIELSEN. Well, like I said, I think as far down as maybe 50, you know, allow Freddie and Fannie and FHA to finance 50 units as opposed to the limits that they have today.

Senator MENENDEZ. Ms. Goodman, how does that sound to you?

Ms. GOODMAN. Obviously, the more units, the better. I think bulk execution actually will give the GSEs much better pricing in the end. I mean, from a large investor's point of view, we cannot afford to buy three properties in Cincinnati, four in Atlanta, six in Cleveland. It is virtually impossible to maintain. You need the incentive to build out the infrastructure for bulk. So certainly 200 would be preferred. Could we live with 50? Yes. Would more be better? Yes.

One-by-one does nothing for anyone. First, it does not encourage us to build out the infrastructure. Second, not all properties are going to trade one-by-one, so the absolutely all in execution is going to be worse. Third, if you trade them one-by-one, you cannot impose the conditions on selling to keep homes off the market for a period of time, which I think is very, very important, which you can do if you sell in bulk. Fourthly, bulk can be executed far more efficiently. Property deteriorates very, very quickly if it is not maintained, and this alone argues for very quick disposition. And finally, quick execution is very important from a macro perspective because it will serve to stabilize the housing market more quickly and, hence, the economy, as well.

Senator MENENDEZ. In this respect, there is a concern that when you have institutional investors buy in bulk, and the larger the bulk, there is this lack of connection locally and the ability to execute with management of those properties once owned. What type of processes would you advocate putting in place in order to screen and monitor bulk investments, if any?

Ms. GOODMAN. I think you have got to make sure the investor is strong and can afford to maintain the properties. But, basically, it is in their financial interest to maintain the properties. They have just paid for these properties. If investors do not maintain them, they are unable to rent them out. The vacancy rate would be really high. And current pricing is not such a bargain that it is a slam-dunk.

That is, investors really have to maintain the properties or they cannot really meet their financial targets. Investors have to maintain the properties in order to get the rent that is making their numbers work. And they are looking at sort of 8-percent type returns. They are not looking at 12-percent type returns after the costs of maintaining and the costs of renting the property out.

Senator MENENDEZ. Mr. Krehmeyer, you do this in a different context. What is some of your experience in terms of what is necessary?

Mr. KREHMEYER. Certainly, I would agree with the other panelists that one at a time is not going to work. The problem is too big. Whether it is 50 or 200, I think the smaller is better for us in the not-for-profit world to secure what limited capital we can for challenges like this.

I would suggest that partnering with local communities, with folks on the ground who know communities, who know neighborhoods, pushing political jurisdictions at the local level, hold folks accountable, whether they are local neighborhood folks or out-of-town investors. Hold everybody to high standards and how are you going to maintain that property, how are you going to take care of it, and if you do not, there should be some penalties associated with that. Failure to do so just means this downward spiral in communities and neighborhoods will continue.

Again, if we do not take an aggressive approach and force people to say, let us align the incentives of, whether it is an out-of-town investor, a local organization, that local political jurisdiction, align the incentives and the goals of what are we trying to accomplish and stop working in silos, because we have tried that and it just has not worked.

You know, my organization would be happy to work with an outside investor to come work in our communities, buy some properties, work with us, because we are rehabbing other homes. We know the folks in the community. We are doing after-school programs. We are doing all that other community-building work. We would love to have somebody else's capital and somebody else take a little risk with us in the community.

Senator MENENDEZ. Let me take one last moment. Mr. Nielsen, you mentioned in your comments, although we are talking about foreclosure here, one of the goals here in these hearings is to make sure we get this housing market moving again. The expiration of the higher loan limits take place September 30. Senator Isakson and I and others have this effort to try to extend that, particularly the 125 percent of area median home price standard for 2 years for FHA, VA, and GSE. What effect do you think happens if the loan limits are not extended and if they expire at the end of this month?

Mr. NIELSEN. Well, there are specific markets that are going to be dramatically affected, basically, those on the coasts where folks just cannot buy a home if you do not have those loan limits where they are today. Any reduction in the loan limits is going to dampen that market, and with a housing market that is in critical need of everything that they can get to purchase homes today, to do that is just piling on, and it seems to me that—and thank you for your leadership on that—if we could keep those numbers where they are today, that is going to be the very best situation for folks that are trying to buy homes and trying to sell homes today.

Senator MENENDEZ. Mr. Dechert, is that the Realtors' view?

Mr. DECHERT. Yes, Senator, that is our view, and again, we appreciate your sponsoring this legislation. I mean, when you look at our State, even, within New Jersey, Hudson County, your home county, this would be a $104,250 drop in loan limits there if this change would go through. Down my way, Cumberland County, which is not a high-cost area, but there is a drop there from $405,000 to $271,050 in loan limits, which is $133,950. That is going to have an impact on the market. As Mr. Nielsen said, we do not need more piling on. We need to incentivize the market, not de-incentivize it. That is very important to us, yes.

Senator MENENDEZ. Thank you.

Senator Reed.

Senator REED. Well, thank you, Mr. Chairman.

Let me make two initial points. The Chairman held last week a hearing on some innovative approaches, not to REO but to the other aspects of the mortgage market, and I commend you for that. Steve Pearlstein wrote a thoughtful opinion piece in the Washington Post, which I would like to put as part of this record, too.

Senator MENENDEZ. Without objection.

Senator REED. He is one of the most, I think, thoughtful commentators on the economy operating in the media. That had to do with refinancing and how we break through the issue of refinancing and give homeowners the benefit of historically low Federal Reserve rates that are not translating, for many reasons, into refinancings, and that is something I think the Realtors are very sensitive to, also. That would be very, very helpful. So point one.

But point two, when we talk about the REO, we have been collectively working with Senator Menendez, Senator Merkley, and others, trying to get FHFA to kind of begin to think about creative ways of doing this, and there has been some progress. There was a request for information. I think many of your organizations submitted comments that they were moving on this front.

And one of the issues, and let me open it up with Ms. Goodman, is the appetite, not just your company but for the investment community at large, to get into the acquisition of these properties as affordable rental properties. You think that is a real positive force out there?

Ms. GOODMAN. Absolutely. There is a lot of capital being raised for exactly this purpose. Housing is quite affordable in a historical context. Buy-to-rent looks OK. It produces reasonable returns at current prices. And then there are two sources of upside.

First, rents are likely to rise. That is because borrowers who are not making their mortgage payments at some point are apt to become renters and are apt to put more pressure on this market. Actually, we would argue that the homeownership rate is more like 61 percent than 66 percent——

Senator REED. Right.

Ms. GOODMAN.——as four million of the 4.5 million delinquent borrowers are going to be unable to make it in the end.

And third, home prices—investors have the option that home prices rise at some point. So I think it is a good investment and you are actually seeing a lot of capital raising for that purpose.

Senator REED. One of the other aspects that we have tried to stress is not only simply transferring the property to an investor, either not-for-profit or for-profit, but also encouraging retrofits or renovations so that you capture some of the new energy technologies, which in the long run is a benefit not only for the tenant, but also for the owner because it is more effective and efficient, and in the short-run also puts people to work, which is a desperate need. Instead of building new houses, retrofitting and weatherizing existing houses. Is that something that in the context of private investors would be looked at as a positive, I hope?

Ms. GOODMAN. I think you would have to weigh the economics, how much does it cost, and build it into the purchase price. So the analysis would be on a home-by-home basis, and again, you would just have to weigh the economics.

Senator REED. The other aspect of this, we have found out, is that the FHFA, as the conservator, has a legal obligation to maintain value. I am sure there is another specific legal phrase. But essentially, when we get into this argument of is it a 200 unit minimum purchase or a 50 unit purchase, is it to small groups, *et cetera,* one of the decisive factors, I think, is going to be, frankly, FHFA looking to see what is their best return, and you might want to comment on that, also, in terms of being able to convince the GSEs, Fannie and Freddie, but more importantly the FHFA Director, that this approach is not only good for potential renters, not only good for kind of the industry, but this basically enhances the value, because the sense we have is that they feel it does not add value or diminishes, they cannot do it even legally. So I would like your comment, Ms. Goodman, and then open it up to the panel.

Ms. GOODMAN. I think this would enhance value. The economics are such that what investors want to do is, at the minimum, continue to maintain the property, and more likely enhance the property so it can be rented out at the maximum rent.

If Fannie and Freddie feel like they are giving too much away, there is the conceptual alternative that they join as joint venture partners. And, in fact, the FDIC has implemented this very effectively on their Legacy Loan Programs, where they basically are co-investors and also provide some financing. There is no reason why that could not be adopted to this environment.

Senator REED. Essentially along the lines of they would share in any appreciation upon a disposition of the property——

Ms. GOODMAN. Right. It would be a partnership. Exactly.

Senator REED. And the other side—again, I will get to other people—I am running out of time—the other side of this, if—the status quo seems to be absolutely unacceptable for the real estate industry, for renters, *et cetera.* These properties sitting, and these are mostly single-family homes we are talking about, are sitting in the middle of the neighborhoods. The grass is not cut. The values are going down. It is a challenge. And again, I am sometimes frustrated because it seems so clear to us this makes sense, and yet we have had—it has been like pulling teeth, trying to get FHFA I have to say it properly—enthusiastic.

Ms. GOODMAN. Every day you do not maintain the property, its value just continues to decline, and that is actually one of the big arguments for bulk sales.

Senator REED. I have got just a minute. Would anyone else like to comment on this general line of questioning?

Mr. NIELSEN. I absolutely agree. You need to maintain those. And, frankly, that is the reason why we think that the number of units that could be sold together should come down. We think that those that will maintain a community the best are those that are in that community. And we also think that has an effect on pricing, where FHA and Freddie and Fannie need to get the most money that they can for those houses. If you bring it down to a point where more and more people can bid on those, it is going to have an effect on pricing.

Senator REED. Well, I think from the perspective, and I am being presumptuous about FHFA, their whole notion would be, how do we maximize the price to us——

Mr. NIELSEN. Exactly.

Senator REED.——because that is what their legal—and if you can make that case effectively.

The other issue, too, and just a comment more than a question because the Chairman has been most indulgent, there would seem to be a natural kind of connection between a national investor, particularly going to an unknown market, to reach out, I do not know if we make that a requirement, but to reach out to the local industry or at least someone in the local industry to be the representative. And I would think, again——

Ms. GOODMAN. Absolutely. You would end up using local contractors, *et cetera,* who know the neighborhood. You would have to.

Senator REED. Local Realtors in terms of rental capacity so that——

Ms. GOODMAN. Local contractors, local property managers.

Senator REED. Yes.

Ms. GOODMAN. You need someone who knows the area and knows the community, absolutely.

Senator REED. I do not think it is necessarily kind of a disconnect between a big 200 units and no local participation.

Mr. KREHMEYER. I think we just need a little help in getting us aligned. We, as a general rule, do not work together well without some incentives and a little prodding to get us there.

Senator REED. No, I think you are absolutely right, Chris.

Mr. DECHERT. Yes, Senator. The Realtors are not opposed to the bulk sale. We just have some concerns and want to have some guidelines and maintain the local involvement like you are talking about. That is what we want to do, too.

Senator REED. Well, one thing you have to do is thank your Senator, because he has been terrific in making sure that your voice is heard.

Mr. DECHERT. Yes.

Senator REED. I have never been to Avalon, but some day, he will invite me.

Senator MENENDEZ. All right. I will.

Mr. DECHERT. I will give you my card after the hearing.

Mr. NIELSEN. But, Senator, you want to be sure that the term "bulk" does not preclude people from participating. You want to make sure that it is small enough so that everyone can participate, or as many people as possible can participate in the process.

Senator REED. And the auction price determines——

Mr. NIELSEN. Exactly.

Mr. HUMPHRIES. It is probably also worth pointing out, if I may, while a lot of the conversation has focused on bulk purchase, the vast bulk of properties being bought by investors are being bought by relatively small investors, and it is the long tail that actually drives a lot of this marketplace. So, certainly, there is a place for bulk investors, but I think things that do stimulate smaller investors, people in their communities who want to buy a house down the street for turning it into a cash-flow positive property, I think that is really where the bulk of—a lot of these sales go, and making sure that we continue—and that is these people who are buying all cash, paying all cash for homes and turning it around and turning it into rental properties, that is these people. And we need to make sure that we continue to have programs like FHA and Fannie Mae that are facilitating that part of the market, because that is the long tail and that is who is doing all this buying.

Senator MENENDEZ. Thank you.

Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair.

Mr. Dechert, I wanted to start with your mention of your support for lease-to-own strategies. Could you share your vision for how that would work?

Mr. DECHERT. Our vision, you know, as we had talked about earlier, there are just—we think it is a great program. We think it should be privately administered by local investors, I had said, local nonprofits. We would like to see local real estate agents involved, involved in the process there, and have some guidelines in contracts that are specific regarding the maintenance, purchaser responsibility, purchase price, percent of that downpayment. And then, also, which we think is very important, is minimize the detrimental effects on neighborhoods by implementing strict guidelines as far as the rehabilitation and continued maintenance of the property, and also setting up guidelines with the percent of payment allocated to downpayment, too. So I think it could be a good process.

Senator MERKLEY. So you are picturing not just an option, but a negotiated purchase price arranged up front?

Mr. DECHERT. Yes, I think so. I mean, I have to really check a little bit more with our staff on that and get back to you on it, but yes, I think it might be something along those lines. Yes.

Senator MERKLEY. OK. And, Ms. Goodman, you noted you support renting to current occupants. Do you have a specific vision of how you would like to see that executed?

Ms. GOODMAN. Yes. I think you have to evaluate this property on a—you have to evaluate each piece of property on a one-by-one basis. There are some cases in which the current occupant cannot afford the rental income, cannot afford to be in the house at all, and there are other instances in which they can. I think you basically have to have an experienced manager work with borrowers on a one-by-one basis. But certainly to the extent the current borrower who is not paying his mortgage because he cannot afford his mortgage payment, but can afford to rent that property, there is no reason to kick the borrower and his family out and rent the property to a third party with a similar financial profile. There is no reason why the borrower has to dislocate his family, move from the community, and rent another home.

Senator MERKLEY. Should the families have some sort of option to repurchase?

Ms. GOODMAN. I think the answer is you want to give them the right of first refusal, but I think it is very, very hard to lock in a price up front.

Senator MERKLEY. I want to turn to a concept that none of you have mentioned, at least not as advocating for, and that is homebuyer tax credits. In my work with low-income families through Habitat, I saw neighborhoods where the primary obstacle to homeownership was the downpayment, and one strategy is sweat equity, like Habitat. Another is an IDA strategy, Individual Development Account strategy, where you have matching grants. So there is certainly money being put in by the homeowner, but they earn over time through their savings matching grants to help them purchase a home. Those programs recognize that home ownership is one of the three main pathways to the middle class, one being small business, one being education, the third being homeownership.

I look at the fact that we subsidize homeownership through the home mortgage interest deduction, about $100 billion a year, roughly. Why not, in addition, spend a little bit of money up front helping working families help absorb this inventory of foreclosed homes by being able to purchase a home now when the prices are very low, likely near their bottom. Why not spend a little money in a matching grant program, not simply on a temporary basis, and I think, Dr. Humphries, you have noted that a temporary basis simply shifts buyers forward, but as a longer-term aspect.

I just want to know one other thing, is that for a working family, the 5 percent on a $200,000 house is less than the standard deduction, so a working family does not get any help from the mortgage deduction to become a homeowner in the first place. So we are spending all this money to help reduce the price of a house in the longer term. Why not spend a little bit of money up front to help working families become homeowners? Any thoughts?

Mr. KREHMEYER. Yes, Senator. We in St. Louis carry out an Individual Development Account program. We have done so for about 10 years. Right now, we have about 400 account holders, and certainly we think it is a great idea, the idea of having people think long-term to build their assets and to build their wealth and provide them with the incentives. You commit, you make the sacrifices to save and get prepared for home ownership and we will, in turn, provide you with that financial support. I think it is a fantastic idea if we can create a national model that says we are going to create an Individual Development Account for households all across the country. I think that would be a great benefit to the current problem we are facing.

Mr. NIELSEN. And the Homebuilders would certainly support that program.

Senator MERKLEY. What about tax credits, which are a little bit faster version of providing support to families' matching so it is not simply substituting for a homeowner's own, but the up-front costs are substantial. What if we had a $2,500 tax credit per person, $5,000 per person, had to be matched dollar-for-dollar by the homeowner, to help people become homeowners right now, when the prices are low?

Mr. NIELSEN. Absolutely. Any program that makes it easier for folks to get into a home makes total sense to us.

Senator MERKLEY. Mr. Dechert, what is your——

Mr. DECHERT. I was going to say, Senator, I agree with that, and the first-time home buyer tax credit program that was in effect last year and extended was great as far as getting people into the market and getting first-time home buyers involved. So I think anything that could be done along those lines would be great for the market.

Senator MERKLEY. Mr. Humphries, I know you had concerns about a short-term program just shifting demand, but we have long-term programs. Why not a long-term working family matching tax credit?

Mr. HUMPHRIES. Yes, I think it is an interesting idea, and if I understand—I do not understand all the details of what you are proposing, but certainly in terms of the shorter-term version, as you already mentioned, Senator Merkley, the tax credits in 2009–2010, we did extensive research and survey work at that time and we believe that it did primarily just shift demand around within the year. So we definitely saw a boost in home sales during the period of the tax credits, but we did see a fairly—almost a commensurate decrease in home sales following the expiration of that tax credit. So our sense is that it did not have a long-term impact on the trajectory of the housing market but did have a short-term impact.

In terms of a longer-term stimulus as you are suggesting, and I do not know all the details of what you are proposing, I guess a mild concern I would have is whether—is the possible distortive impacts of that policy. We do have extensive—a host of other ways that we do make homeownership advantageous. You mentioned the mortgage deduction, certainly the implicit, now explicit, backing of Fannie and Freddie behind the mortgage market has kept rates low and it was an implicit subsidy to the housing market. We have numerous ways in this country that we do stimulate housing because we consider it to be very useful for, as you said, a pathway to the middle class.

I guess I would be concerned that, one, about the distortive impacts and whether we are over-subsidizing housing at that point and distorting people's choices from some people for whom renting is actually a very good option, based on the long-term stability of their income and some other factors, perhaps their mobility preferences, and whether we are then incentivizing them to actually buy when actually renting is right for their financial situation.

Senator MERKLEY. Thank you.

Senator MENENDEZ. Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and thank you so much for holding this hearing.

Sometimes in this town, I feel like people are forgetting what people in our States are really going through, through this incredibly difficult economic period. It manifests itself, I think, very clearly in housing, where there are these twin problems that people are suffering through. One is the negative equity issue that I want to hear you on, Dr. Humphries, and the second, the other, is the cashflow issue, people that are underemployed or unemployed and cannot afford to stay in the houses. They are related, obviously, but distinct, and I wonder if you would talk a little bit about the observation in your testimony that negative equity is much harder to solve, more than the other pieces of this.

Mr. HUMPHRIES. Yes, and this is—I guess this is an issue that I wrestled with a great deal, because I do not have an ideological position on it. My——

Senator BENNET. Another—I am sorry. Another way of saying negative equity, the issue is is there a way to prop up the values of people's homes, or do we need to take the pain as an economy going forward?

Mr. HUMPHRIES. Well, I think, in general, I guess I tend to advocate taking the—you can pick your poison. Either you are going to take the pain now and you are going to get back to a normal market sooner, or we are not going to take the pain and we are going to go through a longer period of malaise before we get back to normal market conditions. And I think that both are quite detrimental to homeowners and U.S. citizens, and I tend to prefer probably getting the pain over with and getting back to normal market conditions with the realization that anything we can do through forbearance and refinancing programs that do try to stretch out the length of the payments and other things that try to keep people who can reasonably need some help in their homes is a good idea.

I guess in terms of directly answering your question about negative equity, the reason it is a thorny problem, I think, is because, essentially, there are three classes of homeowners out there. We have got a large number of homeowners who do not need our help. They are in mortgages, and they may be down from where they bought—their home value may be down from where they bought it at, but they can still afford the mortgage.

And then we have got the second group of people who do not really—who cannot benefit from our help——

Senator BENNET. Because they are so underwater.

Mr. HUMPHRIES. They are so underwater. They are in long-term unemployment and essentially no amount of help that we are able to give them is going to keep them in that house.

And then there is this third group of people who a little bit of help could actually make the difference for them. Reducing their payments $200 or $300 a month could actually keep them in their home, and that is the group that I think we are all united in saying, we should find something to target that group.

The trouble is that that group is very small relative to the first and second groups, and it is very hard to target policies at that group without the first and second group coming in to avail themselves of those policies, and that tends to drive up the cost of these programs enormously, like we saw with the tax credits, where by our research, on the first round of tax credits, four out of five people who took the tax credit were going to buy a house anyway. So, basically, we were paying money for people who were going to buy a house, making the effective cost of that tax credit, instead of $8,000 per house, it ended up being almost $45,000 per house of the new homes that we were incentivizing because most of the people were going to buy the house anyway.

So these programs, while if there was a silver bullet to solve negative equity and keep foreclosures at bay, I would definitely—want that silver bullet. It is such a thorny problem because, typically, of moral hazard problems.

Senator BENNET. Ms. Goodman, do you have something you would like to add?

Ms. GOODMAN. Yes. I would like to add on something to that, and I think, actually, Senator Menendez hit the nail on the head there. I think the way you have to deal with negative equity is by doing principal reductions. We know exactly what it takes to do a successful modification. You need to modify early. You need a significant payment reduction. And you need to do principal reduction to re-equify the borrower.

If the question is, how do you deal with the moral hazard issue. Well, I am sitting there at a 150 LTV. I get a principal reduction down to 115 in exchange for giving up 50 percent of my upside. Stan Humphries, a much better borrower than me, is sitting there at a 120 loan-to-value ratio. He is not willing to give up 50 percent of his upside to get written down to 115. So, basically, a shared appreciation mortgage allieviates the moral hazard issue. If you accept a principal reduction, you then have a shared appreciation mortgage. This deals very nicely with the moral hazard issue.

Essentially, we have to stop thinking of mortgage default as a moral issue and we have to start thinking of this as an economic issue. How do you put into place the economic incentives to get people to make the decision you want them to make. That is, you want me, at 150 LTV, to accept the principal reduction. You want him, at 120 LTV, not to, and you can easily do that.

Senator BENNET. How do you feel about that?

Mr. HUMPHRIES. Well, I guess I would have to understand, in terms of when I say moral hazard, I do mean the economic sense of moral hazard——

Senator BENNET. Right.

Mr. HUMPHRIES.——not the actual ethics of that issue. But I would have to understand in terms of—so you are suggesting a product, I guess, which does not exist out there

Ms. GOODMAN. It actually does. It actually exists. There is one major servicer who is currently doing it.

Mr. HUMPHRIES. OK, so——

Senator BENNET. And who is that?

Ms. GOODMAN. That is Ocwen.

Mr. HUMPHRIES. And I guess if you were then to walk away from—if I were to sell my home subsequently, would I be left with a second mortgage equal to the amount that I had not paid on that shared appreciation upside possibility? Is that how that would work?

Ms. GOODMAN. That would be a principal reduction to, say, 115 percent of the mark-to-market LTV, and then you would share your upside with your lender.

Mr. HUMPHRIES. But if I took the shared appreciation mortgage and 2 years later sold that house, am I left with any debt burden in that scenario——

Ms. GOODMAN. No. No.

Mr. HUMPHRIES.——because I certainly would see the upside, but I could——

Ms. GOODMAN. No.

Mr. HUMPHRIES.——at that point, I am walking away from that debt. Is that how that would work?

Ms. GOODMAN. You do not owe anything more than what you have been written down to. It would be essentially a forgiveness program.

Mr. HUMPHRIES. Right. So I guess the concern there, would that be moral hazard in slow motion, then? Would you get a shared appreciation mortgage now and then you would incentive people to a year or two later walk away and release themselves of the debt at that point? Is that how——

Ms. GOODMAN. No. They still have 50 percent of the upside, so they would stay in their home at payments they can afford and——

Mr. HUMPHRIES.But I guess in the scenario where I have got, let us say, a $150,000 mortgage and my home is only worth $100,000, you are going to write me down to $100,000 and then you are going to give me a shared appreciation mortgage so that I can participate in the upside. But, I guess, what is to prevent me from then selling my house a year or two later and I have now shorn myself of $50,000 of debt? Is that how that would potentially work?

Ms. GOODMAN. You probably want to include the requirement that you buy into that principal forgiveness over, say, a 3-year period.

Senator MENENDEZ. The Chair has been——

Ms. GOODMAN. I do not want to——

Senator MENENDEZ.——extremely liberal here——

[Laughter.]

Senator MENENDEZ.——in trying to maximize the discussion, both by Members' time as well as by interaction between the panel, which I am happy, as long as the Senator is using his time for this purpose.

Senator BENNET. I appreciate it, Mr. Chairman. The only thing that I would ask Mr. Nielsen, who looked like he wanted to get in on this, to comment, and then I will get out of your way.

I do think it is—throughout all the hearings that we have had and the work that has been done, I think it is very clear that what continues to elude us here is an alignment of incentives that could help create some velocity in the market. I do not think we could prop up these values myself. I think we have to let the market do what the market does. But to the extent that there are impediments and there are incentives that are unaligned from the outcomes that we would all like to see, that is the place where we need to be in order to begin to see this market start turning around. Obviously, employment being a big piece of all this.

But, Mr. Nielsen, you get the last word in. You stand between me and the Chairman's patience.

Mr. NIELSEN. Well, to that end, Senator, you heard the dialogue, so there is lots of devil in the details.

Senator BENNET. Yes.

Mr. NIELSEN. And those details need to be worked out. But I think it is important to understand that even though, as Laurie said, there are servicers that are doing some of these workout programs and there are States like the State of Nevada which mandate workouts between banks and homeowners, it is not getting done.

Senator BENNET. Right.

Mr. NIELSEN. So whatever we are going to do, it has to be hard and fast and probably legislated. So thank you very much.

Senator BENNET. Thank you. Thank you, Mr. Chairman.

Senator MENENDEZ. Well, thank you.

I just want to just come back to revisit a central point here. I appreciate moral hazards as much as anyone else. I think there are moral issues into how people were led into mortgage products they should have never been into. That is a whole issue, as well. There is a moral issue when 4 million families will find themselves outside of their home, and the list goes on.

So I am concerned about how we move this market forward, and it seems to me that one of the fundamental issues that we have talked about here a little bit, but I would like to just, if I can, nail it a little further down with the panel, and that is the whole question—the primary concern for the GSE about bulk sales is taxpayer reimbursement, and, of course, that is something this Committee is sensitive to. But I look at it in a little bit broader picture.

Right now, who is the biggest holder of this liability? It is all of us as Federal taxpayers through the GSEs and the FHA? So I would want to limit that liability as much as I can and at the same time try to get a market moving. So I look at it maybe in a little different way because surely holding on to the proposition that I want 100 percent of what I have got when 100 percent of what I have got is dramatically different in terms of value today than it was is a write-down in and of itself.

And so looking at this in a way that—I think the GSEs think that selling properties in bulk will result in lower prices for taxpayers, but bulk sales also force investors to buy both the homes—the desirable properties and the less desirable ones, as well, and that has a value to it in and of itself when that is done in one bundle rather than in cherry picking the best. Others would suggest that improvements to the overall housing market from the bulk sales approach would help with individual sales and taxpayer returns on other properties, as well.

So I get a sense that there should be a broader view as to how we ultimately get the taxpayer in the best position as well as stabilize neighborhoods and create greater values, and I would like to hear some direction to that, because I think that goes to the very heart of the matter. Do the GSEs and the FHA, you know, their concern for getting the best return for taxpayers by selling homes one on one or selling them in bulk, you know, how do you address that question? I open that to anyone on the panel who wants it. Mr. Nielsen.

Mr. NIELSEN. We hope there is a happy medium there, and that is why we are advocating that the number of homes be smaller, because it gives you more participants in that auction concept. In addition to that, I would say, with deference to Mr. Krehmeyer, that we should not limit anything to nonprofits. They are good at what they do and they should be equal participants with for-profit organizations. I think the more folks you have involved, the better off the pricing will be to the GSEs and to FHA.

Mr. KREHMEYER. Yes. I think there is not an easy answer. Otherwise, we would have moved forward, Senator, and I think you framed it perfectly in terms of the two ends of the spectrum, about how do we manage taxpayers' dollars and how do we move the housing market forward.

The genesis of our financial meltdown was the housing market. If we are going to return to being strong and healthy, my opinion is we have got to get the housing market going quickly, and again, we have to be bold and aggressive and say, short-term, this may not be the best thing that we feel comfortable with, but if we do not start moving units, if we do not start getting them reoccupied and positive use for new homeowners and for rental property, strengthening communities, pick up property values, increase the tax base, create some more jobs, we are going to continue to struggle.

And again, I hope we can find a way to be bold and to be aggressive and to not be timid on this, because each and every day we wait, the problem gets bigger and bigger.

Ms. GOODMAN. We have talked a lot about getting as many investors as possible involved. The current one-by-one system actually squeezes out the large investors because they are not able to buy in bulk and put into place the infrastructure that is necessary.

Mr. HUMPHRIES. I guess I would suggest that it is fundamentally an issue of the flow of foreclosures by the GSEs and by the FHA. Are they happy with the current pipeline and the flow in which they are being released onto the marketplace? If they are not, then there is a price issue. They could lower the price, and from the investors' side, yes, I think the reason more bulk investors are not—they could move into the marketplace now and buy them individually and over time aggregate enough supply in individual markets to actually make a workable business. I think the issue that prevents investors from doing this is the fact that the price point is not right for investors.

So, yes, they would like the prices lower, but if individual buyers are willing to buy them at a higher price, then I think the GSEs should sell them at the higher price. If they cannot sell them, then, yes, they will have to lower the price and that might become more interesting for larger bulk investors if they did so.

Senator MENENDEZ. While we have focused here on the foreclosure element of the marketplace, while I have the expertise on the panel, let me ask this final question. What about getting the GSEs to just let people who are presently in place lower rates to refinance at lower rates today? This would create, number one, certainty in that universe that that would not add to potential defaults. Second, it would create, obviously, a whole flow of money into the economy that individuals would have. Is that something that is desirable? Mr. Dechert.

Mr. DECHERT. Yes, I think it is, Senator. I think it could be very helpful, as long as we could work that out. You know, what we are seeing is—I mean, the pendulum as far as the banks were concerned, first, it was over here. It was way over here back in 2006–2007. They were giving some mortgages out that should not have been and they were pretty liberal. And now it has swung over here and they are being so tight and so strict with all the guidelines that it is tough to get the flow of money in there. And if we could get the pendulum back in the middle and work to maybe do something like you are talking about there, that would be very helpful, I think. It really would be, because keeping the homeowner in the property is a benefit for everybody all the way around and ultimately the taxpayer, too.

Mr. NIELSEN. But it clearly needs to be a specific policy. I mean, it needs to be stated so that there is no unequivocal decision to be made there. A good example—this may be a little bit off-track, but a good example is in multi-family, where there are some foreclosures where people have tried to work with the GSEs and sometimes have to resort to the Bankruptcy Court to set those issues aside and make it work, and that is wrong. But if there were a policy that you all decided on, this is the way it is going to work, then I think it would work.

Mr. HUMPHRIES. That, if I may——

Senator MENENDEZ. Yes, Mr. Humphries.

Mr. HUMPHRIES. I think that policy response—it is intriguing to me. I guess it has grown on me, the more I look at it. If you were to entertain that idea, I think you would have to do so as a form of economic stimulus for the economy, rather than a housing solution. I think that, for the reasons I articulated when I discussed negative equity, this program will not have a huge impact on the housing market. I think we are not going to avoid a lot of defaults. We will avoid some defaults by doing that, but I think we will not materially change the outcome of that in that marketplace there. But certainly it does offer the potential of $50 to $70 billion of stimulus, which may be helpful on the stimulus side, on the larger economic stimulus side. But I would not do it for reasons of helping housing.

Ms. GOODMAN. I actually think that enhancing refinancing opportunities is a very noble goal, and, in fact, those most prone to default are paying the highest rates and oftentimes are the most difficult to refi.

Having said that, I think it is very difficult to refi, enhance refi opportunities significantly in such a way that it is not NPV negative to Fannie and Freddie and, therefore, would not be inconsistent with the idea of conservatorship. I think the goal is noble. I think it is incredible difficult to get it done.

Senator MENENDEZ. Well, I guess that the conservatorship would have to look at what it is going to get at the end of the day if people default, what is the real value there. I mean, there is this presumption that there is, you know—if you bought your home, for argument's sake, at $400,000, and it is now worth $250,000, well, the entity that has backed the loan is looking at a valuation of $250,000, not $400,000. And so the question is, if I can allow that individual to refinance, stay in that home, and be able to, in doing so, over time, have an appreciation again that we expect, that that would be a whole different ball of wax. But if you want to just go and say, you know, I want to get that piece of property now, let us foreclose on it, it is not worth what the loan amount was. So it just seems to me that that has got to be part of the equation when we are trying to determine what is value at the end of the day.

Senator Merkley, do you have anything else? Senator Merkley.

Senator MERKLEY. Well, thank you, Mr. Chair. Yes.

I wanted to explore a little bit more this bulk sale concept, and, Ms. Goodman, you note that you bring in the big investors when you do very large sales, but certainly you are providing a convenience to big investors, but there is nothing that stops them from acquiring homes in smaller batches, but you definitely exclude smaller investors. There are very few folks who can buy 200 homes at a time, for sure.

There has to be a discount involved in that, and I am familiar with one bulk sale that occurred from a savings and loan in a neighborhood that I am very familiar with in which the investor bought the homes at roughly a 50 percent discount on what they would have sold individually. What do you estimate the discount to be if one investor buys 200 homes?

Ms. GOODMAN. I think we actually have not seen that, so it is really hard to estimate what the discount would be, if there would be a discount at all. I would argue that there is so much capital raising going on for investors to participate in this market, and if you have several large bidders, there may not be a discount at all—and, in fact, you might end up getting better execution than you would one-by-one because, in fact, the large investors could accumulate the properties as a group and could put in place the necessary management structure all at once.

Senator MERKLEY. I am slightly dubious about that because I have not seen large sales that were not done at substantial discount. Dr. Humphries, what do you think?

Mr. HUMPHRIES. I mean, just to ballpark it, not looking at a specific deal, but if you look at some of the deals that were done through the PPIP where bulk purchases of FDIC inventory, those were oftentimes 50 percent of the outstanding mortgage balance, and that was—oftentimes those portfolios were, if you think that they were nationwide and home values are down 30 percent, then that puts about a 20 percent discount, roughly, on those deals, just as a ballpark.

Senator MERKLEY. I guess one thing I would be interested in is whether there is a way in which homes could be offered, if you will, to homeowners for a month or some period of time at the level that they would otherwise be included in the investment package. If they do not sell, then you include them in the investment package.

My point is that if you are going to do a substantial discount, why not give individual families who have suffered with so much difficulty in this economy the chance to be a homeowner first and take advantage of that discounted rate? Any thoughts about that? Yes.

Mr. DECHERT. I would agree with that, Senator. I mean, the affordability index now is—I mean, it is at an all-time high and rates are low. If there could be some type of an opportunity for home buyers to get involved in a process like that, it could be very beneficial. I think it would be very helpful, and maybe even help to keep the property values up some, too.

Senator MERKLEY. Ms. Goodman, would that kind of hybrid both accomplish what you are looking at, which is to be able to bring larger investors in to help clear this inventory and have them well managed, but also give individual families a chance to participate at whatever discount the homes are going to sell at?

Ms. GOODMAN. I think the problem is that a lot of the distressed homeowners are not going to be able to buy a new home. They are going to be turned into renters, and it is not the way you or I would want it, but that is the economic actuality. They are not going to be able to afford a downpayment on a new home, and if there is one thing we have learned from the crisis, it is that you need to have some—the borrower needs to have some skin in the game.

So I think it would be very disruptive to offer the homeowner the ability to buy the home for a month. And to the extent that you offer someone a free option for a month, I think you end up with cherry-picked homes that end up being substantially less valuable at the end of the day. And I think maybe you do some as bulk sales and some as individual sales, but I do think you need the bulk aspect. It would not be improper to maintain some individual sales, as well, but I think allowing cherry picking is just going to guarantee you a worse price at the end of the day.

Senator MERKLEY. Yes. Mr. Krehmeyer.

Mr. KREHMEYER. Yes. I would suggest on the idea of bringing distressed homeowners, I think it has some possibilities, but I would urge, put some home buyer education and training with that to make sure, OK, are we positioned, are we ready, have we done all the analysis, are we positioned for long-term success and do not have any short-term challenges.

And I would also suggest that the idea of taking a family that is being foreclosed and let them stay in their home as a renter, about 3 or 4 years ago, that idea was not very palatable, in my estimation. As the problem continues to grow and get worse, right now, it seems, quite frankly, anything we do to keep families in their homes seems to me to make a great deal of sense. If we can create a structure where, again, the ownership can be transferred, that family stays, the children do not get uprooted, the neighborhood does not lose another homeowner, another asset goes down the tubes, if we can create a model like that, in addition to everything else we are talking about, I think that makes a ton of sense.

Ms. GOODMAN. I could not agree with him more.

Senator MERKLEY. Well, Ms. Goodman, in your concept, not all those homes would be occupied by families, because many of them are empty, right? A lot of the homes that would be in these inventories——

Ms. GOODMAN. Yes. I mean, I really like the idea of investors buying up blocks of nonperforming loans and, where the borrower is clearly not going to make it in the end and wants to stay in his home, turning him into a renter. As Chris suggested, I think that makes a ton of sense. My firm is already doing it on a very small scale.

Senator MERKLEY. I would argue with the point you made earlier a little bit in which you said, if there is one thing we have learned, it is that there needs to be skin in the game. I would say, if there is one thing we learned, liar loans are unacceptable. Predatory teaser rate loans are unacceptable. And steering payments in which the mortgage originators have an incentive undisclosed to the buyer to steer people into predatory loans are unacceptable.

And I say this because I saw so many families who were able to become homeowners and pay less as a homeowner than they did in rent, and they had a huge incentive to stay in those homes even if they did not have a huge amount of money up front for a downpayment. But the families that got tossed out, or largely got tossed out because they were steered into predatory loans or they lost their jobs in this downturn of the economy, I mean, there are other factors that have a much bigger impact on what occurred than, I would say, the size of the downpayment. I will just throw that out.

Yes, Mr. Nielsen.

Mr. NIELSEN. You know, we would absolutely agree. We think it has a whole lot more to do with underwriting than it does the size of the downpayment. If they are underwritten properly, if people are underwritten properly, they are in the home. In fact, there are programs with very small downpayment requirements, from historically, that worked very, very well because they were well underwritten.

Senator MERKLEY. Thank you all very much.

Senator MENENDEZ. Let me thank the panel.

I know that prices, home prices, are low, and interest rates are about as low as they get. That still has not moved the market forward. So there are challenges here beyond that. You cannot have lower interest rates, and you cannot have prices that have significantly gone down and still see no action. So there are other challenges here.

Certainly, I get concerned when I see the suggestion that a qualified residential mortgage is now 20 percent. And while I totally believe, Ms. Goodman, that there has to be skin in the game, no question about that, I also think that when you say 20 percent, it seems to me that the broader criteria of determining the lending criteria is important.

This is going to take a whole universe out of the market who can be responsible borrowers at the end of the day and help the market, and the market seems to have gone there notwithstanding that there has not been any regulation to that effect yet. So this is a little bit chilling to me, so I hope we can deal with that issue, as well.

It is the focus of the Subcommittee from its last hearing and today and continuing to, as a result of some incredibly good testimony here and on the panels we had last week, to try to devise an overall plan as to how we work with the Administration and get this market moving again, because it is difficult to be optimistic about the economic future without having a housing market that is more robust than it is today.

So with the thanks of the Committee to all of you for your testimony, the record will remain open for 1 week so that any of our colleagues who may not have been able to attend, or who attended and have further questions, can do so. We would ask you to respond to those as quickly as you can in pursuit of our efforts here to have some action in the very close days ahead.

With that, this hearing is adjourned.

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF ALLAN H. "DUTCH" DECHERT

PRESIDENT, NEW JERSEY ASSOCIATION OF REALTORS

SEPTEMBER 20, 2011

INTRODUCTION

On behalf of the more than 1.1 million members of the National Association of REALTORS® (NAR), thank you for holding this timely hearing on new ideas to address our Nation's continuing foreclosure problem.

My name is Dutch Dechert, and I am the 2011 President of the New Jersey Association of REALTORS®. I have been a REALTORS® since 1981, and am the broker/co-owner of Ferguson Dechert Real Estate, Inc. in Avalon, N.J. Over the years, I have served the New Jersey Association of REALTORS® in many capacities (*e.g.,* director, division officer, and committee chairperson), and in 1990, and again in 2001, was selected as REALTOR® of the year by the Cape May Association of REALTORS®. In addition to my involvement within the REALTOR® community, I am a trustee of the Avalon Chamber of Commerce, where I served as president from 2004 to 2007, and am also a member of the Cape May Chamber of Commerce.

The U.S. housing sector is in a precarious state. According to many economists, it appears to have reached bottom and sales volumes and prices are beginning to stabilize. However, the uncertainty that has plagued the sector's recovery looks like it could be reintroduced as expirations dates for the national flood insurance program and loan limits quickly approach. As we begin the process of repairing the housing sector, let us remember that the first goal should be to do no more harm.

ADDRESSING THE NATION'S FORECLOSURE CRISIS

REALTORS® appreciate the Administration's attempts over the last two and half years to keep families in their homes, and its recognition that homeownership matters. The foundation of our economy is housing. Over a million small businesses have developed from it, and many more thrive because of it, including real estate sales services, housing finance, and construction and rehabilitation services.

Though several Federal programs were put into place in an effort to keep families in their homes, nearly all have depended on the efforts of large financial institutions to assist consumers. To date, all of these programs have fallen far short of their ambitious, but achievable goals. REALTORS® are concerned that many of these same financial institutions, who received vital funding from both the Treasury Department and Federal Reserve Board at the onset of the economic crisis, continue to deny similar support for distressed households across the country. A key purpose of the extraordinary support that these institutions received was to ensure that liquidity—for all types of lending—was available throughout the crisis. Yet many creditworthy households, specifically those requiring new or refinanced mortgages, are unable to obtain fair and affordable loans.

REALTORS® know firsthand that another attempt needs to be made to fix the housing sector, particularly the large inventory of real estate owned (REO) properties that exists and continues to grow. REALTORS® believe the any proposal designed to address this issue must:

- Focus on providing mortgage financing to qualified home buyers and investors to increase the absorption rate of the current REO inventory and prevent increases to existing REO inventory,
- Expand resources dedicated to pre-foreclosure efforts, including loan modifications and short sales (foreclosures are typically more costly than loan modifications and short sales, so this would minimize the need for more taxpayer dollars being used to support the GSEs), and
- Continue the timely and orderly disposition of REO inventory assets, and in limited geographic areas where alternatives are needed, rely on the expertise of local businesses including contractors, real estate brokerage firms, and professional property management companies.

NAR suggests that, as the Government evaluates proposals in response to the recent request for information regarding the renting of Government-backed foreclosed properties, the basic principles of any proposal should be to assist in reducing the number of properties in the foreclosure process that will add to the REO glut, maximize the recovery on REO assets currently held by FHA and the GSEs, and preserve housing values in neighborhoods across the country.

FINANCING

In response to the 2008 economic crisis, the Obama and Bush administrations have taken extraordinary steps to ensure that most of our large financial institutions survive. Most of these large institutions received funding from both the Treasury Department and Federal Reserve at extremely favorable rates considering the inherent risk. Yet, private capital in support of the mortgage market—meaning without Government participation via FHA, VA, or the GSEs—virtually disappeared.

The lack of financing is putting downward pressure on home values, increasing the number of homeowners whose mortgages exceed the value of their home, and increasing foreclosures. Since the beginning of the crisis, the GSEs and FHA have provided about 90 percent of all mortgage lending. During this time, FHA has raised its insurance premiums, the GSEs have raised their upfront fees (including loan-level pricing adjustments), and the lending industry as a whole has tightened underwriting standards to the point that only those with pristine credit histories have access to reasonably priced mortgage credit. Increasing access to financing for qualified borrowers and investors by reassessing the higher fees and excessively tight underwriting standards will increase the availability of mortgage lending for all types of housing, and will go a long way in allowing potential homeowners and investors to absorb excess foreclosed (REO) inventory.

Increasing Consumer Lending

As a consequence of extreme economic events, most notably high unemployment, lower home values, and tighter credit, many families now find that renting is their default option. Moreover, many creditworthy consumers continue to experience difficulties in obtaining fair and affordable mortgage loans. NAR supports strong underwriting standards; however, potential home buyers have become discouraged during this time of unprecedented housing affordability due to high fees, unduly tight underwriting standards, and the lack of availability of private mortgage capital.

REALTORS® ardently believe that the lending industry should reassess its policies and increase lending. The excessively stringent underwriting standards that are preventing creditworthy buyers from obtaining loans now need to be weighed against the broader recovery of the economy, because they are impeding the confidence of potential mortgage applicants and threatening to reproduce cracks in a very fragile housing recovery.

Liquidity for Investors

REALTORS® firmly believe it is important to have private capital return to the mortgage market and give the Government the ability to reduce its market share. Unfortunately, the refusal of financial institutions to return in support of the housing finance sector and provide mortgage financing means all borrowers, including investors, are finding it more and more difficult to obtain affordable mortgage options.

REALTORS® recognize the importance of affordable rental housing. For markets with large numbers of REOs and a high foreclosure pipeline, REALTORS® support giving local investors the opportunity to finance the purchase of distressed REO properties for rentals until the market recovers or to rehabilitate for more immediate resale. In order to facilitate this, the Government should implement temporary financing policies to give local investors the opportunity to purchase properties. Here are two examples of existing Agency policies that can be modified to offer incentives to investors:

(1) HUD should open up the FHA Section 203(k) rehabilitation program to investors. This will facilitate the rehab of the existing housing stock and increase the availability of financing for rental housing, and

(2) The GSEs should temporarily suspend investor financing limitations, especially the limit on the number of mortgage loans allowed for any one investor/borrower (currently 4 for Freddie and 10 for Fannie), to enhance affordable rental opportunities.

Amending these policies will give small, private investors the opportunity to absorb some of the excess inventory, resulting in the stabilization of prices for existing REO properties. Also, hard hit communities would benefit from improvements made to the vacant properties, and local economies would improve as small businesses would have the opportunity to participate in the rehabilitation of these properties by providing, as an example, renovation and property management services.

PRE-FORECLOSURE

The current economic and political environments are very budget conscious. Therefore, REO disposition programs that appear to increase taxpayer losses while seeming to enrich large institutions would raise concerns among Congressional members and millions of taxpayers, who remain angry that "Wall Street" received Federal support while "Main Street" was left behind. REALTORS® believe the best opportunity to reduce costs to taxpayers and assist in the stabilization of housing values and neighborhoods is to respond more effectively to, and provide more resources for, pre-foreclosure efforts on loans insured by FHA or owned or guaranteed by the GSEs. These efforts not only are net-positive outcomes for homeowners, but taxpayers as well.

Since early 2008, NAR has continually urged the lending industry to take every feasible action to keep families in their homes with a loan modification or, in cases where it is not possible to avoid foreclosure, a short sale.

Commitment to Loan Modification and Short Sales

REALTORS® are acutely aware of the downward pressure that foreclosures have on housing market prices. To relieve this, REALTORS® recommend that the Government reassess current policies to make sure that as many loan modifications and short sales are approved as possible. This will reduce adding to the ever increasing glut of REOs. A recent Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) report noted that less than 5 percent of TARP funds allocated for housing support programs, such as the Home Affordable Modification Program (HAMP) and Home Affordable Foreclosure Alternatives Program (HAFA), has been used. The success of these programs depends on the resources available and efforts of participating large financial institutions. Repurposing a portion of the existing housing focused funds to increase borrower participation will improve the performance of these programs, and will reduce the pipeline of severely delinquent mortgages that end up in foreclosure. Loan modifications keep families in their homes and reduce the probability of default.

Short sales, for those unable to meet their mortgage obligations, stabilize home values and neighborhoods, by keeping homes occupied. Also, short sales help reduce taxpayer losses by selling the probable foreclosure at a premium over its potential REO sales price. Unfortunately, our members' report that many potential home buyers still choose to simply walk away from a short sale due to the length of time it takes for the lender to complete the transaction. The dependence on large financial institutions has resulted in a short sale market that is clearly not functioning as it should. REALTORS® believe that homeowners and taxpayers deserve better.

IMPROVED DISPOSITION OF REO INVENTORY

Bulk Sales

In August, the Administration requested advice from market participants on the pooling and disposition of GSE and FHA REO inventories. FHFA, Treasury and HUD expect these disposition strategies to involve REO assets totaling at least $50 million in value, and in the case of joint ventures, up to $1 billion. Though bulk sales may quickly alleviate the critical mass of REO inventory held by the agencies, these types of proposals will likely require taxpayers to accept larger losses than is necessary.

As described earlier, REALTORS® strongly believe that every effort should be made to incentivize individual versus bulk sales because individual sales maximize recovery on the assets and minimize the impact on housing values. Exclusively selling in bulk to large national investors at deep discounts will only work to further consolidate a large section of the housing market into the hands of a few market participants

REALTORS® are also concerned that the unintended consequences of bulk sales at the proposed scale could devastate communities across the country. Providing a few large, private investors access to cheap assets for rentals could very likely erode market rent and sales prices. The consolidation of a large number of rentals to an institutional investor could mean that small landlords would be unable to match the rental prices that an institutional purchaser of a discounted pool of agency assets could offer. Rather than encouraging bulk sales across the board, bulk sales should only be considered in small geographic areas with high rental demand and should contain rigorous stipulations that ensure the revitalization and stability of local communities. It is also important that consideration be given to the pricing of these pooled assets to prevent the negative effect bulk discounts could have on the rest of the market and smaller competitors if the discount is so large that the bulk purchaser can sell these properties quickly at a deep discount.

Structuring Bulk Sale Proposal

Should a pilot program be implemented for the bulk sale of distressed properties, the Federal Government should first offer local governments, investors, and housing authorities, with vested interests in their communities, the opportunity to purchase the properties. Such limited sales could be made to non-profit and for-profit organizations that must meet specific program requirements and are familiar with the needs of the communities where the homes are located. Ultimately, the success of any program will be determined by its stabilizing effect on a particular locale and whether it maximizes value for taxpayers.

Maximizing recovery on the assets will depend on the determination property valuations and the assurance that the valuations are accurate, appropriate, and reflective of current market conditions. REALTORS® strongly recommend that entities investing in pools of distressed REO inventory be required to have a local presence and work locally with contractors, real estate brokerage firms, and professional property management companies. Knowledge of regional and local markets is crucial in the orderly disposition of REO assets and minimizes taxpayer losses related to REO properties.

Lease-to-Own

REALTORS® believe that sustainable rental housing is an integral component of the housing market. Furthermore, they understand the opportunities affordable rentals provide for potential home buyers as they save for down payments. Therefore, an option to combine REO disposition with affordable rental is a lease-to-own program. NAR recommends that any lease-to-own solution should be first focused on keeping families in their homes. FHA and GSE policies should minimize foreclosures that will result in the sale of the properties at a very large discount to a purchaser in a bulk sale, regardless of whether the purchaser has a lease-to-own component in place. Where lease-to-own programs are an appropriate solution, they should focus on the rehabilitation of blighted properties, affordable homeownership and, where it makes sense due to excess REO supply and significant rental demand, rental opportunities without an initial purchase requirement.

Structuring Lease-to-Own Programs

As the Government considers REO disposition solutions, REALTORS® believe that the following principles supporting affordable rental and homeownership opportunities should be considered. Lease-to-own joint ventures:

- Should not be run or administered by the Government,
- Should be administered, whenever possible, by local investors or local non-profits that can manage the specialized needs and challenges of local markets,
- Should be widely marketed by real estate agents to ensure visibility and encourage homeownership,
- Should have clearly defined expectations,
- Should have guidelines and contracts that are specific regarding maintenance, purchaser responsibility, purchase price, and percent of payment allocated toward a down payment,
- Should include Condominiums, and
- Should minimize detrimental effects on neighborhoods by implementing strict guidelines on the rehabilitation and continued maintenance of properties, ensuring that the properties do not become rentals that are in disrepair.

ADVISORY BOARD

Finally, as the President recently noted, a recovery of the housing market cannot be accomplished solely by the public sector. As the Government reviews ideas for alleviating the foreclosure crisis, including the pooling of properties for bulk sales and lease-to-own joint ventures, NAR recommends the creation of an advisory board made up of public and private industry participants. A wide range of board members including Government staff, asset managers, real estate professionals, professional property managers, and others with extensive real estate industry experience can work to ensure that the efficient disposition of Government-owned REO properties minimizes taxpayer losses and negative effects on local real estate markets.

CONCLUSION

The recovery of the broader economy depends on housing. The last two and half years have shown that, with housing prices bumping along the bottom, a robust economic recovery will remain exceedingly difficult. NAR believes that the best way to extinguish the glut of foreclosed properties is through an expansion of financing opportunities to qualified home buyers and investors, bolstering loan modifications and short sale efforts, and focusing on enhancing the orderly and efficient disposition of REO assets. Where bulk sales or lease-to-own programs are unavoidable, NAR urges you to consider our recommendations. Doing so will reduce taxpayer losses on REO assets, minimize the impact distressed assets have on local real estate markets, and ensure the stabilization of neighborhoods.

I thank you for this opportunity to present our thoughts on the foreclosure crisis, and as always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.

PREPARED STATEMENT OF ROBERT NIELSEN

CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS

SEPTEMBER 20, 2011

Chairman Menendez, Ranking Member DeMint and Members of the Subcommittee on Housing, Transportation and Community Development, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on how to address the glut of foreclosed homes that are currently on the market. We appreciate the invitation to appear before the Subcommittee on this important issue. My name is Bob Nielsen and I am the 2011 NAHB Chairman of the Board and a home builder from Reno, Nevada.

NAHB represents over 160,000 members involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction. NAHB commends this Subcommittee for seeking solutions to the major problem of home mortgage foreclosures, through this hearing on reducing the inventory of foreclosed homes as well as last week's hearing on new ideas for refinancing and restructuring mortgage loans. As these sessions illustrate, there are two distinct components to the foreclosure program—shrinking the large pool of foreclosed homes and reducing the flow of additional homes into that pool.

Home mortgage foreclosures continue to have a significant negative impact on the housing market and contribute to the lag in the Nation's economic recovery. While the majority of foreclosures have been concentrated in a handful of States, no State has avoided the negative effects on prices created by foreclosures. Home prices have fallen by record amounts across the country, making consumers hesitant to undertake home purchases and making it more difficult for homeowners to sell their current home in favor of a new residence. Many mortgage borrowers are "underwater"—with their house values lower than what is owed on their mortgages. Not only is this impacting household wealth and spending, more recently there is a growing problem of strategic defaults, where borrowers who could afford to make their monthly payments instead choose to walk away from their homes.

The decline in house prices makes it difficult for new home construction to compete in current market conditions, as the cost of building a new home can be higher than the final appraised value. Many times foreclosed or distressed property sales are used as comparable sales in these appraisals, which further depresses home values and puts new construction at a disadvantage. As a result, new home construction is at a record low level. The downward spiral in values is also adversely affecting outstanding residential construction loans, as lenders demand equity pay-ins to offset declines in collateral value, and making it more difficult for builders to obtain adequate funding to start new projects. Ultimately, stopping this trend in foreclosures will have benefits beyond the housing industry. Stabilizing home values will improve the balance sheets of financial institutions and will reassure home owners that their biggest asset will retain its value.

NAHB Recommendations

The Federal Housing Finance Agency (FHFA), in consultation with the U.S. Department of Housing and Urban Development (HUD) and the U.S. Department of Treasury, recently issued a Request for Information to solicit ideas for strategies on disposing of the substantial inventory of Real-Estate Owned (REO) properties held by Fannie Mae and Freddie Mac (the Enterprises) and the Federal Housing Administration (FHA). NAHB appreciates that the agencies are seeking input from industry stakeholders before moving forward with disposition strategies. We support the agencies' goals of reducing the REO portfolio in a cost-effective manner; reducing average loan losses to the Enterprises and FHA; addressing property repairs and rehabilitation needs; responding to economic and real estate conditions in specific geographies; and stabilizing neighborhoods and local home values. NAHB submitted comments to the agencies in response to the Request for Information, and we would like to share those comments with the Committee as they are relevant to today's hearing topic.

General Principles

NAHB believes that it is extremely important for the Enterprises and FHA to take a balanced approach in disposing of their large inventory of REO properties to avoid further disruptions to pricing and markets and to limit losses to the Enterprises and FHA. In particular, the Enterprises and FHA should avoid bulk sales to large investors that have no stake in the neighborhoods in which these properties are located. Local and small businesses should be the driving force behind the disposition of the REO inventory, which will result in the creation of jobs and the stabilization of neighborhoods. In addition:

- The FHFA should allow a more decisive approach to mortgage modifications, which would help reduce the number of foreclosures.
- The excessive bias against investors in the current system must be removed in order to facilitate innovative solutions and assure adequate capacity to effectively reduce the REO inventory.
- For-profit companies should be permitted to fully participate in all aspects of the disposition of the REO properties, including the purchase, management, leasing, and rehabilitation of the properties. With the scale of the problem so large, it is necessary to deploy all resources in both the private and nonprofit sectors.
- The disposition process should facilitate local job creation. Local businesses and small businesses should be primary players in this effort, particularly local home builders and remodelers, as well as property managers and realtors.
- The disposition process should not further adversely affect values. Do not allow "fire sales" of REO properties. It is critical that the disposition process helps stabilize house prices, not contribute to further devaluation.
- The process should facilitate homeownership opportunities where feasible and available.
- Rental opportunities should be created where appropriate, but the agencies should ensure that the disposition of REO properties does not result in concentrations of large numbers of rental properties in any single neighborhood.
- It is essential to return to more balanced credit requirements for home purchasers. Current credit requirements are so restrictive that it is difficult for many potential purchasers to obtain a loan.
- NAHB strongly suggests extending the higher Economic Stimulus Act (ESA) loan limits beyond the September 30, 2011, expiration date. This is not a time to lower loan limits as the lower limits will exclude many homes and home buyers from FHA and the Enterprises loan programs, particularly in areas like California where there is substantial foreclosure inventory. NAHB would specifically like to thank the efforts of Subcommittee Chairman Menendez for his leadership in extending the loan limits past the current expiration date, and strongly supports his legislation (S. 1508) to extend the higher loan limits through December 31, 2013.
- NAHB understands that establishing credit risk retention rules was required by the Dodd-Frank Act. However, NAHB is very concerned about the immediate impact this proposed rule will have at this precarious point in the economic recovery. We are also concerned about the implications of overly restrictive rules on future growth of the housing market and the entire economy. NAHB has recommended the elimination or postponement of any new restrictive regulations. The proposed rule has far-ranging implications across the housing and development sectors, particularly the narrow definition of a Qualified Residential Mortgage (QRM), which, if implemented, would have a severe adverse impact on the availability and cost of residential mortgages.

Modify Federal Housing Programs To Allow Investor Participants

Modifications to Federal housing programs to allow investor participation in disposing of REO properties is appropriate at this time. These modifications could be made on a short-term basis while the inventory of REO properties remains high.

- Modify the FHA Section 203(k) program to allow for-profit investors, which will help expedite the sale of vacant and distressed properties until the foreclosure crisis is alleviated. Understanding that investor/non-owner occupant loans present higher risks, FHA could impose prudent restrictions such as higher down payments and providing owner-occupants a first look before offering to investors. In addition an incentive could be developed to encourage investors to sell the property to an owner occupant within a reasonable period of time through lease purchase or other targeted programs.

- Encourage HUD to provide guidance to participating jurisdictions (PJs) on the use of HOME funds to help purchasers buy foreclosed properties. Although PJs set their own priorities for spending HOME funds, HUD can play a role by providing best practice approaches for using HOME funds to help with neighborhood stabilization.
- Improve the Neighborhood Stabilization Program (NSP) to allow more for-profit participation, expand income levels served and generally streamline the process. States and localities should be encouraged to undertake both homeownership and rental programs.
- Encourage USDA Rural Development to use Section 502 to help homeowners purchase foreclosed homes or REO properties.
- Consider changes to loan terms in all Federal programs (*e.g.,* stretch amortization to 40 years; allow higher loan-to-value).
- Considering the most recent data, FHA-financed condominium purchases are performing stronger than other purchase loans with a delinquent/claims rate of 1.14 percent, which is less than half of the overall claims rate. The FHA condominium rules should be relaxed to provide greater liquidity to this sector of the market. We support enhancements that would 1) eliminate owner-occupancy ratios, enabling more buyers to purchase units and help stabilize those developments and the community; 2) amend or, at least, temporarily suspend the FHA concentration limit; 3) increase the investor ownership percentage owned by one investor, particularly if the investor is the builder or developer; 4) reduce or eliminate pre-sale requirements; and 5) extend delinquent Home Owner Association (HOA) assessments from 30 days to 90 days.

Modify Fannie and Freddie Programs

The economic crisis pushed the Enterprises to implement overly stringent credit requirements and other restrictions, in addition to ceasing programs that were once in operation. However, prudent modifications to several programs could greatly assist in the reduction of the REO inventory without excessive risk to the Enterprises.

- The Enterprises should prudently modify existing mortgage programs that are overly restrictive and prohibit originators from adding any overlays that would be more restrictive.
- The Enterprises should remove excessive bias against investors by increasing the number of GSE loans an investor can have. Currently Fannie Mae limits investor properties to 10, including their primary residence, and investors with 5 to 10 properties face more rigid underwriting criteria. Freddie Mac is even more restrictive, allowing only four.
- The Enterprises' renovation programs like Fannie Mae's HomeStyle Renovation should be reevaluated. The guidelines should be targeted to include investors and to provide incentives to home buyers to acquire deteriorated inventory and recondition them.
- Both Enterprises have operated lease-to-own programs in the past which are now dormant; the Enterprises need to do more in this area by facilitating the creation of investor lease-to-own programs that can be operated at scale.
- The Enterprises should ease their condo policies to provide needed liquidity to reduce the excessive inventory. Similar to recommendations for FHA, we support enhancements to owner-occupancy ratios, investor ownership ratios, presale requirements and delinquent HOA assessments. Enhancements to the Enterprises' condominium rules will ensure the still-fragile recovery stays on track and will protect the long-term value of homeownership in the United States.

New Programs

NAHB suggests that new programs, such as described below, could contribute to the reduction of the REO inventory.

Investment Fund

The Enterprises could transfer REOs to a newly created investment fund (REIT-like) that is open to individual investors. The funds would have full faith and credit backing by the Federal Government and a guaranteed rate of return similar to the current Ginnie Mae (GNMA) rates. Local real estate management companies should be used to inspect and manage the properties and report quarterly on the condition of properties to the fund.

Lease-To-Own

A new lease-to-own program should be developed that is geared to all income levels, as the foreclosure crisis has affected families from all walks of life. Such a program could be operated at various scales, with 50 to 100 units as a minimum. An effective program would include the following elements:

- A 12 to 24-month lease period to allow time to save for the downpayment, repair credit, bring up FICO scores; downpayment funds would be escrowed over this period. There would be a penalty if the participant drops out (some or all of the escrowed funds would be forfeited; those funds revert to the builder/investor to be used to repair the unit and remarket it).
- Downpayment escrow of 5 percent of the purchase.
- Mandatory homeownership counseling to consist of both financial literacy (understanding mortgages, credit requirements, *etc.*) as well as home maintenance and responsibilities of being a homeowner.
- Participant responsibilities during the lease period to include interior maintenance; exterior maintenance responsibilities would depend on whether there is a homeowners association and if those services are included otherwise.

Project Rebuild

The President proposed in his *American Jobs Act of 2010* to create "Project Rebuild." Project Rebuild would authorize $15 billion to rehabilitate and refurbish vacant and foreclosed homes. Two-thirds of the funding would be allocated by formula to State and local governments, with the remainder allocated through a competitive process. NAHB is particularly pleased that the proposal would allow for-profits builders to compete directly for the funds. NAHB commends the Administration for recognizing the urgent need to deal both with vacant and foreclosed homes as well as to promote job creation in the construction industry.

While Project Rebuild has the potential to create more than 100,000 jobs [1] in the remodeling and home building sector, the draft legislation also seeks to impose the prevailing wage and administrative requirements of the Davis-Bacon Act of 1931 on the use of these funds. Extending Davis-Bacon in this manner will undermine the very objective of the legislation: job creation. The vast majority of home building and remodeling companies are very small businesses who simply lack the ability to tackle the complex administrative requirements of Davis-Bacon. Congress has previously imposed Davis-Bacon requirements on the use of stimulus funds in the American Recovery and Reinvestment Act (ARRA), and this requirement became a significant barrier preventing struggling construction companies from accessing these funds. A February 2010 Government Accountability Office report analyzing the effects of Davis-Bacon under ARRA noted that " . . . Davis-Bacon administrative requirements would require a more detailed payroll tracking system, which would be particularly burdensome for small companies." [page 16] Additional Government regulation is not the path to successful small business job creation.

Conclusion

Thank you again for the opportunity to testify on this important issue. NAHB stands ready to work constructively with this Subcommittee, as well as the full Senate Banking Committee, to address the critical issue of foreclosures and their impact not only on the current housing market but on the economic recovery of the Nation as a whole.

PREPARED STATEMENT OF CHRIS KREHMEYER

PRESIDENT AND CEO, BEYOND HOUSING

SEPTEMBER 20, 2011

Chairman Menendez, Ranking Member DeMint and all Committee Members, it is my honor to be here today to discuss the very critical issue of the glut of foreclosed homes that are currently on the market. I am the President/CEO of Beyond Housing, a Neighborworks America network organization and a 35-year-old not for profit in St. Louis, Missouri. In addition, I am on the Board of Directors of the National NeighborWorks Association, a national membership group that works to unite housing and community development practitioners to advocate for affordable housing and economic opportunities for individuals, families, communities and neighbor-

[1] NAHB estimates that for every $100,000 spent on residential remodeling, 1.11 jobs are created.

hoods across the country. I currently chair the Association's External Policy Committee.

Furthermore, I am a founding board member of Practitioners Leveraging Assets for Community Enhancement, or PLACE. PLACE is the single unified voice of housing and community development practitioners who build, preserve, and maintain adequate and affordable housing and promote community development for low- and moderate-income families across the country. Our members are the expert end-users of Federal, State and private housing and community development funding, leveraging various sources of capital to build and strengthen America's communities.

So, I'm the local guy; the practitioner on the ground who works with housing programs and policies to get things done in local communities.

My organization tries to tackle the problem of foreclosures and the damage it does to families and communities each and every day. Our staff confronts this issue from every angle starting with prevention in our first time home buyers work where we provide the needed and necessary guidance to ensure that families are truly prepared for long term, sustainable homeownership. Prevention continues with foreclosure counseling work using the National Foreclosure Mitigation Counseling (NFMC) program that is run in an incredibly efficient manner by Neighborworks America. Our efforts also include the purchase and rehab of foreclosed homes using the Neighborhood Stabilization Program (NSP) and other resources we are able to secure. In the past twelve months we have used NSP funds to buy and rehab 30 homes that were added to our rental portfolio of over 340 single family homes. Just last month we created a community land trust to use as a vehicle to secure property in our targeted community in St. Louis. We plan to purchase and rehab six vacant/foreclosed properties before the year is out with the land trust.

Our work was recently cited by the White House in their July 2011 "Neighborhood Revitalization Initiative Report".

So what can be done to stem the tide of foreclosed properties causing such great damage to the neighborhoods and communities across the country? I would be remiss to not state that the best thing that can be done is to keep families in their homes. This is not the focus of this hearing but it is indeed critical and greater action such as across the board principle reduction must be looked at right away if we are to slow down the pace of foreclosed homes coming in the market place.

Here are critical, over arching principles that need to be in place no matter the end use or type of developer that were created by myself and group of peers from across the country who are all a part of the Neighborworks America network:

- Recent and emerging neighborhood stabilization could be put at risk if there is no alignment of the investment by third-parties with the commitments to community stabilization activities underway in these communities.
- Long-term affordability would not be served by a blanket transfer of properties without consideration for pricing discounts to be provided along with affordable income qualifications.
- Long-term downward drag on these communities would continue if for-profit investment is not able to manage a long-term investment strategy (3 to 5 years). Short-term investment strategies may require assets to be sold at distressed values and thus perpetuate the current situation.
- Community value is not strengthened if non-local investors neglect maintenance and repair of properties. Good stewardship of properties during the transition phase is important to strengthen viability of communities and protect other asset values in neighborhoods.
- Property values continue to suffer unless sufficient reinforcement of appraisal guidelines on valuing in distressed communities so that the bulk transfers do not further erode value in these communities.

The following address the specific methods of disposition called out in the testimony confirmation letter.

Conversion to Rental Properties

Managing and maintaining a scattered site, single family portfolio is challenging but as my organization's 35-year track indicates it is possible. As recent data sadly reflect more families live in poverty today than ever. The need for safe, affordable rental housing has never been bigger. There are a number of for-profit and not-for-profit developers and property managers across the country that can both perform the management services and train others to also be successful. The key elements of this strategy will be:

- Aligning the goals of the public sector, servicers, investors, community leaders, for-profit developers and not-for-profit developers. Failure to do so will create a delivery system that fails to meet expectations as we have seen in the foreclosure counseling work.
- Significant discounts in pricing to acknowledge the financial challenges in bringing the home back on line as a sound asset for the community and for the owner. (Detailed financing structure is presented later in testimony)
- Ensuring the debt structure subsequent to total development costs provides a debt coverage ratio of at least 1.2, *i.e.,* given reasonable occupancy rates and after paying mandatory costs (insurance, taxes, management, maintenance, utilities, *etc.*) there is still enough revenue to pay the debt service plus 20 percent. The 20 percent is for reserves and unanticipated costs.
- Securing experienced and qualified property management firms to ensure that the home remains in good condition and an asset to the community.

Demolition

There will be a portion of the foreclosed properties that simply need to be demolished. In most cases the only possible way to dispose of a home in this situation would be to donate the parcel to the local government or qualified entity with a guarantee that the home will indeed be demolished. The use of land banks or land trusts should be expanded across the country to be the holder of these properties until redevelopment can occur. There are instances where demolishing a home on a block can provide much needs emotional and psychological assistance to existing community residents to let them know positive things can occur.

Bulk Sales Partnership with Government-Sponsored Entities (GSEs)

A partnership model that was designed by a group of my Neighborworks America network peers and I would create a great vehicle to address the glut of foreclosures. The model builds on existing work and could really move the needle on getting homes back into productive use.

The partnership model proposed below leverages many institutions created by the community development industry in response to the crisis. This includes the National Community Stabilization Trust, which NeighborWorks America, Enterprise, LISC, Housing Partnership Network, National Council of La Raza, and the Urban League helped form. The NCST provides a critical function to aggregate REO inventory among servicers and create a platform for offering this inventory to nonprofits across the country and simplifying the execution process to transfer these assets.

This partnership model can deliver on several fronts:

- It can collectively reach a substantial volume of property transfers that individual relationships would not be able to achieve—thus creating a wholesale-like execution.
- It can connect REO assets in these communities to nonprofit community builders that are paramount to rebuilding the communities and establish new residents and quality housing.
- It can assure that those assets of most strategic value to the community and most influence community value are handled by local interests.
- It leverages the established tools in the marketplace (*e.g.,* the National Community Stabilization Trust ("NCST")) to handle aggregation and transfer of multiple assets to multiple locations from multiple servicers.
- It allows for quality rehab to take place (including energy efficiency to create long-term financially and environmentally sound properties) and returns housing assets to productive use.
- It can ensure that when assets are made available for sale as owner-occupied units that low- and moderate-income households have opportunity and options to purchase these assets.
- It recognizes that GSE's and FHA should be able to be compensated for the asset if the market returns.

In general terms, the nonprofit community development/affordable housing program alternative would carry the following characteristics:

- GSE's and FHA identify and reserve assets that are located in either NSP markets or similar targeted geographies being worked by nonprofits ("target markets").
- These assets are made available to NCST as the "First Look" clearinghouse of assets to qualified nonprofits. The assets are available for acquisition by quali-

fied nonprofits for a set period of time after which the assets revert for broad market sales.

- Qualified nonprofits working in the target markets would purchase assets at a prudent, transparent discount price that considers the balance between the costs of acquisition, rehabilitation, and management and feasible rents to low- and moderate-income families in these markets. In consideration for this discounted price the non profits would execute an agreement to share gain on sales if they would occur with the GSE's or FHA.
- Nonprofits take title to assets from Enterprises or FHA.
- Nonprofits rehabilitate the housing stock to appropriate levels at a target percentage of appraised value and improve the longevity and operating cost of the home by including as much energy efficiency and additional green improvements within the budget. To facilitate this rehabilitation, the Enterprises or FHA offer the nonprofits the opportunity to take out a mortgage as the mortgagor from Enterprises or FHA that covers the rehabilitation costs of the home. The mortgage would be assumable by a future buyer of the property. (Alternatively, the nonprofit could use a working capital lines to finance rehabilitation.) The nonprofit improves the property and makes the home available to a low-/moderate-income family.
- The nonprofit manages the asset as rental property and uses rental income to cover mortgage note payment (or line of credit costs) and operating costs; any additional rental income proceeds are kept by nonprofit to further its community improvement strategy.
- At a point in time when values have stabilized, the nonprofit markets the property as an affordable housing unit to a low-/moderate-income family.
- The GSE's and FHA make available specific mortgage products with flexible terms to allow low-/moderate-income families to purchase the homes.
- Nonprofit sells asset and shares an established percent of the difference between costs of asset (*e.g.,* rehabilitation costs, holding costs, sales costs, developer fees) and sales price with the GSE's or FHA.

The nonprofit community development/affordable housing approach is offered as a strategy to deliver quantities of quality affordable housing and simultaneously address the destabilizing influences of foreclosure. It achieves these goals by creating strong, community-based owners of assets with an interest in community improvement through a partnership between the GSE's and FHA in the redevelopment of these communities along with fair consideration for the assets. The outcomes of this approach are many. Existing homes are used to provide affordable housing and meet the demand for this product throughout the Nation. Properties are improved to make them longer-term assets that meet higher energy efficiency standards; thus preserving assets for the long term and making the homes more economic to operate for lower income households.

The rental properties are maintained to high standards in the community. The property values are not diminished in the community as the nonprofit will market to preserve value in the community as sales will occur when market stabilizes. The Enterprises and FHA get performing assets on their books in the rehabilitation loans and they are compensated for assets through a shared gain on sales approach. And, in the end quality, affordable homes are returned to low-moderate-income families for rental and eventual homeownership.

Coordination of Strategies

The strategy detailed above would fit in perfect alignment with existing work already taking place using the NSP and NFMC programs all across the country. Overt and intentional coordination needs to occur if we are to derive the collective impact of these programs. Local community leadership, not-for-profit developers, for-profit developers and local units of government will be tasked to ensure and prove levels of coordination through Memorandums of Understanding (MOU). These MOU's will call out specific objectives, deliverables and responsibilities for all parties. Failure to work in this intentionally integrated fashion will hinder any opportunity for community wide success.

Again, thank you for the opportunity to present my ideas and the ideas of my not profit peers from across the country to address the serious challenges we face each in every day as we try to make a difference in the lives of those we serve.

Amherst® Securities Group LP

September 20, 2011

Laurie S. Goodman / lgoodman@amherst.com / 212.593.6026

9/20/2011 Testimony of Laurie S. Goodman, Amherst Securities Group

to the

Subcommittee on Housing, Transportation and Community Development

of the

Senate Committee on Banking, Housing and Urban Affairs

Topic— New Ideas to Address the Glut of Foreclosed Properties

Mr. Chairman and Members of the Subcommittee, thank you for your invitation to testify today. My name is Laurie Goodman, and I am a Senior Managing Director at Amherst Securities Group LP, a leading broker/dealer specializing in the trading of residential mortgage-backed securities. I am in charge of the strategy and business development efforts for the firm. We perform extensive, data-intensive research as part of our efforts to keep ourselves and our customers informed of critical trends in the residential mortgage backed securities market.

One of the trends that we have documented is a very significant supply/demand imbalance in the housing market. Distressed loans are moving very slowly through the delinquency/foreclosure pipeline. These loans weigh heavily on the residential real estate market, and are often referred to as shadow inventory. In addition, many of the borrowers that are not delinquent on their loans have a tainted credit history and/or are seriously underwater, suggesting more defaults to come. Thus, there are many distressed homes that will need to change hands over the next 5–6 years. At the same time, mortgages are becoming increasingly difficult to obtain. Overall credit availability is tightening and the pool of qualified mortgage applicants is shrinking dramatically. A large number of borrowers who are delinquent on their current mortgage, and do not have the financial means to purchase another home, are likely to convert to renters. Despite this cloud surrounding the mortgage market, we see housing as very affordable by most traditional measures.

Given this backdrop, we believe that long-term investors in 1–4 family residential real estate are the key to a housing recovery: they are the only potential buyers of many distressed homes that are likely to hit the market over the next 5–6 years. Investors need to be part of the solution.

At the same time, this is a good business opportunity for interested investors to rent the distressed homes as the rental market strengthens. Given the large decline in home prices, rental yields are high enough now to attract a limited amount of private capital. With modest governmental action (not assistance), more private investment capital can be attracted to this market, helping to stabilize home prices, neighborhoods and communities, and very importantly, ensure that the housing needs of the distressed homeowners and their families are met. In fact, my firm, Amherst Securities Group LP, along with several of our partners, has successfully launched such a program. In the final section of this testimony, we present our views as to the best way for the government to structure increased investor participation in the market; these views are firmly grounded in our analysis of the problem.

Sizing the Problem

Many analysts looking at the housing problem mistakenly assume it is limited to loans that are currently non-performing (we use 60+ days past due as our definition of non-performing). Such borrowers have a high probability of eventually losing their homes. However, the problem also includes loans with a compromised pay history; these are re-defaulting at a rapid rate. We define these re-performers as loans that were at one point 60+ days delinquent, but no longer are.

Moreover, borrowers with good pay histories who are substantially underwater have shown that they, too, have a reasonable probability of transitioning to default (going 60+ days delinquent).

Let's review the scope of the housing problem. An understanding of this will allow market participants and policy makers to put our supply/demand imbalance numbers in perspective.

In Exhibit 1 (below) we have outlined our methodology for estimating the total supply of homes which may be subject to distressed sales over time. We show both a number we view as reasonable as well as a "lower bound" estimate. To derive these results, we classify the outstanding loans into five groups. In total, we estimate that there are approximately 80 million homes in the US, 55 million of which have a mortgage. Of these 55 million mortgages, there are 4.5 million non-performing loans (NPLs), 3.9 million re-performing loans, 2.6 million always performing loans with a mark-to-market LTV (loan-to-value) ratio >120, 5.4 million always performing loans with a mark-to-market LTV of 100-120, and 38.6 million always performing loans with a mark-to-market LTV of ≤100. To size the problem, we focused on the eventual default rate of each group of loans. Our methodology is detailed in the Appendix.

Our results indicate if no changes in policy are made, 10.4 million additional borrowers are likely to default under our base "reasonable" case, and 8.3 million borrowers will default under our lower bound numbers. Since there are 55 million homes carrying mortgages, 10.4 million borrowers roughly equates to 1 borrower out of every 5. This includes 4.1 million of the 4.5 million borrowers who are already non-performing; the remainder of defaults will come from borrowers current on their loans, but who are likely to eventually default. Many in this group (2.5 million) represent re-performing loans that history suggests are very prone to another default.

Exhibit 1: Sizing The Crisis

	DQ Status	Number of Loans	% of Loans	Total Balance	% by Balance	WA MTM LTV	3Mo cTr	3Mo vPr	3Mo D/TV
Total	NPL	4,517,820	8.2%	934,226,036,870	9.9%	117.8	-	-	-
Total	RPL	3,863,756	7.0%	661,639,607,498	7.0%	105.2	47.2%	2.6%	94.7%
Total	APL >120 MTM LTV	2,646,578	4.8%	518,227,067,100	5.5%	140.9	13.8%	5.0%	73.6%
Total	APL 100-120 MTM LTV	5,351,340	9.7%	1,047,433,214,477	11.1%	110.7	7.0%	7.0%	49.9%
Total	APL <=100 MTM LTV	38,574,077	70.2%	6,309,815,808,405	66.6%	68.6	2.4%	13.3%	15.4%
Grand Total		**54,953,570**		**9,471,341,734,350**					

			Estimated Default Rate		Number of Homes in Jeopardy	
	DQ Status	Total Number of Loans	Lower Bound Estimate	Reasonable Estimate	Lower Bound Estimate	Reasonable Estimate
Total	NPL	4,517,820	80%	90%	3,614,256	4,066,038
Total	RPL	3,863,756	50%	65%	1,931,878	2,511,441
Total	APL >120 MTM LTV	2,646,578	25%	40%	661,644	1,058,631
Total	APL 100-120 MTM LTV	5,351,340	10%	15%	535,134	802,701
Total	APL <=100 MTM LTV	38,574,077	4%	5%	1,542,963	1,928,704
Grand Total				Total	8,285,875	10,367,515

- The estimated default rates used in the "reasonable" calculation are more conservative than what is currently being experienced
- Assumes no change in overall housing prices, interest rates, or new home construction

Legend:
NPL = Non-Performing Loans
RPL = Re-Performing Loans
APL = Always Performing Loans
Non-PLS = Agency/Portfolio Loans
PLS = Private Label Securitized Loans

cTr = Annualized Monthly New Default Transition Rate
vPr = Annualized Voluntary Prepay Rate
D/TV = cTr / (cTr + vPr)

* - CoreLogic reports on approximately 60% of the non-PLS universe, which is extrapolated to the entire mortgage market

Source: CoreLogic, Amherst Securities as of August 2011

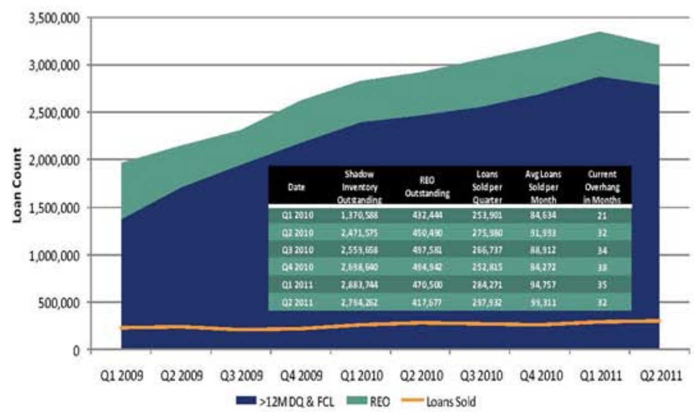
Supply/Demand Imbalance

In today's market, precisely when we have a large number of loans that will need to liquidate, liquidations are quite slow. Exhibit 2 (below) shows that we are liquidating roughly 95,000–100,000 loans every month. Even if we define the shadow inventory very narrowly (as homes that are >12 months delinquent or in foreclosure), we find that there are 2.8 million units, with another 400,000 plus units in REO, which raises total shadow inventory to 3.2 million units. So, if we are liquidating 100,000 loans/month, it will take 32 months (or 2.7 years) just to liquidate what is already ≥12 months delinquent. However that overlooks loans that are <12 months delinquent, as well as re-performers, that have a high chance of eventual default, or "always current" loans that are deeply underwater.

As we have demonstrated, the supply/demand imbalance is caused not just by the loans in REO, but the seriously delinquent loans behind them, and the borrowers that are paying on underwater mortgages behind that. ***We believe that any comprehensive solution should include a plan to deal with non-performing loans as well as loans in REO.***

To put these numbers in context and calculate the supply/demand imbalance, we have taken a very simple view of the market, as shown in Exhibit 3 (next page). For the supply side, let's use our estimate of the 8.3–10.4 million defaulters as a starting point. Assuming that these defaults occur over 6 years (an admittedly arbitrary assumption), this suggests a range of 1.38 (8.3/6) to 1.73 (10.4/6) million units defaulting yearly. Adding 500,000 units of new 1–4 family construction gives us 1.88–2.23 million units of total supply. [Over the last 2 years, 1–4 family housing completions has totaled approximately 500,000 units per year, we use this number as our going forward estimate. This is much higher than new home sales, as new home sales include only homes that are built for sale. New home sales does not include custom

Exhibit 2: Growth—Shadow Inventory



Date	Shadow Inventory Outstanding	REO Outstanding	Loans Sold per Quarter	Avg Loans Sold per Month	Current Overhang in Months
Q1 2010	1,370,588	432,444	253,901	84,634	21
Q2 2010	2,471,575	450,490	275,980	91,993	32
Q3 2010	2,559,658	497,581	266,737	88,912	34
Q4 2010	2,698,640	494,942	252,815	84,272	38
Q1 2011	2,883,744	470,500	284,271	94,757	35
Q2 2011	2,794,262	417,677	297,932	99,311	32

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

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, FDIC, Fannie Mae, Freddie Mac, FHA, Amherst Securities as of August 2011

Exhibit 3: Mortgage Market Math: Supply/Demand Gap

- 10.40 million homes are at risk of default over the next 6 years. Even if we try to be extremely conservative we can't get the number below 8.3 million units.

Estimate of Supply (per Year)

	1.38 – 1.73 million distressed units per year
+	0.50 million units new construction
	1.88 – 2.23 million units total annual supply

Estimate of Housing Demand (per Year)

	0.60 million demand due to demographics (1.20 million housing formation x 0.50 home ownership)
	0.40 million obsolescence
+	0.20 million second home purchase
	1.20 million units total annual demand

	1.88 – 2.23 million total supply per year
-	1.20 million total demand per year
	0.68 – 1.03 million units net annual supply

Over the next 6 years:

4.1 – 6.2 million units

- To solve the housing crisis you must create **4.1 to 6.2 million units** of housing demand over the next 6 years.

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, US Census Bureau, Amherst Securities as of August 2011

homes in which the homeowner buys the land, and works with a general contractor, or acts as his own general contractor to build a home. It also does not include homes built to rent out.]

The demand side of the equation is more difficult. Household formation has been very low in recent years. Census data (The Current Population Survey/Annual Social and Economic Supplement) indicates that the rate of household formation from 2007–2010 is about 500,000 units. This is very low by historical measures. The average rate of household formation for the period 2000–2010 was 1.3 million units per year. It was 1.0 million units per year during the 1990s. We assume a more normal household formation rate of 1.2 million units annually. The Joint Center for Housing Studies of Harvard University in their State of the Nation's Housing, 2011, has estimated that out of the nearly 12 million units of expected household formation over the 2010–2020 period, 7 out of 10 will be minorities, whose home ownership rate has been historically lower. Note that we used a very generous number (50%) for demand from new households. We add to this the 400,000 units that will become obsolete each year and 200,000 second home purchases. This gives us 1.20 million (600K + 400K + 200K) units of total annual demand. So, excess supply is 0.68 to 1.03 million units/year (1.88 to 2.23 million units of total supply—1.2 million units of total annual demand). Thus, over the next 6 years, excess supply will total 4.1–6.2 million units.

It is important to realize that the problem is not over-building, it is quite simply that there are fewer families that can and want to own a home than there are homes for sale. While overbuilding played a role in the initial downturn in the market in 2006–2007, 3.5 years of very limited new home construction has brought the supply and demand for newly constructed housing into balance. Over the 10-year period from 2001–2010, new home construction + placements of mobile homes was about 16 million units, averaging 1.6 million units per year; assuming that 300,000 units per year were lost to obsolescence over this period, that will roughly balance the 1.3 million new households per year that were formed over the period.

The supply/demand imbalance is not uniform nationwide. There are some areas in which the housing market is relatively healthy, and other areas in which the problem is much worse than the national average.

Tightening of Credit Standards

The supply/demand imbalance is exacerbated by the tightening credit standards for new GSE origination, as demonstrated by ever-higher FICOs and ever-lower LTVs. To a large extent credit availability has been choked off. A few exhibits will make this very clear. Exhibit 4 (below) shows that of the 55 million borrowers with a mortgage in June 2007, 19% of those homeowners would not qualify for a mortgage today due to pay history. That is, 5% of the borrowers have defaulted on their mortgage, and the home has been liquidated. Another 14% have reached 90+ days delinquent. Taking out 19% of all borrowers at a time when increased demand is needed is likely to have adverse consequences. In addition, many Americans that want to buy a home despite the fact that home prices could decline further will either not have the necessary down payment or will lack the high credit score now required for home ownership. Exhibit 5 (below) shows that average LTV ratio is 67% and the average FICO (Fair Isaac Corporation) score for new GSE origination (excluding HARP loans) was 762 for 2009 and 2010.

Exhibit 4: Supply & Demand Function of Housing = Broken

Status since June 2007	Loan Count	% of Loans
Prepaid	19,892,400	36%
Never 90 days DQ	24,549,503	45%
Reached 90+ DQ	7,400,774	14%
Defaulted	2,954,733	5%
Total Outstanding Residential Mortgages as of June 2007	54,797,410	100%

Based upon payment history of mortgages originated before June 2007,
*19% of all homeowners **NO LONGER QUALIFY** for a mortgage loan based solely upon Payment History.*

Source: CoreLogic, Amherst Securities as of August 2011

Exhibit 5: GSE & Bank Portfolio Loans Exhibit Similar Origination Characteristics (2009/2010 originations)

	Orig. LTV	Orig. FICO	Balance ($MM)	% Purchase	% Conforming Fixed	% Jumbo Fixed	% Conforming ARM	% Jumbo ARM
GSE	67	762	1,373,034	19.8	95.5	0.0	4.5	0.0
Bank Portfolio	66	756	77,784	27.7	47.2	19.8	8.4	24.6

	Orig FICO				
	< 700	700 to 750	>=750	Missing	Total
GSE	8.2	21.7	67.5	2.6	100.0
Bank Portfolio	11.1	22.0	66.2	0.7	100.0

	Orig LTV				
	<=70	70 to 80	80 to 90	> 90	Total
GSE	48.5	37.0	8.5	6.0	100.0
Bank Portfolio	53.6	34.3	4.3	7.8	100.0

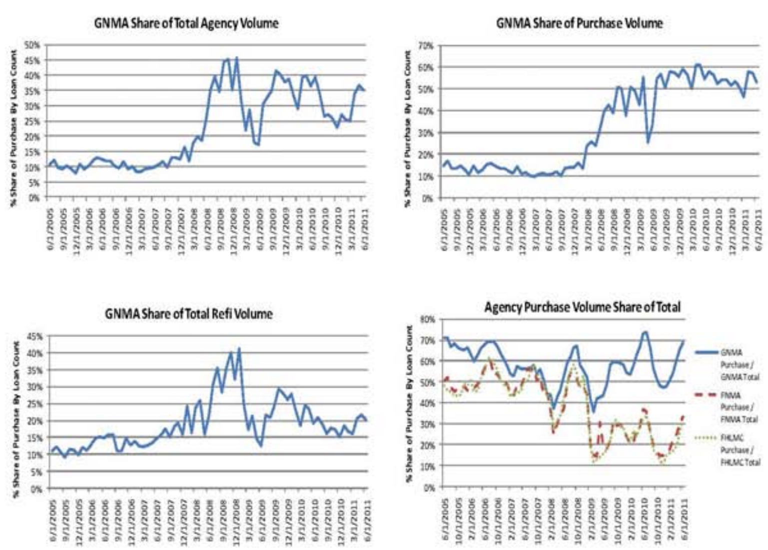
Source: Source: CoreLogic Prime Servicing Database, Amherst Securities as of August 2011

Do bank portfolios have more relaxed standards? Are they absorbing loans that would not be GSE-qualifying? Exhibit 5 illustrates the banks are not filling the gap. Bank portfolio origination standards do not differ significantly from those for GSE loans. That is, versus GSE loans, bank portfolio loans on average tend to have a marginally lower average FICO score (756 for bank portfolio loans, 762 for GSE loans), and a marginally lower average LTV (66 for bank portfolio loans, 67 for GSE loans).

How are purchase borrowers meeting GSE guidelines? The short answer is that they are not meeting the guidelines. The top left section of Exhibit 6 (below) shows that the GNMA share of total Agency volume [GNMA/ (GNMA + Fannie Mae + Freddie Mac)] has been running around 30–35%. GNMA mortgage-backed securities are comprised primarily of FHA and VA loans. The top right section of the exhibit shows that the GNMA share of purchase volume has consistently ranged 50–60%. The bottom left section shows that GNMA share of refinance (refi) volume has been 15–20%. Thus, GNMA is a far larger part of the purchase market than of the refi market. The best way to look at the relative amount of purchase activity is shown in the bottom right section. GNMA purchases comprise 60–70% of total GNMA activity. Freddie and Fannie purchase comprises 20–30% of total Freddie and Fannie activity. Thus, FHA/VA loans, which comprise GNMA pools, are the main mortgage vehicle used for home purchases. Fannie Mae and Freddie Mac process mostly refi loans.

Almost every single proposed governmental action has been aimed at further tightening credit availability. HUD is considering tightening the DTI (Debt to Income ratio) requirements on FHA loans. FHFA has observed that lower credit mortgages are subsidized by their higher credit counterparts (FHFA Report "Fannie Mae and Freddie Mac Single-Family Guarantee Fees" dated July 2010). It seems inevitable that loan level pricing adjustments will rise further. And the proposed Dodd Frank rules implementing the Qualified Residential Mortgage (QRM) and Qualified Mortgage (QM)

Exhibit 6: GNMA Has Become The Major Outlet For Purchasing A Home (%s are in loan count terms)



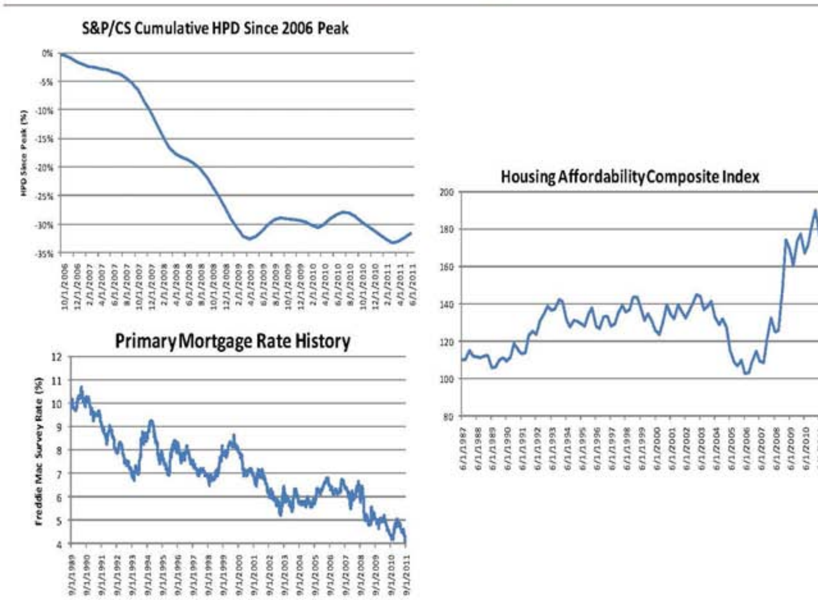
Source: Freddie Mac, Fannie Mae, Ginnie Mae, Inside MBS & ABS, Amherst Securities provisions are likely to tighten credit availability further, particularly when the interplay between these two proposed rules and the lower HOEPA thresholds, which are also included in the legislation, are considered. The combined impact of the QRM and QM rules may be delayed because Fannie and Freddie mortgages are exempt from QRM until they are no longer in conservatorship. The impact of the lower HOEPA thresholds may be felt sooner.

Let's put it all together. Almost 1 out of every 5 borrowers is in danger of losing their home if no further policy actions are taken. That will create a huge supply/demand imbalance over the next six years or so, as these homes must change hands. Thus far, the supply/demand imbalance has been contained through modification plans that have had low success rates, and through a huge increase in the amount of time necessary to liquidate a home. These actions have not solved the problem, they have merely postponed it. Meanwhile, there are not enough potential homeowners to absorb the number of homes that need to be purchased. Nearly 1 borrower out of 5 that had a mortgage in 2007 does not qualify for a new mortgage by virtue of payment history alone. And mortgage origination standards have tightened considerably, thus it's even harder for existing borrowers to trade up, or for first time purchasers to enter the market. Finally, a majority of governmental action that has been taken makes already tight credit availability even tighter.

Implications—Home Prices

This housing supply overhang occurs against a backdrop in which homes are very affordable using traditional measures. Exhibit 7 (below) shows that the S&P/Case Shiller 20-City Composite Index is off 32% since its peak in mid-2006. Primary mortgage rates are at a generational low, and look extremely attractive in any reasonable historical context. Affordability is well illustrated in the bottom left section of Exhibit 7, showing the Freddie Mac Survey rate from 1989–present. The result is that housing is very affordable using traditional metrics. The ability of the average family to afford the average price home is at a generational high, as shown on the right side of Exhibit 7.

Exhibit 7: Prices Down, Rates Low → Affordability At 20-year High



Source: Freddie Mac, National Association of Realtors, S&P/Case-Shiller, Amherst Securities

However, the overhang means that home prices, despite being very affordable, are likely to decline further. This may re-create the housing death spiral—as lower housing prices mean more borrowers become underwater. We have determined LTV is the single most important predictor of default. So more underwater borrowers means more defaults; more defaults means more inventory, more overhang, and even further declines in home prices. While home prices can go down another 5% without re-igniting this housing death spiral, a 10% decline would certainly re-ignite the spiral in our opinion.

What is the best solution? There is no simple solution, but we believe the situation requires both supply side and demand side measures. On the supply side, the modification success rate needs to rise in order to keep homes off the market. We actually know exactly what it takes to create a successful modification—reduce principal, give the borrower substantial payment relief, and modify the borrower in the early stages of delinquency. Since negative equity drives defaults, principal reduction is the key to a successful modification. ***On the demand side, we need to increase the level of investor participation, and a government program is the best way to start.***

Encouraging Investor Participation in the Market

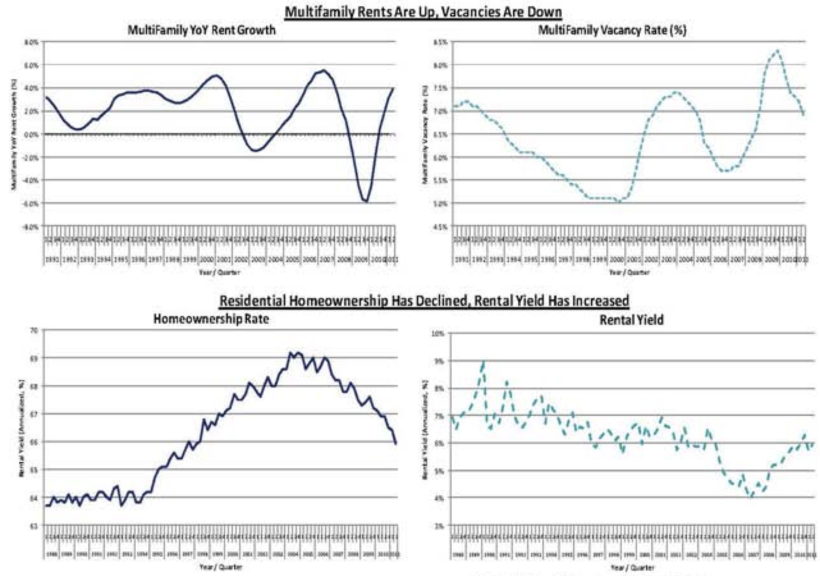
The only way to absorb the excess supply of housing in an environment of constrained demand is to increase the demand for housing. This can come from two sources: either allow borrowers who recently defaulted on their mortgages to qualify for new mortgages, or encourage investor purchases. The problem with the former is that borrowers who have just defaulted do not have the means to make a down payment on a new home. Investors represent the most promising avenue to increase demand. It is very clear that policymakers need to aid the creation of a new asset class—investor-owned homes for rent. Thus far, the overwhelming majority of the rental units are in multi-family properties. That has to change.

What makes this asset class attractive for investors? First, as shown in the top left section of Exhibit 8 (next page), rents are up 3.9% on a year-over-year basis. The multi-family vacancy rate is down from the peak of 8.4% to 6.9%, as shown in the top right section of Exhibit 8. That is, as the homeownership rate has declined from 69.2% to 65.9% (bottom left section of the exhibit); many of these families have become renters, which pushes up the rental rate. And given the overhang we have discussed above, as well as the demographic make-up of new households, the homeownership rate is apt to decline more, putting further upward pressure on rents. In fact, we would argue that the borrower who has not made his mortgage payment in 18 months should not be considered a homeowner for the purposes of these calculations, but he is!

The bottom right section of Exhibit 8 shows that rental yield has risen dramatically—from 4% to 5.9%. This number was computed from comparing annual income on a 2 bedroom apartment to the average selling price of a single family home using US Census Bureau numbers. The average rental income was calculated from the Census Bureau's Housing Vacancy Survey. For Q2 2011, the average asking rent was $684/month or $8,208/year. The average selling price of a home was $138,400. Thus, the average rental yield is 5.9%. This yield calculation is likely to be substantially understated, because we are using the average selling price (not the average distressed price) to determine the rental yield (distressed sales occur at a discount to non-distressed sales). We have also assumed rental income remained constant. We would expect it to rise, as the demand for rental housing increases; this is courtesy of increased housing formation as well as borrowers who can no longer afford, choose not to be, or cannot qualify to be homeowners. However, we have not included any of the costs in this calculation; this includes rental fees, insurance and maintenance expenses and property taxes. It is substantially more expensive to maintain scattered site properties than single site properties. Moreover, the net rental yield based on the distressed selling price and adequately reflecting costs and expenses will differ substantially from market to market.

What has to happen to increase investor participation in this market? It is very clear that investors are already participating in this market to some degree. The most recent release of National Association of Realtors data (July 2011) shows that 29% of existing home sales were for cash, 18% was to investors. While the National Association of Realtors has stated (and we agree) that "investors account for the bulk of cash purchases"; we would go one step further and

Exhibit 8: Rental Demand Is Outpacing Rental Supply



*- Rental Yield = Median Rent / Median Sales Price
Source: US Census, PPR, Amherst Securities

Source: Freddie Mac, National Association of Realtors, S&P/Case-Shiller, Amherst Securities

assert that most of these cash purchases are on distressed properties. We do not have the data to know what percent of the distressed market is trading to investors for cash; unfortunately, it is not tracked.

A Successful Government Program would Spur Investor Participation

Investor participation needs to happen on a much larger scale. A government program is necessary to spur investor participation without further declines in home prices. We would argue that a successful government program must have four objectives. First, it must be scalable enough to have an impact. Second, it must hold homes off the market for several years to give the market a chance to stabilize. Third, it must place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers. Finally, it should maximize the economics for the GSEs and the taxpayers.

We believe all these objectives could best be accomplished by allowing for a program in which: *(1)* opportunities were provided for bulk purchases of REO properties as well as non-performing loans; and *(2)* financing was more available to investors. We discuss each of these items in turn.

Selling Blocks of Distressed Properties

The difficulty of buying up sizable blocks of distressed properties inhibits large scale investors from participating in the market. In order to build out a rental organization, which includes rental agents and property managers, it is critical to obtain a critical mass of properties in a given area. Thus, we would strongly urge the FHFA, working with Fannie and Freddie, to bundle together properties in a given MSA (Metropolitan Statistical Area) and conduct an auction on an all-or-none basis. ***One very important point: a program that includes NPLs as well as REO properties would be more effective than an REO program alone.*** If the REOs are auctioned, but a large stock of NPLs remain, the government will not get the best price. Bidding a portfolio of NPLs/REOs would allow for the bundling of a larger group of properties in a given geographic area. In addition, since the borrower is often a very suitable tenant for a property, it saves the transaction costs of a move, the emotional costs of a move, and it keeps the family entrenched in the community. Finally, the bidder is often willing to pay more if the home is sold with a "ready-made" renter (the distressed borrower), as it saves the time, effort, and cost of finding a renter.

This is not just a theoretical idea of my firm, Amherst Securities. We believe in it and have put our own capital to work. We recently purchased, for September settlement, the first block of homes auctioned by Fannie Mae with a tenant in the home. (This was known as the TIP Portfolio, for "Tenant in Place").

We would suggest the following auction parameters:

- **One MSA per auction. (This will provide for stronger bids, as some investors will want to specialize in a few geographies).**
- **No less than 200 properties in an MSA. (This will allow large scale buy-to-rent organizations to obtain critical mass.)**
- **Bidders would be given the information with a 2–4 week lead time. This will give investors time to evaluate the properties.**
- **Investors must bid on the entire pool of assets; the winning bidder should be able to kick out assets only because they do not meet the stated parameters**. Thus, investors would submit a bid on each individual asset, as well as a bid on the whole pool. The bid on the whole pool is the sum of each of the bids on the individual units.
- **Investors must agree to hold 80% of the properties for a minimum of 3 years before flipping. This will keep this supply of homes off the market for a period of time.**

If properties in an MSA are sold in bulk, what ensures that the government/Fannie Mae/Freddie Mac will get the best price? We believe it would because selling in bulk would allow a large scale buy-to-rent organization to obtain critical mass in a geographic area, making it economically feasible to build out the organizational structure necessary to support the operation (rental agents, property managers etc.). Thus, these organizations would have a much stronger bid for larger packages than for smaller packages, and there would be competition between these buy-to-rent organizations.

Would pricing for homes sold in bulk be more favorable than selling each property individually or as part of a small group? The appeal to selling each property individually is that it could be sold to the single entity with the highest bid. The disadvantages are: (1) not all properties will move on this basis, and (2) it takes much longer to move homes one by one, resulting in a lower price. It is critical to realize the longer a property remains in a "distressed" state—either abandoned or occupied by an owner that has no vested interest in keeping up the property (as he is no longer paying his mortgage and knows it is only a matter of time before he is foreclosed on)—the more the property deteriorates and is apt to sell for a lower price. The property also detracts from the neighborhood, driving down values for other homes in the area. There are a few other points to consider. If home prices continue to deteriorate, the government is worse off the longer it takes to sell the properties. Moreover, the slower the liquidations, the longer it will take to eliminate the overhang, providing a further drag to the housing market and to the economy.

Financing

We view the inability to accumulate large blocks of distressed properties in a given area to be the single largest obstacle to investor participation on a larger scale. However, financing would serve to stimulate investor demand and further cushion home price declines. An example will make this clearer. Assume the net distressed rental yield was 7%, this would be the unlevered yield to the investor. Assume further that an investor was able to obtain financing on 60% of the purchase amount, at a 4.5% rate, the return to investors would rise to 10.75%. This would make the purchase of distressed homes a much more attractive proposition, making for stronger investor bids. Again, while this type of program could be structured with or without financing, we believe that conservative government financing (60–75% of purchase price) would result in bids that are at least 20% higher. The risk to the government is remote. For example, if investors were able to finance 60% of the purchase price, home prices must decline another 40% from today's level before the taxpayer is exposed, a very unlikely event given that housing is already quite affordable.

Where would this financing come from? We have three alternatives:

1. Expand the number of properties Fannie and Freddie are willing to finance. Currently, Freddie Mac will not allow investors to finance more than 4 homes, Fannie has a 10 home limit. Clearly, an expansion of these limits would be necessary to provide financing for bulk purchases. However, since the package is purchased in bulk, it would be necessary to "assign" a value to each home for mortgage purposes; this amount would be the price on the individual asset that is contained in the winning bid.
2. Implement this program under the auspices of the Fannie/Freddie multi-family financing programs. Currently, single family homes in a given geographic program, purchased at the same time (scattered sites), would not qualify for this channel. The program specifications could be changed.
3. Financing could be made available through FHAs 223(f)/207 multifamily program. This allows for investor loans, but does not allow for scattered sites. Again, minor tweaks would need to be made to FHA program specifications to allow for this.

Will investors participate if there isn't government help? Absolutely! However, to build out a large scale property management company requires the ability to buy a large number of properties in a given geographic area. Unless investors participate on a much larger scale than has been the case to date, it is unlikely that the necessary amount of supply will be absorbed. Financing would allow for broader investor participation and would allow investors to pay a higher price for the properties, cushioning further home price declines.

If this is so profitable, why don't the GSEs retain equity in the real estate, and do this as a joint venture? We think that this is a good idea, and a program could be structured accordingly. Managed and cash flow generating real estate would trade for quite a bit more than where distressed home are trading today. The right program could capture significant upside for the GSEs and thus the taxpayers. The FDIC's sale, investment and financing program that they have used for the liquidation of secured bank loans offers a valuable model. The program combines private investor capital, matched by an FDIC investment and FDIC financing. We understand the prices achieved on the loans are much higher than they would have been if the loans were sold without the FDIC financing.

Is this the complete solution to the housing crisis? No, not all homes will fit for this program. Higher priced homes generally do not work, because the rent is not high enough to be appealing to investors. That is, a $500,000 home does not rent for 5x as much as a $100,000 home. Moreover, in some communities the rental demand is exceedingly weak and investors are unlikely to be able to rent the homes (e.g. Detroit).

Conclusion

The housing market remains very vulnerable. By our estimates, nearly 1 borrower out of every 5 is in danger of losing their home. As currently configured, the market cannot absorb this excess supply of housing. 19% of all borrowers who owned a home in 2007 no longer qualify for a mortgage by virtue of payment history alone. The demand for home ownership has further contracted because credit availability is very limited. (Many borrowers lack either the cash down payment or the necessary FICO score to meet ever tighter mortgage standards.) Every single governmental action seems to be moving toward limiting credit availability still further. To work our way through this crisis, we need both supply side measures (making mortgage modifications more successful, in particular through principal reductions) and measures to increase the demand for housing.

We strongly believe that investors are the key (actually, they are the only realistic alternative) to increase the demand for housing. Many of these distressed properties must be absorbed by investors and turned into rental properties. The benefit of this is that it will put a floor on housing prices, stop the vicious cycle in which deteriorating home prices cause borrowers to default, which in turn causes more deterioration in home prices and more defaults. It would also introduce much needed supply in the rental market, keeping rents lower and more affordable than would have otherwise been the case.

A successful program must have four objectives: (1) it must be scalable enough to have an impact, (2) it must hold homes off the "for sale" market for several years, (3) it must place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers, and (4) it must maximize the economics for the GSEs and the taxpayers.

How do we accomplish these objectives?

- ***Provide opportunities for bulk purchases of REO properties and non-performing loans.*** If each auction focused on a narrow geographic area we believe it would maximize the economics for the GSEs. We would require, as a condition of sale, that most of the properties be held off the market for a reasonable period to time, to allow the market to stabilize. This would clearly place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers.
- ***Enhancing financing for investors, which will allow a higher rate of return on invested equity.*** That should encourage more investor participation, and higher bids from participating investors.

Again, thank you for the opportunity to appear before the Subcommittee. We look forward to working with you on practical solutions that will help to ease the housing crisis and promote housing market stability.

Appendix—Sizing the Housing Crisis

Exhibit 1 is an attempt to size the eventual number of 1–4 family units that will be forced to liquidate over time. We have incorporated data from the private label securitizations (PLS) market, computed from the CoreLogic Securitized databases; the information on these loans is fairly complete. This is combined with data from the CoreLogic Prime Servicing Database, which provides information on GSE, FHA/VA and bank portfolio loans (to avoid double counting, we filtered out loans in private label securitizations). The prime servicing database, a contributed set of data, covers the majority of the market, but that coverage is not complete. We gross up the non-PLS number, assuming that the rest of the loan universe looks like the loans of the CoreLogic contributors (the largest servicers).

As we noted in the testimony, if no further action is taken, we reasonably expect 10.4 million units to liquidate, with an 8.3 million unit lower bound. To derive these results, we classify the outstanding loans into 5 groups. In total, we estimate that out of the 55 million homes with a mortgage, there are 4.5 million non-performing loans, 3.9 million re-performing loans, 2.6 million always performing loans with a mark-to-market LTV (loan-to-value) ratio >120, 5.4 million always performing loans with a mark-to-market LTV of 100–120, and 38.6 million always performing loans with a mark-to-market LTV of ≤100. To size the problem, we make estimates on the eventual default rate of each group of loans.

The non-performing loans (NPLs; those 60+ days past due) have a low probability of paying off according to their original terms (or even modified terms). This can be best seen in the top half of Exhibit A1 (below), by looking at the fate of loans that were non-performing 12 and 24 months ago (the bottom two lines of the top section of the exhibit). We essentially did a "Facebook" look-up on these loans, asking "where are you now?" Note after 2 years (bottom line of the top half of the exhibit), 16.8% of these loans were "successful"— *i.e.*, either re-performing (16.7%) or voluntarily prepaid (0.1%). The vast majority of "successful" loans are re-performing loans what can still default at some point in the future. Many of

Exhibit A1: Performance Of Non-Performing/Re-Performing Loans After 12 And 24 Months

Non-Performing Loans by Product Type

Product	Category	Liquidated	Non-Performing	Re-Performing	Voluntarily Prepaid	Total	% Success (Prepaid + RPL)
Prime	NPLs 12 Months Ago	26.5%	57.9%	15.5%	0.2%	100.0%	15.6%
	NPLs 24 Months Ago	45.4%	37.2%	17.1%	0.4%	100.0%	17.4%
Alt A	NPLs 12 Months Ago	24.6%	61.4%	14.0%	0.1%	100.0%	14.1%
	NPLs 24 Months Ago	46.7%	38.2%	15.0%	0.1%	100.0%	15.1%
Option ARM	NPLs 12 Months Ago	23.3%	68.1%	8.5%	0.0%	100.0%	8.5%
	NPLs 24 Months Ago	45.2%	44.3%	10.5%	0.0%	100.0%	10.5%
Subprime	NPLs 12 Months Ago	16.8%	65.2%	18.0%	0.0%	100.0%	18.0%
	NPLs 24 Months Ago	34.3%	45.4%	20.3%	0.1%	100.0%	20.3%
All	NPLs 12 Months Ago	21.1%	64.1%	14.8%	0.0%	100.0%	14.8%
	NPLs 24 Months Ago	40.5%	42.7%	16.7%	0.1%	100.0%	16.8%

Re-Performing Loans by Product Type

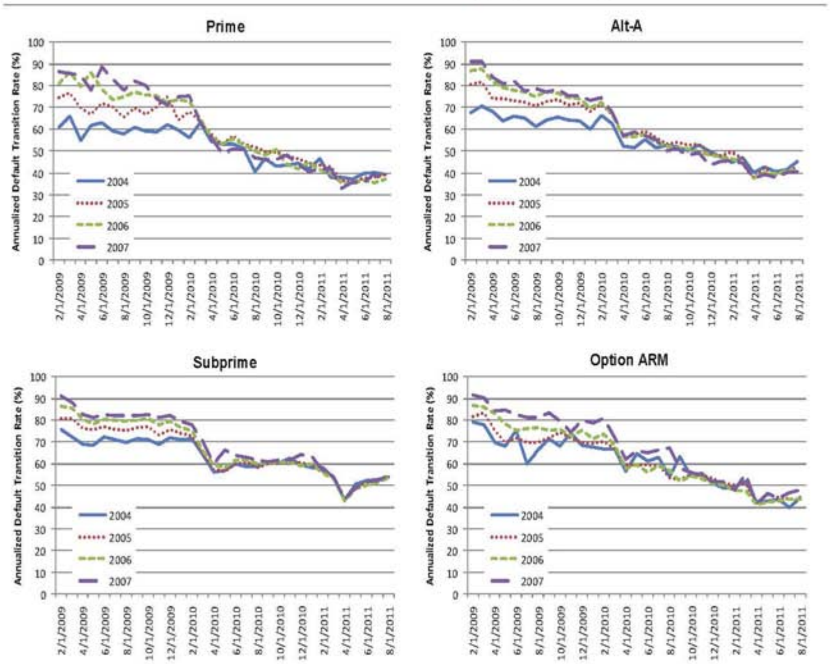
Product	Category	Liquidated	Non-Performing	Re-Performing	Voluntarily Prepaid	Total	% Success (Prepaid + RPL)
Prime	RPLs 12 Months Ago	1.7%	18.7%	76.5%	3.1%	100.0%	79.6%
	RPLs 24 Months Ago	7.4%	27.6%	55.8%	9.2%	100.0%	65.0%
Alt A	RPLs 12 Months Ago	1.2%	21.7%	76.2%	1.0%	100.0%	77.1%
	RPLs 24 Months Ago	8.0%	34.4%	55.0%	2.6%	100.0%	57.6%
Option ARM	RPLs 12 Months Ago	1.2%	26.9%	71.4%	0.5%	100.0%	71.9%
	RPLs 24 Months Ago	10.0%	42.8%	46.1%	1.1%	100.0%	47.1%
Subprime	RPLs 12 Months Ago	0.9%	27.0%	71.5%	0.6%	100.0%	72.1%
	RPLs 24 Months Ago	5.7%	37.3%	55.4%	1.6%	100.0%	57.0%
All	RPLs 12 Months Ago	1.1%	25.0%	73.0%	0.9%	100.0%	73.9%
	RPLs 24 Months Ago	6.8%	36.8%	54.3%	2.1%	100.0%	56.4%

Source: CoreLogic, Amherst Securities as of August 2011 these loans were recently modified; see our discussion below for the re-default of modified loans. The remaining loans were either liquidated or remain non-performing. We generously assume a "reasonable" long-term "success" rate of 10%; thus 90% of these loans will eventually default (and an 80% default rate as our lower bound).

The re-performing loans (RPLs) have a reasonably high chance of re-defaulting. Note that over the past 3 months, 47.2% of the re-performers (on an annualized basis) have again transitioned to delinquent status. This is shown in the column labeled "3Mo cTr" (in Exhibit 1), as it measures the constant transition rate at which these borrowers again become 60+ days delinquent. These re-performing loans voluntarily prepay very slowly ("3Mo vPr", or voluntary Prepayment Rate). Mortgage loans rarely pay on schedule all the way to the end or their lives; they customarily either prepay or default. The column "3Mo D/TV" measures the ratio of defaults to (defaults + prepayments). Thus, if 47.2% of the loans transition to non-performing status (where they have a high likelihood of eventual default) and 2.6% of the loans prepay, it suggests that 94.7% of the loans would eventually default [47.2/ (47.2+2.6)]. Intuitively, if a loan does not default or prepay in year 1, and these ratios remain unchanged, the loan again has a 47.2% chance of default and a 2.6% chance of prepay in year 2, *etc*. Thus, over the life of the loan, 94.7% of the borrowers would default if these ratios remain unchanged. That is far too high a number, as transition rates have declined markedly, as shown in Exhibit A2 (below).

The bottom section of Exhibit A1 sheds more light on this. If we look at the fate of re-performing loans a year ago, 73.9% are successful in the sense that they have either remained re-performing (73%) or voluntarily prepaid (0.9%). Of the

Exhibit A2: Transition Rates of Re-Performers: 2004-2007 Vintages by Product Type



Source: CoreLogic, Amherst Securities

loans that were re-performing 24 months ago, 56.4% can be classified as "successful"—that is, the loans remain re-performing (54.3%) or voluntarily prepay (2.1%). Some of these loans are re-performing because they are on their second or third modification. So, if the success rate after 2 years is 56.4%, we assume a "reasonable" long-term success rate of 35% — *i.e.*, 65% of these mortgages will eventually default. Our lower bound estimate was 50%.

We separate the "always performing loans" (APLs; those loans that have never been 2 payments behind) into 3 groups, based on their equity status. The most underwater borrowers are the 2.8 million mortgages with LTVs >120. These borrowers have been transitioning to non-performing status (going 60+ for the first time) at 13.8%/year, and pre-paying at 5.0%/year. If the ratio of [defaults / (defaults+ prepays)] remains constant, then 73.6% of these borrowers would eventually default. But with credit burnout a reality, we assume this number will be considerably lower. We use a 40% default rate on this bucket as our "reasonable" scenario, with 25% as our lower bound.

The middle category of APLs (5.4 million) represents loans with a 100–120 mark-to-market LTV. These have been transitioning at 7.0%/year, and prepaying at 7.0%/year. If nothing changes, 49.9% will eventually default (the ratio of [defaults/(defaults + prepayments)]. Under our "reasonable" scenario, we scale this number back to 15% to account for credit burnout, and use 10% for our lower bound.

The largest category of borrowers is the 38.6 million APLs with an LTV ≤100. Readers should be aware that these borrowers do not necessarily have equity in their homes. That is, we have used mark-to-market LTV, *not* mark-to-market CLTV (combined loan-to-value) for this analysis. We do not have the CLTV information for the non-PLS universe. Thus a 95 LTV borrower could actually be a 120 CLTV borrower. The borrower will behave as if they have no equity. This group of loans is becoming 60+ days delinquent for the first time at 2.4%/year; voluntary prepays are running at 13.3%/month. If neither ratio changes, then 15.4% [2.4/ (2.4 + 13.3)] of these loans will eventually default. We use a 5% eventual default rate as our "reasonable" case, and 4% as our lower bound.

When you add these numbers together, as is done in Exhibit 1, we find that there are most likely 10.4 million units in danger of liquidation, with a lower bound of 8.3 million units.

Amherst® Securities Group LP

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PREPARED STATEMENT OF STAN HUMPHRIES, PH.D.

CHIEF ECONOMIST, ZILLOW

SEPTEMBER 20, 2011

Introduction

Thank you Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee, for the invitation to speak today. I am the chief economist of Zillow, the leading real estate information marketplace, where I closely follow and report on the state of the housing market.

I'd like to preface my statements by noting the perspective with which Zillow approaches analysis of the housing market. We launched our Web site in 2006 with the goal of creating more transparency of real estate information for consumers. As a media-supported business, we have no vested interest in the outcome of this debate, other than the hope that whatever is decided will best address the needs of consumers (by which I mean sellers, buyers and homeowners with no intent of moving).

Today I'll make three points about the housing market and about how to address foreclosures.

First, don't underestimate the market's ability to fix itself. This is, in fact, already happening. We may not like the timetable, but economic recovery can't always happen overnight.

Second, many policies addressing foreclosures are simply addressing symptoms, not fundamental drivers of a healthy housing market. Yes, declining values have led to foreclosures, which have created an excess supply of housing. But eliminating this excess supply can't easily be achieved via policy. But policy can help the demand side, chiefly when targeted at decreasing unemployment.

Third, in trying to speed up the recovery of the housing market, the first priority of the Government should be to do no harm. The Federal home-buyer tax credits of 2009 and 2010, while they stimulated sales in the short term, did not materially change the trajectory of the housing market in the long term. In fact, it is arguable that they delayed the ultimate market bottom. We should be sure not to make similar mistakes in the future which are incredibly costly to taxpayers but net very few positive long-term results.

How the housing market is fixing itself

Regarding my first point about the ability of the housing market to fix itself, there are several reasons I believe this is already happening. It is true that there is a large pool of previously foreclosed properties owned by banks, and by entities like Fannie Mae and Freddie Mac. Estimates suggest that there are more than a half million real-estate owned properties held by lenders and Government-sponsored enterprises, about 2.2 million more homes in the foreclosure process, and still another 1.9 million homes with mortgages that are delinquent more than 90 days. These homes are flooding the marketplace with abundant, cheap inventory which pushes prices down near-term and will keep a firm lid of price appreciation in the long-term even after the bottom in home values has been reached.

But, while we often focus on the dismal state of the purchase side of the housing market, the other side of this same coin is a booming rental market. With the foreclosure epidemic converting many homeowners into renters, rental supply is reportedly as tight now as it was prior to the recession, and effective rents are estimated to rise 4 percent this year. The homeownership rate crested in 2004 at 69.2 percent, fueled by easy lending, low rates, and a positive feedback loop of appreciation and irrational expectations. During the housing recession, this rate has fallen to 65.9 percent currently, still not even in line with the longer term historical average of 64 percent.

Investors smell a distinct opportunity in this situation: The chance to buy an asset cheaply and rent it out dearly. In fact, close to one-third of the purchases of existing homes this year have gone to all-cash buyers, the bulk of whom are real estate investors.

The private market is stepping in briskly to buy up distressed homes and convert them to rentals (or, in some cases, fix them up and sell them on to other buyers). Additionally, thanks in part to these investors, the inventory of foreclosed homes owned by Fannie Mae, Freddie Mac and the FHA declined at the end of the first quarter. This market-clearing is sometimes hard to watch. It's a slow process of healing, but one that plays out when natural dynamics are not disrupted.

Addressing the continuing problem of foreclosures

Regarding the second point I outlined, the two fundamental factors that will affect housing over the next several years are negative equity and unemployment. Negative equity—estimated by Zillow as 26.8 percent of single-family homes with mortgages—contributes to foreclosures and also suppresses housing demand. Unemployment affects household formation and consumer confidence. Unfortunately, negative equity is a difficult problem to influence via policy and it will only recede slowly over time.

But employment is more easily addressable by policy action. Make no mistake, the quickest and best way to improve the housing market is to grow jobs faster. Just last week, we were reminded where so much housing demand has gone during the recession when the Census Bureau reported that almost 22 million households are currently doubled up. Grow jobs and these households can start to uncompress and occupy additional housing units. A jobs plan is a housing plan.

There have been numerous proposals to more directly stem the tide of foreclosures, many of which we have already tried, but which have unfortunately yielded more limited results than we hoped. I greet with great optimism each new idea about how to help prevent more foreclosures because the aggregate numbers defining this crisis mask such terrible suffering for millions of individual homeowners who experience foreclosure.

But the reality is that most proposals to fix this issue become problematic or infeasible because targeting only the people who truly need and can benefit from help is exceedingly difficult. With respect to foreclosure risk, there are essentially three categories of homeowners: 1) those who don't need our help; 2) those who need more help than we can possibly give them because they are facing a fundamental change in their household financial situation; and 3) those for whom modest assistance like principal reduction, reduction in mortgage rate, or unemployment forbearance can make a difference in outcomes.

Helping this third group, which is the smallest, without spilling over into the much larger first and second groups, where our money is wasted because they don't need it or because it won't fundamentally help them, is extremely challenging. And ineffective targeting of any policy balloons the cost and creates substantial unintended consequences, usually involving moral hazard in which people will avail themselves of the remedy even when they do not truly need it. I believe that the need to thread the eye of the needle so closely here is why we've seen such lower than expected outcomes for programs like the Home Affordable Modification and Refinance Programs.

Assuring Government policy does no harm

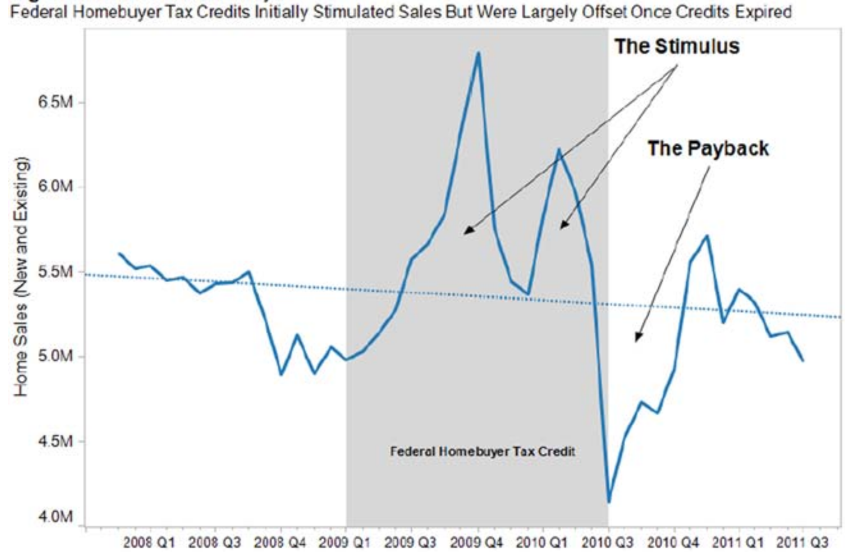
Finally, let me return to my third point about Government policy doing no harm. One idea being explored is that of Fannie and Freddie getting into the rental market in some fashion. I've already discussed how private investors are soaking up distressed inventory and transforming many of these homes into rentals. The Government should be very careful about trying to interfere with this natural process. Investors have been and currently are betting that more foreclosures will create more renters, and they are moving to serve that market. Any plan that may upset this balance—such as Fannie and Freddie getting into the rental market and creating competition—will have a chilling effect on private investment in the one segment of the housing market that is performing well. Yes, Fannie and Freddie becoming landlords could decrease the number of foreclosed homes coming into the market, but at the expense of further decreasing demand because investors will no longer buy properties for conversion and buyers may choose to rent instead of buy.

Our recent experience with the Federal home-buyer tax credits should tell us something about the limits of policy in shifting long-term market dynamics. Yes, we were successful in stimulating more housing demand during the period of the tax credits. Unfortunately, this demand was largely stolen from future months, resulting in a decline in sales after the tax credit expiration which was commensurate with the increase during the credits. We should be cautious about similar proposals that, like the tax credits, would stimulate the market only in the short-term, when what we really need is long-term recovery.

In summary, forces in the housing market are at play that will lead to long-term stabilization. But it's a delicate balance that should be well-understood before the Government steps in to help it along.

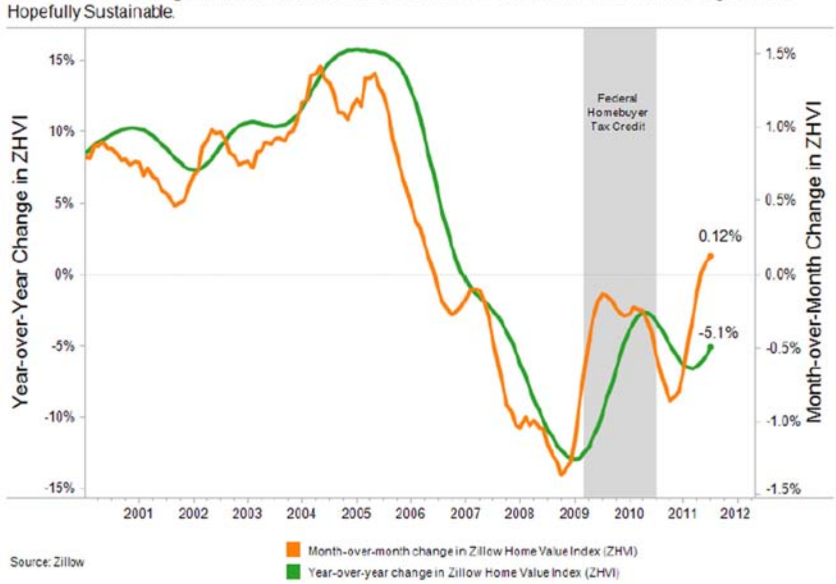
Thank you again for the opportunity to address you today and I look forward to answering any questions that you might have.

Figure 1: The Limits of Policy?
Federal Homebuyer Tax Credits Initially Stimulated Sales But Were Largely Offset Once Credits Expired



Note: New and existing home sales, seasonally adjusted annualized rate
Source: Census Bureau and National Association of Realtors

Figure 2: Some Signs of Improvement in Home Value Trends
Tax-Credit Fueled Surge Was Not Sustainable. More Declines to Come But Trends Now are Organic and Hopefully Sustainable.



Source: Zillow

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CORKER FROM ALLAN H. "DUTCH" DECHERT

Q.1. I have heard from some banks that in order for renting to be a viable option from a "net present value" modeling perspective, there would have to be tax breaks on the rental income. That is, it doesn't make economic sense for banks to undertake lease-to-own programs with loans on their book unless there are tax incentives. Have any of you seen similar analysis?

- If homeowners cannot afford to make mortgage payments, are we sure they will be able to afford to make rental payments that are sufficiently high to offer the investor a sufficient return? This concept of turning REO properties into rentals is being billed as something of a panacea. But are you sure that there is a rental price low enough that people can afford but high enough for it to make sense to investors?
- You all point out that negative equity is a major problem right now. I agree. If we are thinking about not having to live through a catastrophe like this ever again, doesn't it make sense to require a sensible down payment so that homeowners have more of an equity buffer against price downturns? We are requiring banks to have more equity. What about homeowners? Isn't equity a vital buffer to market downturns?

A.1. Tax Incentives to Facilitate Lease-to-Own Programs

Our research has uncovered no analysis that indicates that lenders would require a tax incentive to lease their real estate owned (REO) properties. Banks currently have the ability to rent their REO property for up to 5 years while they actively work to sell it. Moreover, if they require additional time, they may ask their regulator to extend the period of rental. Within these situations, there is the possibility that the renter would have an opportunity to purchase the rental unit. And as mentioned, our conversations with lenders have not revealed their need for a tax incentive in order to facilitate the rental or sale of their REO property.

REO to Rental Properties

NAR believes that the GSEs' policies should first be focused on keeping families in their homes through loan modifications or short sales if that's a better option, and that the agencies should not expedite foreclosures so that those properties could be included in a lease-to-own program. Moreover, REALTORS® believe that any lease-to-own programs should not be administered by the Government, but instead should include the participation of local investors or nonprofits that can manage the specialized needs and challenges of the local market.

REALTORS® believe the Government has an opportunity to minimize the impact of distressed properties on local markets by expanding financing opportunities, bolstering loan modifications and short sales efforts, and enhancing the efficient disposition of REO properties. This will help stabilize home prices and neighborhoods and help support the broader economic recovery.

NAR believes that the lack of available and affordable mortgage financing is hurting REO sales and the entire housing market, and urged increased consumer and investor lending. While NAR supports strong underwriting standards, the lack of private capital in the mortgage market, unduly tight underwriting standards, and increasing fees have discouraged many potential home buyers from applying for mortgages. NAR believes ensuring mortgage availability for qualified home buyers and investors will help absorb the excess REO inventory.

To prevent further REO inventory increases, NAR also recommends that the agencies take more aggressive steps to modify loans and, when a family is absolutely unable keep their home, to quickly approve reasonable short sale offers that allow families to avoid foreclosure.

Mortgage Down Payments

Your question regarding the need for borrower equity via higher down payment is the issue that NAR, and a coalition of housing advocates, are discussing with the regulators who will determine the qualified residential mortgage (QRM) rule.

NAR's members believe the impact of the proposed narrow definition of QRM would be to curtail the ability of creditworthy households from obtaining mortgages to purchase a home. Focusing the QRM exemption on underwriting factors that do not significantly improve loan performance (*e.g.,* a mandatory high percent down level) means millions of families will fail to qualify for a QRM mortgage and will have to pay higher rates and fees for a non-QRM mortgage, if they are even able to qualify. A review of loans originated in 2008 reveals that reducing the down payment from 20 percent to 5 percent increases the default rate by only 0.6 percent, but makes 18 percent more borrowers eligible for a QRM loan.

Moreover, based on NAR estimates, assuming that 100 percent of family savings are dedicated toward a down payment and closing costs, it would take more than a decade for a family with a median household income to save enough for a 20 percent down payment for a $150,000 home (lower than the current median). Even a 10 percent down payment would take a family more than 8 years to save.

RESPONSE TO WRITTEN QUESTION OF SENATOR WICKER FROM ALLAN H. "DUTCH" DECHERT

Q.1. What existing programs, if any, are in place to help veterans or service members take advantage of the opportunity to prudently invest in rental property, and are they being utilized effectively? What could be done to make these programs more effective? What more could be done to help prepare veterans or service members to invest in homes that are available for sale (due to the recent surge in foreclosures or in the normal course of events) and to manage rental property?

A.1. Based on NAR's research and inquiries with agencies that provide education for first-time home buyers, and potential real estate investors, there are no known programs that are geared specifically toward service members to help them understand and navigate real estate investment opportunities. There are numerous course offerings and software available to the general public on the topic of real estate investment, of which our service members can partake; however, none that are geared specifically to that population segment.

The void in educational opportunity for service members on this topic may be an opportunity for the National Association of REALTORS® to provide our expertise to a population segment that could derive some benefit. I will work with the association to see if there is an opportunity within our forthcoming REALTOR® University for such an effort.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CORKER FROM CHRIS KREHMEYER

Q.1. I have heard from some banks that in order for renting to be a viable option from a "net present value" modeling perspective, there would be have to be tax breaks on the rental income. That is, it doesn't make economic sense for banks to undertake lease-to-own programs with loans on their book unless there are tax incentives. Have any of you seen similar analysis?

A.1. I have not but we rather see a simple conveyance model to the next owner/manager of the home and not make the transaction more complicated. Further, I have not seen a successful, scalable lease purchase model and therefore believe a conventional rental model is the correct approach.

Q.2. If homeowners cannot afford to make mortgage payments, are we sure they will be able to afford to make rental payments that are sufficiently high to offer the investor a sufficient return? This concept of turning REO properties into rentals is being billed as something of a panacea. But are you sure that there is a rental price low enough that people can afford but high enough for it to make sense to investors?

A.2. The complexity of this problem does not allow this or any other solution to be a panacea. The economic analysis will regrettably be on a parcel-by-parcel basis and for some this idea will not work due to the simple mathematics of the transaction. That being said, having a home sit vacant with no income and the great potential of deterioration and vandalism makes one believe it should be considered in a real and meaningful way. I am convinced that we can make this model work for a portion of the REO inventory currently sitting vacant and harming all those involved.

Q.3. You all point out that negative equity is a major problem right now. I agree. If we are thinking about not having to live through a catastrophe like this ever again, doesn't it make sense to require a sensible down payment so that homeowners have more of an equity buffer against price downturns? We are requiring banks to have more equity. What about homeowners? Isn't equity a vital buffer to market downturns?

A.3. Prior to the sub-prime crisis prudent underwriting, modest (3–5 percent) down payment and home-buyer advisement services to those in the low- to moderate-income cohort created successful long-term homeowners and protected the market place. Once underwriting was dramatically loosened including the modest down payment requirement and no mandate of advisement services prior to purchase this is when the systemic failures occurred. Large down payments as put forth in the Qualified Residential Mortgage proposal would make it near impossible for so many hard working, fiscally responsible families to get their part of the American Dream. There is lots of blame to share on the mortgage mess we are all trying to clean up today but a radical shift in the amount of down payment required will not strengthen the system but rather inadvertently dramatically diminish who can participate in homeownership.

Q.4. In your testimony you outline a cooperative partnership model. Does the local infrastructure exist to make these programs like block sales or rental conversations, successful while also protecting the taxpayer? I doubt very much that Fannie and Freddie, with existing personnel and resources in DC, can successfully manage such an undertaking, and I think you and I agree here. How would the taxpayer be protected in your model?

A.4. I believe there is local infrastructure in place, to varying degrees across the country that could implement a cooperative partnership model. The question of taxpayer protection comes down to when will the haircut take place? We can take a hard stance on valuation of Fannie and Freddie's REO's today and have them sit vacant and lose more value or we can move property to productive use now garnering some return while executing a shared equity appreciation agreement with the local partner. I cannot speak to Fannie and Freddie's capacity but do not believe we are curing cancer here—these are financial models that can be reviewed quickly, efficiently and determined which parcels can be moved on and which need to stay in the portfolio. In both cases trying to strike the balance of protecting the taxpayer and putting the home back in productive use and all the upside financial gains that will occur when this happens.

RESPONSE TO WRITTEN QUESTION OF SENATOR WICKER FROM CHRIS KREHMEYER

Q.1. What existing programs, if any, are in place to help veterans or service members take advantage of the opportunity to prudently invest in rental property, and are they being utilized effectively? What could be done to make these programs more effective? What more could be done to help prepare veterans or service members to invest in homes that are available for sale (due to the recent surge in foreclosures or in the normal course of events) and to manage rental property?

A.1. I am not aware of any significant programs in this vain.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CORKER FROM LAURIE GOODMAN

Q.1. I have heard from some banks that in order for renting to be a viable option from a "net present value" modeling perspective, there would have to be tax breaks on the rental income. That is, it doesn't make economic sense for banks to undertake lease-to-own programs with loans on their book unless there are tax incentives. Have any of you seen similar analysis?

A.1. I do not think tax breaks are necessary for renting to be a viable option. My employer, Amherst Securities, has purchased 100 homes in Phoenix, and we are operating this profitably without tax incentives. It is the case that the current return on the initial investment, after costs, is reasonably modest (6–8 percent). However, with Treasury rates below 2 percent, this return looks reasonable to alternatives. Moreover, there is some potential upside to investors. The upside can come from either from increases in rental income over time, or increases in housing prices once the market stabilizes.

Q.2. If homeowners cannot afford to make mortgage payments, are we sure they will be able to afford to make rental payments that are sufficiently high to offer the investor a sufficient return? This concept of turning REO properties into rentals is being billed as something of a panacea. But are you sure that there is a rental price low enough that people can afford but high enough for it to make sense to investors?

A.2. You are correct. Selling properties to investors to rent them out is not a panacea. Not all homes will work for this purpose. The home price must be such that the rental income is sufficient to entice investors, and rental demand is available in that market at that price. It would be difficult to rent out higher priced homes, as the rental income cannot justify the purchase price. It is also hard to rent out homes in communities where the economy is so weak there is no rental demand. However, the majority of REOs are rentable, and this would be a very valuable program to help stabilize the housing market.

Q.3. You all point out that negative equity is a major problem right now. I agree. If we are thinking about not having to live through a catastrophe like this ever again, doesn't it make sense to require a sensible down payment so that homeowners have more of an equity buffer against price downturns? We are requiring banks to have more equity. What about homeowners? Isn't equity a vital buffer to market downturns?

A.3. I agree, it is critical that homeowners have equity in their home at the time of initial purchase. Down payments are critical, as equity is the single most important determinant of mortgage performance.

Q.4. Your main thesis is that investors are the key to finding a bottom in home prices. So you advocate loosening standards for investors to get credit that is guaranteed by the taxpayer. Do you think this should be a permanent change to Fannie and Freddie guides? Or just temporary until we get through the overhang? One thing that concerns me about making this a permanent change is that investor properties traditionally have higher default rates, and we need to be moving in a direction of reducing taxpayer exposure to risk, not increasing it.

A.4. I don't advocate loosening standards for investors to obtain credit that is guaranteed by taxpayers. I advocate loosening the hard caps on the number of properties that can be purchased, but maintaining conservative rules on necessary down payments to limit default risk. The down payments on investor-owned properties should be higher than on owner-occupied properties. We would suggest a minimum of 25–30 percent down on investor properties. Freddie currently allows for the purchase of only 4 properties by a single investor, Fannie allows for 10 properties. I don't understand the rationale for this. I believe the cap should be unlimited, with a sufficient down payment. To use an extreme example, if an investor was willing to put 40 percent down on 2,000 properties, I believe that Fannie and Freddie should be willing to finance all 2,000 properties.

RESPONSE TO WRITTEN QUESTION OF SENATOR WICKER FROM LAURIE GOODMAN

Q.1. What existing programs, if any, are in place to help veterans or service members take advantage of the opportunity to prudently invest in rental property, and are they being utilized effectively? What could be done to make these programs more effective? What more could be done to help prepare veterans or service members to invest in homes that are available for sale (due to the recent surge in foreclosures or in the normal course of events) and to manage rental property?

A.1. I am not an expert in veterans programs. This question is better addressed to some of the other witnesses.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CORKER FROM STAN HUMPHRIES

Q.1. I have heard from some banks that in order for renting to be a viable option from a "net present value" modeling perspective, there would have to be tax breaks on the rental income. That is, it doesn't make economic sense for banks to undertake lease-to-own programs with loans on their book unless there are tax incentives. Have any of you seen similar analysis?

A.1. No, I haven't seen analyses related to this issue. In general, my sense is that rent-to-own programs are best administered by private companies that purchase the delinquent mortgages from the bank, not administered by the bank or loan servicer directly as this is not their core business.

Q.2. If homeowners cannot afford to make mortgage payments, are we sure they will be able to afford to make rental payments that are sufficiently high to offer the investor a sufficient return? This concept of turning REO properties into rentals is being billed as something of a panacea. But are you sure that there is a rental price low enough that people can afford but high enough for it to make sense to investors?

A.2. The homeowner may not be able to afford the mortgage based on the original home value, but could afford a mortgage based on the current lower home value. Alternatively, the home could be bought by an investor, at the current lower home value, and rented back to the current occupant at a rent price which is lower than the occupant's current mortgage payment but higher than the investor's new mortgage payment based on the lower current price.

Q.3. You all point out that negative equity is a major problem right now. I agree. If we are thinking about not having to live through a catastrophe like this ever again, doesn't it make sense to require a sensible down payment so that homeowners have more of an equity buffer against price downturns? We are requiring banks to have more equity. What about homeowners? Isn't equity a vital buffer to market downturns?

A.3. Yes, equity in the home is one element of the overall default risk of a mortgage holder. But credit worthiness and debt-to-income ratios are also very important. All homeowners should be asked for some down payment, but the amount needed to influence default risk can vary depending on the other two factors.

RESPONSE TO WRITTEN QUESTION OF SENATOR WICKER FROM STAN HUMPHRIES

Q.1. What existing programs, if any, are in place to help veterans or service members take advantage of the opportunity to prudently invest in rental property, and are they being utilized effectively? What could be done to make these programs more effective? What more could be done to help prepare veterans or service members to invest in homes that are available for sale (due to the recent surge in foreclosures or in the normal course of events) and to manage rental property?

A.1. I am not aware of any special programs targeted at stimulating real estate investment by current or former military service personnel. They presumably have equal access to credit from Fannie Mae for the purchase of up to 10 investment properties. There may be an opportunity to better raise awareness of these general opportunities to military personnel.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

STEVEN PEARLSTEIN: HOW ABOUT REFI.GOV?

The Washington Post, September 17, 2011

By Steven Pearlstein

It's been less than 2 weeks since President Obama spoke to Congress and the Nation about the urgency of taking additional steps to stimulate job creation by increasing public and private spending in the short term. Since then, two things have happened.

The economic outlook has only gotten worse, largely because of the financial turmoil in Europe and further declines in consumer confidence.

Meanwhile, the political outlook for actually doing something about it has gotten worse, because the business community and cowardly Democrats failed to rally behind the president's plan, giving Republicans the political head room to continue peddling their Rotary Club nonsense that what's holding back the economy is a crushing tax burden, stifling regulations and all-consuming worry over the budget deficit.

Given the almost certain prospect of a continuing political stalemate, the president's best option is to use the power he's had all along to deliver tens of billions of dollars in additional stimulus by allowing millions more households to refinance their mortgages at today's low rates.

I'm not talking about significant modifications to troubled mortgages, which the banks and mortgage bond investors have done a fabulous job of preventing since the last years of the Bush administration.

Nor am I talking about providing taxpayer relief to homeowners who have fallen behind on their payments and are facing foreclosure.

I'm talking about the millions of households that are paid up on mortgages that still have interest rates of more than 5 percent and could use the lower rates engineered by the Federal Reserve to reduce annual payments by an average of $2,500 a year.

Here's a statistic that tells you pretty much all you need to know: Back in the recession that began in 2001, roughly 85 percent of households that were eligible to refinance their mortgages did so, with an average decline in interest rates of about 1.3 percentage points. That freed up about $67 billion each year in bond payments that could be spent on other things.

This time, only about 25 to 30 percent of mortgages has been refinanced, despite the lowest interest rates since the Great Depression. The average decline in rates on those refinanced loans has been less than half a percentage point, resulting in $45 billion in overall savings to borrowers.

The biggest reason for this refinancing gap was a decision by Fannie Mae in 2008 to increase the fees it charges to guarantee all new loans, including refinancings. The fee varies by borrower, but is particularly steep for those with low or middling credit scores, those with loans that are 90 to 125 percent of the current market value of the house and those living in areas where home prices declined the most.

Given the shoddy underwriting during the credit bubble, this may have seemed like a reasonable step for Fannie to take as it related to guaranteeing new loans. But in terms of refinancing loans that it already guaranteed, it was rather shortsighted. Refinancing would have lowered the monthly payments and, therefore, the probability that the homeowner would default, which has turned out to be Fannie's biggest risk and the biggest contributor to its quarterly losses.

Essentially, Fannie's clever strategy was to use its near-monopoly power to charge higher fees for assuming smaller risks knowing full well that the extra fee would discourage refinancing. The fees ranged from half a percentage point to 3 percentage points, which for many pretty much wiped out the potential benefit of refinancing.

Why did Fannie do that? Because in addition to being in the business of providing mortgage bondholders a guarantee, or insurance, against the risk of default, Fannie also owns a huge portfolio of those bonds. And as a bondholder, refinancing a loan means it would receive less money every month from the borrower. The extra fees were designed not only to discourage refinancing, but to make up for any decline in monthly cash flow.

Historically, whenever Fannie raised or lowered fees, its twin, Freddie Mac, would quickly follow. But this time when it did not, Freddie Mac executives were ordered by its new regulator to do so, apparently with the idea that it would lower the cost of the Government bailout. What may have been good for American taxpayers in the short run, however, turned out to be bad for the economy. Also contributing to increased refinancing costs were the handful of big banks that own or service most of the mortgages in the United States. With the demise of aggressive (and foolhardy) players such as Countrywide, the mortgage banking industry went from being hyper-competitive in terms of price to being not very competitive at all. As a result the spread—the difference between what the banks pay for money and what they charge—widened considerably.

The effect of all this was to thwart the impact of Fed's ultra-low interest rate policy by allowing Fannie, Freddie and the big banks to capture much of the benefits rather than having them pass through to households and the broader economy. Those who still found it worthwhile to refinance tended to need the help the least—wealthier households with higher credit scores and lower loan-to-value ratios. Middle-income borrowers whose home values had fallen below the level of the outstanding loan were largely shut out. The result: a weaker economy, more foreclosures and a steeper decline in house prices.

Over the past 2 years, there have also been numerous proposals for how to fix this problem by ordering Fannie and Freddie to roll back its fees and by somehow limiting the spreads charged by mortgage bankers. But these have been quietly opposed by bondholders who didn't want lower interest payments and by industry executives and some top Administration officials who warned that it would raise the interest rates on all new mortgages in the future. Some Republicans also were so determined to kill Fannie and Freddie once and for all that they couldn't stomach the idea of using them again as instruments for Government management of the mortgage market.

Now, however, with prospects dimming for other stimulus proposals and the housing market still fragile, a bipartisan consensus for mass refinancing may be emerging. Obama mentioned it in his recent speech to Congress. And a Senate hearing last week found support from both parties as well as a number of prominent economists.

The best proposal I've seen comes from Glenn Hubbard, a former economic adviser in the Bush White House, Chris Mayer, his colleague at Columbia Business School, and Alan Boyce, a trader in mortgage bonds. The trio's idea is to order Fannie and Freddie to reduce its fee to a flat $\frac{4}{10}$ of a percent for refinancing any fully paid-up loan that it already guarantees. The process would be streamlined, eliminating appraisals and income verification. The fee would be lower than now, but higher than it has been in normal times, and sufficient to offset the reduced monthly cashflow from refinanced borrowers.

As for the banks, those that accept a lower refinancing fee of $\frac{3}{10}$ of 1 percent would be granted immunity from lawsuits stemming from loans issued during the bubble—a huge cloud that hangs over the big banks. Those who refuse the arrangement would lose their ability to sell their mortgages to Fannie and Freddie, which are pretty much the only games in town since the housing bust began.

The big losers would be the private holders of mortgage bonds—mostly pension funds, hedge funds and other money managers, along with foreign governments—who might take solace in the fact that they have enjoyed three more years of interest payments at the old, higher rates than they would have if the Fed's monetary stimulus had been allowed to pass through to homeowners. And because of the salutary effect of lower mortgage rates on the economy, bondholders eventually would recoup a fair portion of their "lost" income through reduced foreclosures.

Hubbard, Mayer and Boyce estimate that their plan could allow as many as 25 million households to refinance mortgages and have an extra $70 billion every year to spend and invest—the equivalent of a $70 billion-a-year tax cut that can be had at no cost to taxpayers.

A new wave of mortgage refinancing is not an economic silver bullet, but it is a positive step that everyone can agree on conceptually and can be implemented quickly within existing law. What's been missing so far has been the cooperation of Fannie and Freddie's regulator and a determination on the part of the White House and the Treasury to get over all their technical objections and political qualms and just get it done.