S. HRG. 112–709

THE RESPONSIBLE HOMEOWNER REFINANCING ACT OF 2012

HEARING

BEFORE THE

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

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

EXAMINING THE RESPONSIBLE HOMEOWNER REFINANCING ACT

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C O N T E N T S

THURSDAY, MAY 24, 2012

WITNESSES

THE RESPONSIBLE HOMEOWNER REFINANCING ACT OF 2012

THURSDAY, MAY 24, 2012

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

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I call this hearing to order.

I would like to thank our witnesses for joining us here today.

Recently, the Committee has explored a variety of ideas to expand mortgage refinancing opportunities. We are here today to discuss one of those proposals, the Responsible Homeowner Refinancing Act, that was introduced by Senators Menendez and Boxer. The bill seeks to address barriers to refinancing that continue to exist in the HARP program run by Fannie Mae and Freddie Mac. While FHFA made some changes to the HARP program last year at the urging of Members of Congress and the Administration, I continue to hear from constituents and the housing industry that more could be done to encourage competition in the refinancing market and give homeowners additional options as they navigate current market conditions.

The housing market continues to struggle with home values that are far below the levels seen a few years ago. Despite the dramatic decrease in home values since their peak in 2006, many homeowners are upholding their commitments to pay these loans back. However, as we have found in previous hearings, these responsible homeowners are at a disadvantage when it comes to refinancing their loans at today's record low interest rates. They often have limited options when shopping for the lowest interest rate because put-back risks mean they can only refinance with their current servicer.

The GSEs have not applied HARP's benefits in a consistent manner, which creates unnecessary complications for lenders and homeowners. Loan level pricing adjustments increase the cost to homeowners seeking to refinance even though the GSEs already hold the credit risk associated with the original mortgage.

Our witnesses today bring a wide breadth of knowledge concerning mortgages, the housing market, and the economy as a whole. I look forward to hearing your thoughts on how the Responsible Homeowner Refinancing Act will provide homeowners more options for refinancing and encourage competition among lenders to help stabilize our housing market and overall economy.

Improving the housing market is the first step before we can take up broad housing finance reform, and I would ask my Republican colleagues to work with me to move this important legislation.

With that, I will turn to Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. Welcome to all of you.

Today's hearing is focused on legislation that would expand the Federal Housing Finance Administration's Home Affordable Refinance Program. The program, commonly referred to as HARP, is designed to enable the refinancing of mortgages for underwater borrowers with GSE loans. And while this is an important area, I believe, to explore, it should be only one aspect of a broader debate.

Our fragile housing market faces numerous challenges. The uncertainty created by the nearly 4-year conservatorships of Fannie Mae and Freddie Mac is just one such challenge. The resulting lack of clarity in the secondary market is a major impediment, I believe, to private capital returning to our housing finance system. Without that capital, I think it will be difficult to have a sustainable recovery in our housing market.

New statutes and rules created by Dodd-Frank are also proving problematic. The potential consequences of rules pertaining to qualified mortgages, or QM, and qualified residential mortgages, or QRM, have drawn concerns from industry participants and consumer groups alike. FHA has also been woefully neglected. For years, FHA has severely misjudged the risk to which the taxpayer has been exposed, making a taxpayer bailout a real possibility.

And despite these past mistakes, we can take steps to help the market move forward if we honestly assess our current situation. I think today's hearing is a first good step, Mr. Chairman, in that direction. Thank you.

Chairman JOHNSON. Thank you, Senator Shelby.

Are there any other Members who wish to make a brief opening statement?

Thank you all. I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other materials you would like to submit.

Now, I would like to briefly introduce our witnesses. Mr. Bill Emerson is the CEO of Quicken Loans, Incorporated, a mortgage lender based out of Detroit, Michigan.

Mr. Christopher Papagianis is the Managing Director at e21, a nonprofit organization focused on economic research and public policy.

Mr. Moe Veissi is the 2012 President of the National Association of Realtors.

And, last, Dr. Mark Zandi is the Chief Economist at Moody's Analytics.

Mr. Emerson, please commence.

STATEMENT OF BILL EMERSON, CHIEF EXECUTIVE OFFICER, QUICKEN LOANS, INC.

Mr. EMERSON. Chairman Johnson, Ranking Member Shelby, and Members of the Senate Committee on Banking, Housing, and Urban Affairs, thank you for your invitation to testify at today's hearing for this very important issue, S. 3085, the Responsible Homeowner Refinancing Act of 2012.

My name is Bill Emerson. I am the CEO of Quicken Loans. Quicken Loans is a 26-year-old independent retail residential originator proudly based in downtown Detroit. We are the Nation's largest online lender and the Nation's fourth-largest retail lender. J.D. Power and Associates has ranked Quicken Loans highest in customer satisfaction for primary mortgage origination in the United States for 2010 and 2011.

My testimony will address some of the issues with HARP 2.0. HARP 2.0 will help more homeowners than HARP 1.0 and we applaud the current Administration, the FHFA, the GSEs, and the mortgage industry for working together to improve the HARP product. However, HARP 2.0 still is not designed to help enough underwater homeowners who are eligible and deserve assistance.

Why will HARP 2.0 not help enough of these four million homeowners? There are two answers, the difference in repurchase risk for new originators versus same servicers and the lack of origination capacity the larger servicers face.

The risks borne by same servicers and new originators under HARP 2.0 are different because the underwriting guidelines that a new originator must follow are different. To refinance a borrower into a HARP 2.0 loan, the same servicer is not required to verify or document the income ratios, the borrower's income, or the borrower's assets. The same servicer only needs to verify that the borrower has a viable source of income. The new originator, on the other hand, must calculate a debt-to-income ratio and document and verify both income and assets. This is where the significant increase in risk exposure comes in for the new originator.

Both new originators and same servicers are required to represent and warrant to the GSEs that they are originating and underwriting loans according to GSE guidelines. If the originator is found to be in violation of a representation and warranty, the originator is required to repurchase the loan. The GSEs regularly require repurchases based on flaws, however minor, in the origination and underwriting process. Sometimes such flaws are extraordinarily difficult to prevent, for example, a borrower who takes out a credit card or an auto loan 1 day before the loan closes. And originators are required to repurchase loans even though they acted diligently.

Because the new originators have more stringent underwriting requirements than same servicers and, therefore, more rep and warrant risk, there is a much higher likelihood that they will have to repurchase more loans and incur significantly higher losses. Accordingly, prudent new originators stay clear of most HARP 2.0 loans where the borrower is underwater, and for the most part, HARP 2.0 loans are originated by same servicers who bear much less repurchase risk.

The reluctance of new originators to fully participate in HARP 2.0 will limit its success. Roughly 70 percent of all GSE mortgages are being serviced by the largest servicing firms. Because these same servicers can originate HARP 2.0 refinances with greatly reduced risk, these servicers are carrying the load of trying to administer the HARP 2.0 program. Notwithstanding the good intentions of the large servicers, they will simply not be able to help enough HARP 2.0 eligible borrowers given all the other duties these large servicers must perform aside from originating HARP 2.0 loans. They simply cannot wrap up their platforms and hire and train people fast enough to help the millions of homeowners.

Additionally, some of the large servicers have greatly reduced or eliminated their origination platforms, thereby significantly reducing access to credit for the HARP 2.0 borrowers being serviced by these large firms. Thus, the capacity issue I mentioned earlier and the limiting of opportunities for the consumer to take advantage of lower rates.

Quicken Loans is from the Motor City, so let me try an analogy to illustrate my point. If one of the automakers needed to do a recall of all of their vehicles, they would not require the owners to return their car to the factory to have the vehicle fixed. Instead, they would quickly and efficiently use their nationwide dealer network to resolve the problem.

Yet HARP 2.0 is constructed such that it will lender the nationwide origination network largely ineffective and instead rely on a handful of larger servicers to carry the load. The GSEs already bear the risk on these loans regardless of who is originating them. There is no viable reason to create artificial barriers that effectively block new originators from using HARP 2.0 to assist homeowners and to help the GSEs improve their risk position.

Because HARP 2.0 is being utilized by a small number of firms, the demand for HARP 2.0 originations is dramatically exceeding the supply of firms who fully offer the program. The imbalance of this age old law of supply and demand results in higher prices for the new HARP 2.0 mortgage than it normally would if competition existed.

The Responsible Homeowner Refinancing Act of 2012 goes a long way toward addressing many of the underlying problems. If the Responsible Homeowner Refinancing Act of 2012 can remain exclusively focused on improving HARP 2.0 and avoid complicated detours into other subject matters, the new version of HARP 2.0 can help millions of underwater borrowers in short order. Therefore, we support the Act as proposed.

I thank you for allowing me to testify on this very important topic.

Chairman JOHNSON. Thank you.

Mr. Papagianis, please begin.

STATEMENT OF CHRISTOPHER PAPAGIANIS, MANAGING DIRECTOR, e21: ECONOMIC POLICIES FOR THE 21ST CENTURY

Mr. PAPAGIANIS. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify at this legislative hearing on the Responsible Homeowner Refinancing Act of 2012. I am the Managing Director of the nonprofit think tank e21: Economic Policies for the 21st Century. We aim to advance free enterprise, fiscal discipline, economic growth, and the rule of law. We are focused on developing public policy research that advances market performance and implementing rules to prevent market malfunction.

I would like to say up front that I continue to see a great deal of stress across both the demand and supply dimensions of the housing market, as demonstrated by the thousands of borrowers that are still struggling to make their payments and stay in their homes.

However, it is also important to acknowledge that many of the major negative trends that have dominated the headlines since the crisis are now well off their post-crisis peaks. For example, the current level of housing supply that is for sale suggests that the market is close to equilibrium. In many ways, it is now weak demand for single-family homes that appears to have eclipsed the supply challenge.

Another important market development to acknowledge is that lenders are capacity constrained today. As I detail in my written testimony, I believe that lenders and servicers are hesitating to make the necessary infrastructure investments in the near term because they just do not have a good sense of how profitable the housing finance and servicing business will be over the medium to long term.

The implication is that there are a lot of policy and regulatory uncertainty that is holding back a broader housing recovery, and I grouped them into three buckets: Servicing, underwriting, and GSE reform. I believe this backdrop is crucial to understanding the challenges that face the housing market. Resolving some of this uncertainty also holds the greatest potential on a comparative basis for positively and responsibly impacting the housing market.

On the bill before this Committee today, which would further expand HARP 2.0 to, say, 3.0, my summary conclusion is that while I think the intentions behind many of the provisions are admirable, there are potential unintended consequences that this Committee should consider.

For example, changing the eligibility date from June 2009 to June 2010 and/or allowing for HARP loans to be re-HARPed would be controversial. Some additional borrowers might be helped by this date change, but the prices paid by borrowers for HARP refinancings and maybe even the broader agency TBA market would go up. When refinancing programs are continually expanded, investors may be forced to adjust their expectations about future prepayment speeds, effectively assuming that future mortgages will have an embedded policy risk function that could give borrowers easier access to a lower rate mortgage. While that may sound like a good policy objective in the long run, the net effect could be that market participants simply demand higher yields on mortgage-backed securities.

It is also worth noting, or highlighting, that HARP 2.0 has only been up and running since March. Since it is not clear how many additional borrowers could or would be helped under HARP 3.0, it is important to recognize that a new implementation process may actually delay the HARP 2.0 boom that appears to be underway.

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

Chairman JOHNSON. Thank you.

Mr. Veissi, please begin.

STATEMENT OF MOE VEISSI, 2012 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

Mr. VEISSI. Thank you, Chairman Johnson, Senator Shelby, and Members of the Committee. Thank you for the opportunity to testify on the solutions that will provide relief to homeowners who continue to be current on mortgage obligations during this prolonged economic recovery.

My name is Moe Veissi. I am the 2012 President of the National Association of Realtors, with about a million members. I am a practicing Realtor myself in Miami, Florida, a market that has experienced pretty severe downturns during the period of time that we discussed.

The Responsible Homeowner Refinancing Act removes impediments and allows current borrowers—and I would like to underline that, current borrowers—whose loans are held by GSEs to take advantage of record low interest rates. When I say current, I mean that these folks are continuing to make their commitment and obligations in the manner that they promised to do when they took the loan out.

We calculate that it will save borrowers somewhere between $4.5 and close to $5 billion a year after tax considerations and more than about $45 to $48 billion over a 10-year period of time from 2012. That is a significant impact on local markets, not just simply because those folks may invest a portion of the savings, but because those local markets are the quilt that knits the American fabric of homeowner together across this country. We think it will reduce a family's average annual obligation roughly by about $2,800.

There are two examples that I want to bring forward. One, about 4 months ago when I was traveling to D.C., I sat down in my seat on the plane and a young lady sat next to me and she started to recount after some conversation the fact that, one, she is an interior designer, and two, that her husband is a golf pro and they live in Southern California in the desert. They bought a house in 2007 and are severely underwater. I said, "Well, what are you doing about it?" She said, "We are continuing to make the payments and we really do not have any other opportunities to get out from under." A person like that is exactly the person we are talking about, making sure that their obligations are met, knowing that they are on point, and still underwater.

The second example is a little more poignant. I got a referral from a college professor in Chicago, Illinois, who had bought a condo-tel in Miami Beach and another home which he and his wife anticipated retiring to. The condo-tel, he thought would be an income producer for him in his retirement, and the home was a retirement home. He paid $450,000 for the home and upwards of $650,000 for the condo-tel. Well, both of those investments turned south and he used up the balance of his retirement income and savings across the board to carry those two investments until he could no longer. He declared bankruptcy. That is the kind of person that we need to catch before he gets into those kinds, or they get into those kinds of severe circumstances. I guarantee that he paid as long and as efficiently as he could for that length of period of time.

We think that that kind of legislation will benefit about three million folks who are in trouble today. It eliminates unnecessary consumer fees. It allows the refinancing market to—well, we do not think it will explode, but certainly to address those opportunities that exist. The legislation establishes penalties for servicers of second liens and mortgage insurers who thwart the refinance process that exists today.

And the Nation's housing sector remains in a precarious state, as Chairman Johnson indicated. There is no question that this is a fledgling recovering housing market. Six of the last eight recessionary periods have come out of recession because of a strong real estate market, mostly housing and peripheral industry steps. Any steps that can do that and create a better housing market is something we continually support. And any G fees that exist should not be used for the purpose related to housing, such as paying for extensions of payroll taxes and relief. NAR applauds the Menendez-Boxer legislation for not utilizing the G fees for a pay-for.

Home ownership is inextricably linked to a healthy community and a healthy American economy. This is why the National Association of Realtors supports any and all efforts that support the ownership and investment in real estate, and we so say.

Chairman JOHNSON. Thank you.

Dr. Zandi, please begin.

STATEMENT OF MARK ZANDI, CHIEF ECONOMIST AND COFOUNDER, MOODY'S ANALYTICS

Mr. ZANDI. Thank you, Chairman Johnson, Senators Shelby, Corker, Merkley. It is good to be here. I am the Chief Economist of Moody's Analytics and these are my views, not those of the Moody's Corporation. You should also know that I am on the Board of Directors of MGIC, the largest mortgage insurer in the country.

I will make four points in my remarks. First, policy steps to facilitate more refinancing, I think, are among the most straightforward ways to help the housing market and the economy. Both the economy and the housing market are making progress. We are moving in the right direction. But, clearly, conditions are still very weak and the risks are significant. The threat from Europe, the fiscal cliff, lots of different threats to this very fragile recovery. So I think it is important that policy makers continue to think about ways about supporting the housing market in particular and the economy more broadly.

The second point is that the key policy effort to facilitate more mortgage refinancing, HARP, has to this point been a disappointment. If you look at the numbers, according to FHFA, there has been 1.2 million HARP refinancings since the inception of the program back in 2009. A little over 100,000 of those have been for homeowners that are in negative equity positions. Expectations were for something much more significant than that, and so I think it is fair to say it has not lived up to expectations.

The changes that were proposed late last year and are now being implemented appear to be quite good. They seem to be working well. If you look at some of the data coming from the Mortgage Bankers Association on refi applications, they picked up quite significantly. Now, part of that is related to the very low fixed mortgage rates. We are now at record lows, below 4 percent, and obviously a very propitious time to refinance. But I think what HARP has done, the HARP changes have been very, very good and very therapeutic. My expectation for the HARP 2.0 program, if the policy makers do nothing going forward, we will get roughly 2.5 million to 3 million refinancings through HARP at the end of the day.

The third point, given how well the HARP changes seem to be going, I think it makes logical sense to extend those guidelines and rules to all Fannie and Freddie loans. I do not really see any good reason not to do that. And I think we should do it quickly, because mortgage rates are very low and this is such a very good time to refinance.

This is clearly a significant benefit to borrowers. I agree with all of the arithmetic that the Realtors put forward. It is going to save the average homeowner somewhere between $2,500 and $3,000 a year. For the economy as a whole, it will save in interest $6 to $7 billion. That is not considering that tax consequences, but $6 to $7 billion. It is small in the grand scheme of things, but it is very helpful, and I should point out, it is going to be very, very helpful for those markets that are under a lot of stress, so Florida, Atlanta, Arizona, Nevada, California, New Jersey. These are really hard-pressed areas and these are areas where this refinancing money could be quite helpful.

And this comes at no cost to taxpayers. I mean, I think the way this is designed, at the end of the day, it is not going to cost the GSEs anything. It is not going to cost taxpayers anything.

So from a homeowner perspective, a broader economic perspective, a taxpayer perspective, this seems to make a lot of sense to me.

The fourth point, there is a loser in this and that is the investor, the mortgage securities investor. So, very simply, if homeowners are paying less in interest, then the other side of that, the investor is collecting less in interest, and so they do lose. Now, I will make a couple points about that.

First, the Federal Reserve is now the largest mortgage securities investor. So, because of QE, they now have $1.25 trillion in securities on their balance sheet, so they are the biggest investor.

The second thing I would say is the QE action was a windfall to those investors. So MBS investors, mortgage securities investors, have been tremendous beneficiaries of Government policy, and one might argue there is no bigger beneficiary from Government policy throughout the financial crisis than mortgage securities investors.

And then, finally, I would say that these investors in most cases thought they would get prepaid out already. I mean, if the market was well functioning, if there were not these problems in the marketplace, then all the models would say—and all the investors have these models—that they would have already gotten paid out of these mortgages a long time ago. So, in a sense, they are benefiting from the failure in the marketplace, and this legislation, the

Menendez-Boxer legislation, addresses that market failure in a reasonable way and I think this legislation is good legislation and should be passed.

Thank you.

Chairman JOHNSON. Thank you all for your testimony.

As we begin questions, I will ask the Clerk to put 5 minutes on the clock for each Member.

Mr. Emerson, your testimony describes the problems you face when working with homeowners seeking to refinance a mortgage. FHFA continues to deny that there are different requirements for new business compared to refinancing customers under HARP. So that we are clear about how this program works in practice, would you describe the differences again. Also, do these differences create barriers that prevent you from competing with loan originators that also service the loans they are refinancing? How would the Menendez-Boxer bill remove those barriers?

Mr. EMERSON. Certainly, Senator. I appreciate the question. So I cannot speak to what the FHA denies or does not deny. From a practicality perspective, we have conversations with the GSEs on a regular basis. We have looked at the guidelines. We understand how they operate.

So today, if I am originating a loan as Quicken Loans, I have to do a full underwrite on that transaction. I have to fully underwrite income, assets, everything associated with it as I would with a normal loan. The same servicer does not have to do that. There is no verification of income. There is no verification of assets. It is a very streamlined process. So it is faster for a same servicer, but there is also less risk, because at the end of the day, if we originate a loan and we document income and assets and for some reason there is a mistake in that origination process, the GSEs will put that loan back to us.

And when you take a look at the LTVs on these—again, the GSEs own the risk already on this. So when you start looking at increasing LTV is above 125 percent, you are going to see that those loans—if something goes bump in the night for some reason and it is underwater, they will have a higher propensity to default. And when that happens, a person who has more rep and warrant risk, such as a new originator does today, will buy more loans back than a same servicer will and there is no way to quantify that dollar amount and that risk.

So by getting rid of that piece of it, you reduce risk. You bring originators now into the mix who have capacity to help homeowners, and that is what they do full time for a living. A lot of our larger players have multiple things that they serve. A lot of the other originators, that is what they focus on, is just the homeowner and helping that homeowner out. So by eliminating that barrier, you really do open up a much larger landscape. You bring in competition. It allows pricing levels to be competitive. And it really, at the end of the day, I believe, facilitates the opportunity to help more homeowners than will be helped if we do nothing with this—if we leave HARP 2.0 the way it is today.

I am not sure if that clearly answers your question, but——

Chairman JOHNSON. Mr. Veissi, as a Realtor in Florida, you see firsthand the barriers that homeowners and the housing market are trying to overcome. In your opinion, how will the Responsible Homeowner Refinancing Act help homeowners and ultimately the housing market?

Mr. VEISSI. I want to restate it so I am sure I understand the question. How is the—how would it affect the existing housing market?

Chairman JOHNSON. How will the Responsible Homeowner Refinancing Act help homeowners and ultimately the housing market?

Mr. VEISSI. OK. I think it offers an opportunity to those people who have assumed their obligations, like the ones that I made as an example to you, and I think there will be a lot of folks across the country that would take advantage of this, especially today, the opportunity to get into a mortgage at rates at 3.875 to 4.5 percent versus five or 6 percent that they might be paying ultimately.

I think there are two opportunities that exist when somebody does that. We have indicated that there is an opportunity to save about, on average, $2,800 a year. I will bet you a dollar to a doughnut that most of those people will take the majority of that and begin to save, because we have seen over a period of time that people are becoming more savers than before. But I will bet you also that there will be an excess of some of that that will go back into the marketplace to stimulate the economy in those communities that are most hard hit, like Miami, like Las Vegas, like Southern California, like Phoenix, Scottsdale.

Chairman JOHNSON. Dr. Zandi, would you describe for the Committee how investors are affected when a mortgage is refinanced, and would the Menendez-Boxer legislation distort the market reaction to the current historically low interest rates?

Mr. ZANDI. Well, investors would lose the interest income they would collect if the homeowner was paying the higher interest rate. So if we refinance the homeowner down into a lower interest rate, then that lower interest income means less to the investor. Or they get their money back—some investors will get their money back in a lower-rate environment and they cannot invest it and get the same return.

So this is a problem that mortgage investors have been dealing with from the beginning of time, prepayment risk. They understand it very well. They have models that they use to determine what the prepayment risk is in investing in these securities and they price accordingly.

The surprise that many investors received in this recent environment is that a lot of these mortgages have not prepaid as fast as they thought they would because of the marketplace, because house prices are down, because people are in negative equity positions. Because of all the problems in the housing and mortgage market, a lot of loans that would normally get refinanced out, prepaid at these very incredibly low rates, just have not happened. So they have actually enjoyed more interest income over a longer period of time than they would have expected.

But nonetheless, they are enjoying this higher income and these higher interest rates, and this bill, if it facilitates more refinancing activity, means less interest would come to investors and they would suffer as a result.

Now, my own view is, as I expressed in my oral testimony, is that I think that they have already considered this. They have already priced it. I do not think this is going to have any impact—material impact—on market pricing going forward. I think it is already embedded in market pricing.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you.

I hope I pronounce it right, and correct me if not. Is it Papagianis?

Mr. PAPAGIANIS. That is correct.

Senator SHELBY. OK. Thank you. Mr. Papagianis, in some regions of the country, a major problem facing the housing market is the number of underwater borrowers we have talked about. According to data from FHFA, the vast majority of borrowers who would be eligible for a refinancing under the Menendez-Boxer bill would not only be above water but have at least 20 percent equity in their home. If that is true—this is coming from the FHFA—is the Menendez-Boxer bill likely to materially reduce the number of underwater borrowers?

Mr. PAPAGIANIS. That is an excellent question. I think a couple points are worth keeping in mind here. Generally speaking, the number that people throw out is that there are ten to 11 million people in the U.S. that are underwater. The GSEs are probably responsible or own somewhere between three and four million of those mortgages.

When you think about HARP, and this came up in another panelist's statement, HARP really has helped people refinance that have LTVs between 80 and 105. Since 2009, April 2009 when HARP was established, the GSEs have refinanced more than nine million mortgages for those borrowers that have LTVs below 80. So I think your question is spot on, that there are already refinancing solutions for borrowers that have equity in their home.

Senator SHELBY. Would most of the participants be likely to be borrowers who could already refinance in today's market with low interest rates if their properties were above water and they were making their payments and so forth?

Mr. PAPAGIANIS. If the borrower is current and has equity in their home, there are refinancing programs that the GSEs have that have been very robust. There is a pricing differential, but again, those borrowers have equity, and what we are talking about here with regards to moving potentially to a HARP 3.0 program is to lower the cost. But, really, I think, it is wise for the Committee to think about whether we are really reaching truly underwater borrowers as opposed to those borrowers with equity.

Senator SHELBY. Dr. Zandi, in your testimony, among other things, you state that the Menendez-Boxer bill should be amended to remove provisions that would impose monetary penalties on second lien holders and mortgage insurance companies that do not permit refinances. Why do you think that is necessary?

Mr. ZANDI. Yes, that is a good question. My sense is that second liens and MIs are not a problem with respect to HARP refinancing, that the largest mortgage servicers have agreed that if they have the second lien, they are going to resubordinate, and I have not heard anything to suggest that they are not doing that.

With regard to the MIs, they have all——

Senator SHELBY. Please explain what you mean by this. I understand, but——

Mr. ZANDI. Ah, OK. So——

Senator SHELBY. Say you got a first mortgage lien. You got a second mortgage lien. Ordinarily, if you refinance or pay down or whatever the first mortgage lien, that makes the second mortgage worth more, does it not?

Mr. ZANDI. It does. It does. And so——

Senator SHELBY. So when you resubordinate, tell me—explain what you mean.

Mr. ZANDI. So the second lien has to agree to the refinancing on the first, and so that means I resubordinate. It is just fancy words. I agree. Go ahead. And you would think they have some economic reason for doing it. As you say, you are lowering the monthly payment on the first, so that makes it more likely that they are going to pay on the second. But there have been cases for various reasons where seconds have impeded refinancing, but the mortgage servicers who are participating—the big ones that are participating have agreed under HARP 2.0 rules that they will not do that. Most of the second liens are on their balance sheet. They are going to resubordinate.

Senator SHELBY. If you had, say, a $300,000 first lien on a nice home and you had a $100,000 second lien and you refinance and pay down, you know, somebody takes a haircut or they pay it down themselves, you pay down the first mortgage, then the second mortgage obviously goes up in value, does it not?

Mr. ZANDI. All else being equal, yes, because the probability of fault declines.

Senator SHELBY. Sure.

Mr. ZANDI. Yes.

Senator SHELBY. Mr. Papagianis, what do you think about his recommendation? Do you have any thoughts on it?

Mr. PAPAGIANIS. I agree——

Senator SHELBY. Do you agree with him?

Mr. PAPAGIANIS. I agree. I think subordination of second liens, subordination of mortgage insurance, I believe that that problem has largely been addressed, I think, through HARP 2.0. I do think that FHFA did an admirable job of working with industry to wash away that issue. There may be a few remaining miscellaneous holdouts in that area, but I think, largely, that problem has addressed itself.

Senator SHELBY. One last question to you about FHA reform. I will direct it to you, Mr. Papagianis. The Federal Housing Administration, as we all know, continues to face a severe capital shortfall, making it, a lot of us believe, likely that FHA will eventually need a taxpayer bailout. We hope not, but the numbers indicate that. This is a problem that FHA has been seeing coming for years, but nothing has been done to sufficiently address that. Considering the overall importance of having a stable housing market for our economic recovery, how critical is it that we reform FHA? And the sooner, the better?

Mr. PAPAGIANIS. I think it is very critical, Senator. If not for the AG settlement and specifically the award that was directed to

FHA, FHA would be insolvent this year and would require a bailout. I define a bailout as accepting a loan from Treasury to continue its operations. I think——

Senator SHELBY. A loan that might not ever be paid back——

Mr. PAPAGIANIS. That is correct. I think that there is a consensus in the market that FHA does struggle to manage risk, and I think, moving forward, greater attention should be placed on the agency to ensure the taxpayers are protected and that they are appropriately pricing for the risk that they take on.

Senator SHELBY. Mr. Chairman, I have one, if I could, one quick last question to any of you, probably to Mr. Zandi to start. Explain for the record, quickly, how the default rate on home ownership is much higher than the multifamily. Is it because people have to put more money down on multifamily loans or what? Mr. Zandi, are you familiar with the question?

Mr. ZANDI. Well, I think——

Senator SHELBY. In other words, we have had testimony here——

Mr. ZANDI. Right.

Senator SHELBY. ——that the foreclosure rate with Freddie Mac and Fannie Mae on multifamily properties is very low, whereas the foreclosure rate on single family is pretty high.

Mr. ZANDI. In the current environment, that is very true.

Senator SHELBY. Yes.

Mr. ZANDI. The multifamily market is being driven by very strong absorption demand because of the foreclosure crisis and because of demographics. But in a normalized market, on average, over time, historically, single-family mortgages have performed better than multifamily have.

Senator SHELBY. They have?

Mr. ZANDI. Yes.

Senator SHELBY. OK. Do you have any comment?

Mr. PAPAGIANIS. I really do not have any.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Menendez was absent on the floor doing other business, and because he has a leading role in the Menendez bill, I will afford him extra opportunity to begin with an opening statement followed up by questions.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Mr. Chairman, thank you for your courtesy and those of the Members, as well. I was on the floor on something that is incredibly important to New Jersey, which is the FDA reauthorization, as we are the medicine chest of the world. So I appreciate your courtesy and I appreciate you and the Ranking Member holding this hearing specifically on the Menendez-Boxer legislation, which I think is incredibly important.

As I have said many times, we need to fix the housing market in order to get the broader economy moving again and create jobs, and fixing the housing market has to involve multiple strategies to attack the problem from different angles. And to me, refinancing should be one of those strategies, particularly for borrowers who are making their payments but whose interest rates on their mortgages are above today's interest rates of four to 5 percent.

And that is why Senator Boxer and I introduced the Responsible Homeowner Refinancing Act of 2012. The goal of the bill is very simple. Any homeowner with a Fannie or Freddie loan should be able to get a pre-approved package in the mail from their lender, sign on the dotted line, and be automatically put into a refinanced loan that saves them hundreds of dollars a month. No more lending bureaucracy. No more red tape. It should be simple for any homeowner to do this.

That is why our bill is supported by borrower groups, by the National Association of Realtors, the National Association of Home Builders, many lenders, like Quicken Loans, some mortgage investors, like Amherst Securities, and by small business groups.

Our bill will help the 17.5 million borrowers who have Fannie Mae and Freddie Mac loans but who are trapped paying interest rates above 5 percent because of barriers to that refinancing. Most estimates are that it is likely to help an additional three million borrowers to refinance, although that depends on how many borrowers actually take advantage of it.

Our bill will make it easier for homeowners to refinance and lower their mortgage payments, which is both a popular and common sense way to help the housing market, and by the way, I would say help the economy, as well. If I have that roof that has been leaking and all I can do is afford to patch it up, but now I have the wherewithal to fix it, I am going to both preserve my property, preserve its value, and at the same time go ahead and hire somebody to do that, and that creates a ripple effect in our economy.

Allowing a homeowner to refinance from a loan that is at 6 percent interest to a loan that is 4 percent interest, for example, would save them hundreds of dollars a month, putting more money in their pockets and reducing defaults and foreclosures.

Some, but not all, of the refinancing barriers—I heard discussion here about what has already happened in FHFA's HARP expansion called HARP 2.0—not all of the barriers to refinancing were addressed there. For example, HARP 2.0 removed loan-to-value caps for underwater homeowners but does not apply to borrowers under 80 percent loan-to-value ratio, who theoretically should be able to refinance but in practice sometimes cannot. My office has heard from New Jersey homeowners who are in exactly this situation.

FHFA's scaled back lender liability for representations and warranties, which lenders cite as an obstacle to encouraging them to extend refinance loans for same servicer refinances in HARP 2.0, but they did not scale back representations and warranties liability for cases where a different servicer was refinancing the loan, which has led to a lack of competition among lenders that has resulted in much higher interest rates for borrowers, according to analysis from Amherst Securities and many others. It seems to me—that is something I know many of my colleagues support—competition—we need to inject competition and market forces into this market where servicers have an unfair monopoly on refinancing certain borrowers who effectively have no choice but to use their original lender.

Another obstacle, and I have heard discussion on this here today, is that second mortgage holders and one particular mortgage insurer, United Guarantee, do not always allow their interests to be transferred to a new refinance loan even though they are generally better off when the first mortgage refinances to a lower payment since that makes the loan less likely to default and the homeowner more likely to be able to pay the second mortgage, as well.

So I compliment the other mortgage insurers for working with FHFA to streamline these refinances and transfer their interest automatically. But United Guarantee is an AIG subsidiary, a TARP bailout recipient, that has not agreed to do that, thereby hindering refinances and costing both homeowners and Federal taxpayers money. It is pretty amazing to me.

Another obstacle is up-front fees and appraisal costs that homeowners without savings cannot afford keep them trapped in high-interest loans. And yet another barrier is verification of income tax returns and other paperwork which is needed for new loans but not necessary for refinance loans where the borrower is already making payments on time. And I was gratified to hear, Mr. Chairman, at our subcommittee hearing that I chaired a few weeks ago from every witness representing all points of view that they did not think this paperwork was necessary for refinance loans. For these Fannie and Freddie loans, taxpayers already own the risk if these homeowners default regardless of whether we allow the homeowner to refinance or not.

So stopping homeowners from refinancing into lower-cost loans where they are less likely to default harms both homeowners and taxpayers and is obviously, in my mind, terrible policy. FHFA needs to change this now. This is urgent because we do not know how long those low interest rates will remain. And once interest rates rise, it will not make any sense for homeowners to refinance. Every day the FHFA and Congress delays is another day that both taxpayers and homeowners are losing millions of dollars.

Finally, one of the best aspects of the Boxer-Menendez Responsible Homeowner Refinancing Act is that according to preliminary CBO estimates, it will stop bailouts, it will save taxpayers money because fewer homeowners will default when their mortgage payments are lowered. That means that it is not a cost, according to that preliminary estimate.

So, Mr. Chairman, I appreciate that opportunity and I just have two questions. One is to Mr. Emerson. Do you believe that current HARP 2.0 policies give an advantage to the borrower's existing lender, thereby reducing competition among lenders and increasing interest rates for borrowers?

Mr. EMERSON. Senator, I believe that that is the case, simply from the fact that it is, as you said, more difficult and more risky for a new originator to take on the rep and warrant risk associated with the way the loan is originated today, and that as a result of that, they are staying away from doing a lot of the HARP 2.0 loans.

And I think another point that is important is velocity, and you mentioned, you know, we do not know how long it is going to be before rates go up. We may get to 2.5 million borrowers if we do nothing, but how long is it going to take to get there? And I think the sooner that we can act and open up the origination capabilities of the entire country to help these homeowners, the better opportunity we are going to have to help more of them faster and make sure they get into the low rates that exist today.

Senator MENENDEZ. Well, it seems that only the FHFA are about the only ones who think that HARP 2.0 is not limiting competition.

Let me ask Mr. Veissi and, for that fact, anyone who wants to join in, another obstacle to refinancing is that second mortgage holders, as I said, and mortgage insurers do not always allow their interest to be transferred to a new refinanced loan, even though they are better off when the first mortgage refinances to a lower payment since that makes the loan less likely to default and the homeowner more likely to be able to pay the second mortgage. Does it make sense to require automatic portability to the refinance law?

Mr. VEISSI. That is an interesting concept. What we hear, Senator, across the board is a little bit different than the statistical evidence that you get, and I deal with folks from California to New Jersey and back down to Florida, again, across the country, and we are hearing again and again that secondary financing in many cases holds up both refinancing and, in many cases, sales. I would have to think about the answer to that question and maybe confer with you, but my knee-jerk may be that that might be an interesting opportunity.

Senator MERKLEY. Mr. Emerson, what do you think?

Mr. EMERSON. I think we are open to looking at how do we make that process better from a subordination perspective. I do think that there are a lot of second lien holders that are subordinating. I think, though, that the problem is that in the process, it becomes very cumbersome. It is very time—there is a time delay in the information. Many times, you are not—with this HARP program, you are not utilizing an appraisal because there is no need to. But when you subordinate, the second lien holder requires that appraisal and so you now have to go out and charge additional monies to get an appraisal when you do not need it for the first lien.

So while I do think that a lot of people are—a lot of lenders are subordinating. The process itself needs to be dramatically improved. We hear that every day from homeowners. So some form—I do not know if portability is the right answer, but we do need to figure out a way to make that process a little more streamlined.

Senator MERKLEY. Would our bill largely take care of most of what you are concerned about in the context of the process?

Mr. VEISSI. Based off of what I have read so far, I think it goes a long way to getting there, yes.

Senator MENENDEZ. Finally, Mr. Zandi, I am not sure if you say the Federal lender survey that came out recently, but it indicates that mortgage insurance and second liens are, in fact, obstacles to HARP refinancing. I would call your attention to it because I do believe this is one of our challenges in moving forward, and that survey made it pretty clear that these are elements of a real challenge and that is something we seek to take on in terms of the legislation.

Mr. ZANDI. Can I just make one quick point? I think the legislation, the key points of the legislation, are very good, and if enacted quickly, given the rate environment, are going to have a very significant impact. I think, though, to try to complicate it in any way, unless it is absolutely clear that that is going to make it better, is a mistake because it is going to slow things down. It is not going to get done and you are going to lose your window. So you have got to—I would err on the side of being parsimonious here in getting what can be done done, because we are really close to generating a lot of refinancing activity.

Senator MENENDEZ. Thank you for your courtesies, Mr. Chairman.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman, and, you know, while I have a bias—I began with a bias—and I say this to the Senator from New Jersey—we have had 16 programs now trying to fix the housing, and I do think we have done a lot to try to jigger things around. I am open to looking at this and I have some questions that I hope you will consider legitimate as you look at trying to move this legislation through.

And I want to thank the Chairman for having this hearing and I hope—I noticed the other day he left to go to a markup in Appropriations, so I know he knows what those are, and I hope that we will have a markup on this bill, a real markup. I think the Senate has not been functioning properly because we have been air dropping things in, and yet I notice when we pass things out of committee in a bipartisan way, they actually seem to happen, and I hope we will have a markup on this bill.

But with those editorial comments, I would ask—my questions really go to Mr. Papagianis and Dr. Zandi today. I thank all of you for your testimony.

One of the things that—and I notice in this bill, I guess you could just continue to refinance. Would it be fair to say that each homeowner could only use this program one time? Would that be a legitimate parsimonious move to make?

Mr. ZANDI. Yes. I think that would make sense, just to move this thing along. I think that would be an appropriate thing to do. One time, get it done.

Senator CORKER. And you agree?

Mr. PAPAGIANIS. I agree with that.

Senator CORKER. I do not know about the sponsor. I hope so.

Is there a way to do the streamlining in such a way that—and I really appreciate the desire to do that and I certainly appreciate the attempt of the Senator from New Jersey to solve this problem—but is there a way to do it without vitiating the GSEs' ability to put these loans back? In other words, we are saving the taxpayers a lot of money by putting loans back where originators did not follow appropriate guidelines. Is there a way we could streamline this but not give up the right to put it back if things were done inappropriately on the front end?

Mr. ZANDI. Could I say, this is why I think you would only want to do it once, right, because if you allow one refi, then you have—and you have a history with this borrower, in most cases you have several years of history with the borrower, they are current on the loan and you are confident there is not fraud and misrepresentation, that is why it makes sense to do the streamlined refinancing, relaxed rep and warranties, and no recision rights. The MI companies are saying, listen, I have a good experience with this and my economics say I can do this without any recision rights. So once, it makes sense to me.

If you start doing it over again, then you do not have that experience and you may—you just do not know and I think it becomes more of an issue. But once, I think you have got that experience and I do not think we need to do anything. We understand what the risks are and we can go forward.

Mr. PAPAGIANIS. I agree with that.

I think one other issue, and it has come up earlier on the panel, thinking with regards to new servicer refinancing versus same servicer financing and whether in a new servicer situation income needs to be verified—that is one of the challenges that has been presented here before the Committee—I do think it is important to keep in mind that from the GSEs' point of view, and this speaks to rep and warranty risk, is it is really in everybody's interest to ensure that the borrower does have a job and does have income in this situation because it may be that a refinancing is actually not the best option for that borrower. It may be that they should have a modification and they should go through HAMP as opposed to HARP. And I think that is an important point and I do not think it gets talked about enough.

Senator CORKER. I just have a couple more questions, if we could be brief. The changing of the dates—I mean, one of the problems that we are having right now is the huge reliance on Government refinancing. The private sector is on strike, and for good reason. I know all of us want to encourage them back in. But I think there has been sort of an unwritten rule that all loans made prior to June of 2009 were fair game, but anything after that, they had a chance to refinance in a low environment, low interest rate environment, and we would not fiddle with things beyond June of 2009. Would it be an appropriate thing, an appropriate ask on this bill to say that the date should not be June of 2010 but should be June of 2009 so that we, again, do not continue to rattle the private sector side? The two of you.

Mr. ZANDI. I think that is appropriate. I think June of 2009, because, again, you want a historical record and you need that to relax the reps and warranties and give up the recision rights. But moreover, I do not think you are giving up very much, because between June of 2009 and June of 2010, I am not really sure what we are talking about here. The rates were pretty low. So I do not think you are going to give up a whole lot of potential refis by moving the date back to 2009, but you do get the benefit.

Senator CORKER. And since I see a "yes" from the other person, we will leave it there.

And again, I appreciate the streamlining of all this. I know the GSEs have asked if they could at least collect data, not for underwriting, but just so they could continue their risk management processes. Would it be appropriate for them to still collect data if they did not use it—in other words, they continued to streamline these, but they had that data available for future risk management opportunities?

Mr. ZANDI. Well, actually, I would be surprised if they would not do that——

Senator CORKER. Well, the bill prevents them from doing that.

Mr. ZANDI. Oh. OK. I am not sure why that would be the case.

Mr. PAPAGIANIS. I agree. I think it is important to collect that.

Senator CORKER. So I appreciate the input and I certainly hope the sponsors will consider some of the changes that have been proposed by these questions.

I will close by saying the whole junior lien process, to me, has been incredible, that we have given the mortgage servicers in this country such a home run win with all these programs, and yet, you know, typically, a junior lien gets extinguished when something happens with the primary mortgage. And I just hope that this bill does not address that. I know you all talked about some potential changes to make this simpler, but I do hope at some point this Committee will look at this whole junior lien process and realize that, in many cases, these guys have received a huge, huge benefit, I would say unnecessarily so in many cases. You know, there is a big conflict of interest between the servicers and the primary mortgage holders because they hold the second mortgage and they are basically benefiting themselves.

But I thank you for your testimony and, Mr. Chairman, for the hearing.

Chairman JOHNSON. Thank you.

Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair. I have noticed that at a lot of these hearings, we have a similar collection of Senators and I really appreciate my colleagues on both sides of the aisle continuing to wrestle with this issue of mortgages. Certainly, the family home has been such a pathway to the middle class for families across America, and through the whole subprime debacle, 2003 forward, that was deeply damaged and I appreciate colleagues coming back time and time again to wrestle with how we restore home ownership as a pathway to wealth, equity, a piece of the American dream, if you will, for the American family.

A couple quick questions, and I am going to direct these to Dr. Zandi. In your testimony on page three, you note that of the HARP loans, just more than 100,000 out of 1.2 million have been families underwater. That is roughly 8 percent. So you have this other 92 percent that benefit in the HARP program but were not underwater. The question keeps coming up, did HARP need to exist for those families, and if so, what is the short answer, why?

Mr. ZANDI. Yes, because there are other criteria other than LTV determining whether you get a refinancing, right. So it is back-end DTI, meaning what are your other debts, what is your credit score, other factors, and many of those borrowers, because they were kind of on the edge in terms of equity, were getting dinged and could not get refinancing, so I think it did help quite a bit.

Senator MERKLEY. Have you had any ability to analyze the statistics in terms of families that could or could not get refinancing without HARP? And let me throw an anecdote in here.

Mr. ZANDI. OK.

Senator MERKLEY. When I sought to refinance my house, the mortgage agent sent me a HARP refinancing and I called up and said, "Why are you sending the HARP refinancing? This is for folks who have X, Y, and X." And she says, "Well, we are just utilizing that in virtually every case." I thought that was very interesting and it suggests to me that perhaps there are some sizable number of folks—and by the way, I did not get a HARP loan—but——

Mr. ZANDI. Can I ask when that was? Was that recently?

Senator MERKLEY. That was 2010.

Mr. ZANDI. Oh, it was 2010.

Senator MERKLEY. Yes, 2010.

Mr. ZANDI. All right. Yes. So you are asking for the counterfactual, what would it have been without the HARP. I can think about how I might try to approach that. I do not know the answers——

Senator MERKLEY. OK. No need to dwell on it, but it goes to some of the questions that have been raised.

Mr. ZANDI. Right.

Senator MERKLEY. Second, in your spoken testimony, you referred to—that the bond holders have done pretty well by those who are trapped in underwater mortgages. Christopher Mayer testified here and said bond holders have received $60 billion over the last 3 years in excess mortgage payments from homeowners trapped in high interest rate loans. I am assuming to some part, also, though, that folks trapped in underwater loans who have then defaulted, bold holders have lost something there in terms of being able to get their full principal back. Is there a sense of how these two factors have weighed against each other, the benefits of the higher interest—being trapped in higher interest loans versus the foreclosures in that sector?

Mr. ZANDI. Well, generally, in the prepay models that they use, they also account for default. That is just a form of prepay. And if you look at the models, they were all saying this should have all been prepaid out a lot faster, so even accounting for the default. So I think they benefited net quite significantly.

And then, you know, that is kind of first order. Second order effects would be quite significant. What I mean by that is all the things that policy makers did to support the housing market, to stabilize the housing market, obviously were for the benefit of investors, right, because you would have had house prices fall to a much greater degree. There would have been many more foreclosures. It would have been much more of a mess and their losses much greater. So I think it is pretty clear, on net, they have benefited enormously from Government policy.

Senator MERKLEY. Great. Thank you, because that issue of also being affected by the defaults is brought up sometimes when the point is made——

Mr. ZANDI. Yes.

Senator MERKLEY. ——that you had made.

You also mentioned in your testimony the Rebuilding Equity Act, which is a strategy that I put forward to encourage folks who are refinancing who have essentially the choice of do they want to refinance to a lower interest rate, benefit from lower payments, or is it valuable for them to benefit from lower interest but make larger payments and have a shorter term, a 15- or 20-year term. And when you look at the comparison of how quickly people get out from being underwater with the 15- or 20-year strategy, it is substantial. Folks who are 25 percent underwater are largely out from underwater after 5 years under a loan between 15 and 20 years. Does it make sense to help incentivize this option?

Mr. ZANDI. Yes. I think this is a great piece of legislation. I think it is a nice corollary with Senator Menendez's legislation. Basically, you are giving the homeowner an option. Either they can go for the lower monthly payment or they can—they could get a smaller reduction in their monthly payment and use some of the saving to pay down principal quickly and get out from under more quickly. So I think it is a nice option and we are incenting them to save and build equity, which is in everyone's, I think, best interest.

Now, obviously, there is a cost involved. I do not think we are talking billions. We are talking probably hundreds of millions. It depends on the take-up. But that has to be paid for. But I think the reasonable ways of doing it, you can even ask the homeowner to pay for it in the form of a slightly higher interest rate, you know, something like that, over time. Basically, you are taking the closing costs, instead of asking for them up front, you are extending it over a longer period of time and it makes it just—it is an incentive and you get them toward building equity, which, again, I think is in everyone's interest. So I think it is a great idea.

Senator MERKLEY. OK. Thank you very much. Thank you.

Chairman JOHNSON. I would like to thank all of our witnesses for being here with us today. Senators Menendez and Boxer have a substantive bill that seeks to provide relief and assistance to responsible homeowners and I hope we can work together to move it forward.

This hearing——

Senator MERKLEY. Mr. Chairman?

Chairman JOHNSON. Yes?

Senator MERKLEY. Before you close the hearing, I said it to Senator Corker as he was leaving. Unfortunately he had to leave, but I just want it for the record. On the question, our legislation does not prevent data collection. It simply does not require it, and there is a fundamental difference. But I look forward to working with him and other Members of the Committee to get to where we want to be.

Chairman JOHNSON. This hearing is adjourned.

[Whereupon, at 11:09 a.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF BILL EMERSON

CHIEF EXECUTIVE OFFICER, QUICKEN LOANS, INC.

MAY 24, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Senate Committee on Banking, Housing and Urban Affairs, I thank you for your invitation to testify at today's hearing for this very important issue: S. 3085: "Responsible Homeowner Refinancing Act of 2012". My name is Bill Emerson and I am the CEO of Quicken Loans, an independent Detroit, Michigan-based conventional, FHA, and VA retail residential mortgage lender.

As background, Quicken Loans has been in business since 1985, and has approximately 5,000 employees, most of them working in downtown Detroit. We do business in all 50 States and are the Nation's largest online lender, one of the four largest retail mortgage lenders, one of the three largest FHA lenders, and a top five VA mortgage lender. We closed over $30 billion in mortgage loans in 2011, helping almost 150,000 homeowners.

JD Power and Associates has ranked Quicken Loans highest in Customer Satisfaction for Primary Mortgage Origination in the U.S. for years 2010 and 2011.

My testimony will address HARP, HARP 2.0, the differences between the representations and warranties of a "same servicer" and "new originator" and how this affects the approximate four million underwater homeowners in America.

HARP 1.0

Has HARP 1.0 been a success? According to the FHFA's Web site, HARP 1.0, which was introduced in 2009, assisted about 900,000 homeowners through October 2011. On the surface, that seems like a large number. But upon closer examination, there was a missed opportunity to help those who faithfully make their mortgage payment each month, but find themselves unable to take advantage of today's low rates simply because they owe more than their home is worth.

Of the 900,000 HARP refinances, only about 200,000 have been to homeowners who owe more than their homes are worth. The rest were "coded" by the Government Service Enterprises (GSE's) as HARP loans, but actually were made to consumers who still had equity in their homes.

Further, estimates show that there are about four million underwater homeowners who are in a mortgage backed by the GSE's, current on such mortgage and employed. These homeowners could be eligible for a HARP refinance but for their mortgage being underwater. In other words, only some 200,000 eligible homeowners have been helped out of roughly four million who need help. By this key measure, HARP has been less than successful. More should be done to help these homeowners.

HARP 2.0

HARP 2.0 is positioned to help more homeowners than HARP 1.0, and we applaud the current Administration, the FHFA, the GSE's and the mortgage industry for working together to improve the HARP product by rolling out HARP 2.0. However, HARP 2.0 still is not designed to help enough underwater homeowners and as a result, we do not think enough of the four million homeowners who are eligible for HARP 2.0 will be provided with the assistance they need.

Why will HARP 2.0 fail to help many of these four million homeowners?

The answer lies in the difference between the risk the homeowner's existing servicer (same servicer) must bear under the HARP 2.0 program versus the risk any other mortgage originator (new originator) must bear under the program.

The risks borne by same servicers and new originators under HARP 2.0 are different because the underwriting guidelines that a same servicer must follow, as compared to the underwriting guidelines that a new originator must follow, are VERY different.

To refinance a borrower into a HARP 2.0 loan, a same servicer is not required to verify the borrower's (i) debt-to-income ratio calculations, (ii) income, or (iii) assets. The same servicer only needs to verify that the borrower has a viable source of income. The new originator, on the other hand, must calculate a debt-to-income ratio, and verify income and assets.

Both the same servicer and new originator have the same clean title requirements and same appraisal guidelines (if an appraisal is required).

Both new originators and same servicers are required to represent and warrant to the GSE's that they are originating and underwriting loans according to GSE guidelines. If the originator is found to be in violation of a representation and warranty, the originator is required to repurchase the loan. The GSE's routinely challenge the appraisals on loans. In many such cases, the challenges are predicated on simple differences of opinion on the values that third party, licensed appraisers provided. It is almost impossible for a lender to defend themselves in such situations, and they wind up having to repurchase many loans. In addition, the GSE's often require repurchases based on other flaws—however minor—in the origination and underwriting process. Sometimes such flaws are extraordinarily difficult to prevent (for example: a borrower who takes out a credit card or auto loan one day before the loan closes), and originators are required to repurchase loans, even though they acted diligently. Data models show that as a loan's loan-to-value ratio (LTV) rises beyond 100 percent, default rates begin to rise precipitously. When the LTV exceeds 125 percent and beyond, default rates skyrocket. Because many HARP 2.0 loans are deeply underwater, there is great risk of default, and losses on any loan that goes into default can be substantial. It's not uncommon for a minor flaw on an underwater loan to cost $100,000 or more.

Because the new originators have more difficult underwriting requirements than same servicers, the new originators bear a much higher degree of repurchase risk via their representations and warranties. Accordingly, most prudent new originators stay clear of any HARP 2.0 loan where the borrower is underwater, and for the most part HARP 2.0 loans are originated by same servicers, who bear less risk.

The reluctance of new originators to fully participate in HARP 2.0 has limited HARP 2.0's success. Roughly 70 percent of all GSE mortgages are being serviced by the largest servicing firms. Because these same servicers can originate HARP 2.0 refinances with reduced risk, these servicers must carry the load of trying to administer the HARP 2.0 program.

Notwithstanding the good intentions of the large servicers, they will simply not be able to help all HARP 2.0 eligible borrowers. Given all the other duties these larger servicers must perform aside from originating HARP 2.0 loans, they simply can't ramp up their platforms and hire and train people fast enough to help these millions of homeowners. Additionally, some of the large servicers have greatly reduced or eliminated their origination platforms, thereby significantly reducing access to credit for the HARP 2.0 borrowers being serviced by these large firms.

Because we are from the Motor City, we will provide a car-related analogy.

The current HARP 2.0 program which funnels all underwater borrowers to their current loan servicer for their new HARP loan is analogous to a car recall program which requires all car owners whose car has been recalled to return their cars to the factory for the needed repairs, as opposed to visiting one of the many dealers in the nationwide network that are capable of fixing the problem. Such a recall system would never work, and yet that is exactly how HARP 2.0 is set up today.

The GSE's already bear the risk on these loans regardless of who is originating the loans. So there is no viable reason to create artificial barriers that effectively block new originators from using the HARP 2.0 program to assist homeowners and to enable the GSE's to improve their risk position. Because HARP 2.0 is being utilized mostly by a small number of firms, the demand for HARP 2.0 originations is dramatically exceeding the supply of firms who fully offer the program. The imbalance between supply and demand has caused the price of the new HARP 2.0 mortgage to be higher than it normally would be if competition existed. Same servicer HARP 2.0 has created an oligopoly and, by any measure, oligopoly pricing is in play.

S. 3085

The "Responsible Homeowner Refinancing Act of 2012" (the "Act") goes a long way toward addressing many of the underlying problems. Our comments are below.

Eligibility

Allowing a new originator to operate under same servicer guidelines resolves almost all of the issues we've addressed above. The current draft of the Act requires that the GSE's allow all originators to originate loans under same servicer guidelines. This alone would be a major breakthrough. It would enable every loan originator in the country the opportunity to help the four million HARP eligible borrowers.

We strongly support the intentions of the Act to instruct the GSE's to allow all mortgage originators to use the same servicer guidelines.

Appraisals

On roughly 80 percent of HARP 2.0 loans, the GSE's will provide originators an automated valuation that can be used in lieu of an appraisal. Because this valuation comes from the GSE's, the originator does not represent or warrant the value, marketability, condition, or property type of the home that collateralizes the HARP 2.0 mortgage.

On the remaining 20 percent of HARP 2.0 loans that require an appraisal to be completed by a licensed appraiser, there is great and unquantifiable risk to originators. It is very common for the GSE's to require that an originator repurchase a loan if, many years after the loan was closed, the GSE's decide to challenge the value the independent 3rd party appraiser provided at time of origination.

Insuring a 3rd party appraiser's opinion is always risky, but it is downright irresponsible on a loan that is deeply underwater. This reality has led most originators to put restrictions or overlays on the HARP 2.0 appraisal and LTV guidelines.

We support the language in the Act that provides that on HARP 2.0 loans, the originator should only be required to comply with the GSE's methods and standards for properly ordering the appraisal and choosing the appraiser. The lender should not be required to warrant the value, marketability, condition or the property type that is evidenced by the appraisal or any allowable alternative valuation methods.

Re-Subordination of Second Liens

We support the spirit of the Act requiring that lenders subordinate to HARP loans.

Mortgage Insurance

We support the spirit of the Act requiring that all mortgage insurers participate in the HARP 2.0 program.

Consistency

We also agree with the language in the Act suggesting that the FHFA issue guidance requiring the GSE's to make their refinancing guidelines under the HARP program consistent with each other to ease originator compliance requirements.

Remove Barriers That Make Borrowers Ineligible for a HARP Loan

There are barriers which may cause a borrower to be ineligible for a HARP 2.0 loan, such as:

- Credit enhancements
- Repurchase request outstanding
- Loan was previously an alt A or subprime loan

We believe the current language in the Act removes these barriers.

Automated Underwriting

We think the Act should address the use of automated underwriting systems—Desktop Underwriter (Fannie) and Loan Prospector (Freddie). These systems should provide insight into key data required to determine eligibility for a HARP program as well as data necessary for the refinance.

The systems should confirm:

- The loan is eligible for a HARP refinance via confirmation of all guideline requirements, identity of borrower(s), and property address
- The estimate value of the property when/if an appraisal is not required
- Provide all mortgage insurance data applicable to perform a HARP MI Modification

Conclusion

If the "Responsible Homeowners Refinancing Act of 2012" can remain exclusively focused on improving HARP 2.0 and avoid complicated detours into other subject matters, the new version of HARP 2.0 could help millions of underwater borrowers in short order. Therefore, we support the Act as proposed.

Thank you for allowing me to testify on this very important topic.

PREPARED STATEMENT OF CHRISTOPHER PAPAGIANIS

MANAGING DIRECTOR, E21: ECONOMIC POLICIES FOR THE 21ST CENTURY

MAY 24, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify at this legislative hearing on "The Responsible Homeowner Refinancing Act of 2012." I am the Managing Director of the nonprofit think tank e21: Economic Policies for the 21st Century (also known as Economics21). We aim to advance free enterprise, fiscal discipline, economic growth, and the rule of law. Drawing on the expertise of practitioners, policy makers, and academics, part of our mission is to foster a spirited debate about the way forward for democratic capitalism. We are supportive of free markets while recognizing the need to devise and implement a reasonable structure of law and regulation that will help ensure our markets avoid catastrophic events in the future. We are therefore focused on developing policies that advance market performance and implementing rules to prevent market malfunction.

Previously, I was Special Assistant for Domestic Policy to President George W. Bush over the last few years of his Administration. In this role, I helped guide the collaborative process within the Executive Branch to develop and implement policies, legislation, and regulations across numerous agencies, including the Departments of Treasury and Housing and Urban Development.

Today, I will focus on the following themes and provisions:

1. Reflections on the "evolving" housing market—supply and demand dynamics.
2. Micro-policy uncertainty (servicing, underwriting, and GSE reform).
3. The Responsible Homeowner Refinancing Act—Overview.
4. Realistic expectations for "more" refinancing—HARP 2.0 to 3.0.
5. Expanding the initial objective of HARP.
6. Addressing representation and warranty issues (i.e., putback risk).
7. Loan Level Pricing Adjustments and other fees.
8. Mortgage insurance and second liens.
9. Moving the cut-off date and "re-Harping" loans.
10. Efforts to increase homeowner awareness of HARP.

1. Reflections on the "evolving" housing market—supply and demand dynamics.

Six years have passed since aggregate house prices started to decline. Yet, the housing market remains weak and any looming rebound in 2012 or 2013 is uncertain.

Over the last few years, house prices have been under tremendous downside pressure. Distressed sales from foreclosures and the shadow inventory have been large contributing factors. Broader economic forces have also been at work, including high levels of unemployment, stagnant income or wage growth, and negative wealth effects from the decline in home equity.

Without a doubt, there is still a great deal of stress across both the demand and supply dimensions of the housing market, as demonstrated by the thousands of borrowers that are still struggling to make their payments and stay in their homes.

However, it's important to acknowledge that many of the major negative trends that have dominated the headlines since the crisis are now well off their post-crisis peaks. New delinquencies are trending lower on a percentage basis.[1] The decline in home prices also appears to be leveling off or approaching a bottom on a national basis. While prices are only flat to slightly down year-over-year, there is finally some optimism in this area for probably the first time in more than 3 years. Data from Corelogic suggests that house prices have increased, on average, across the country over the first 3 months of 2012 when excluding distressed sales.[2]

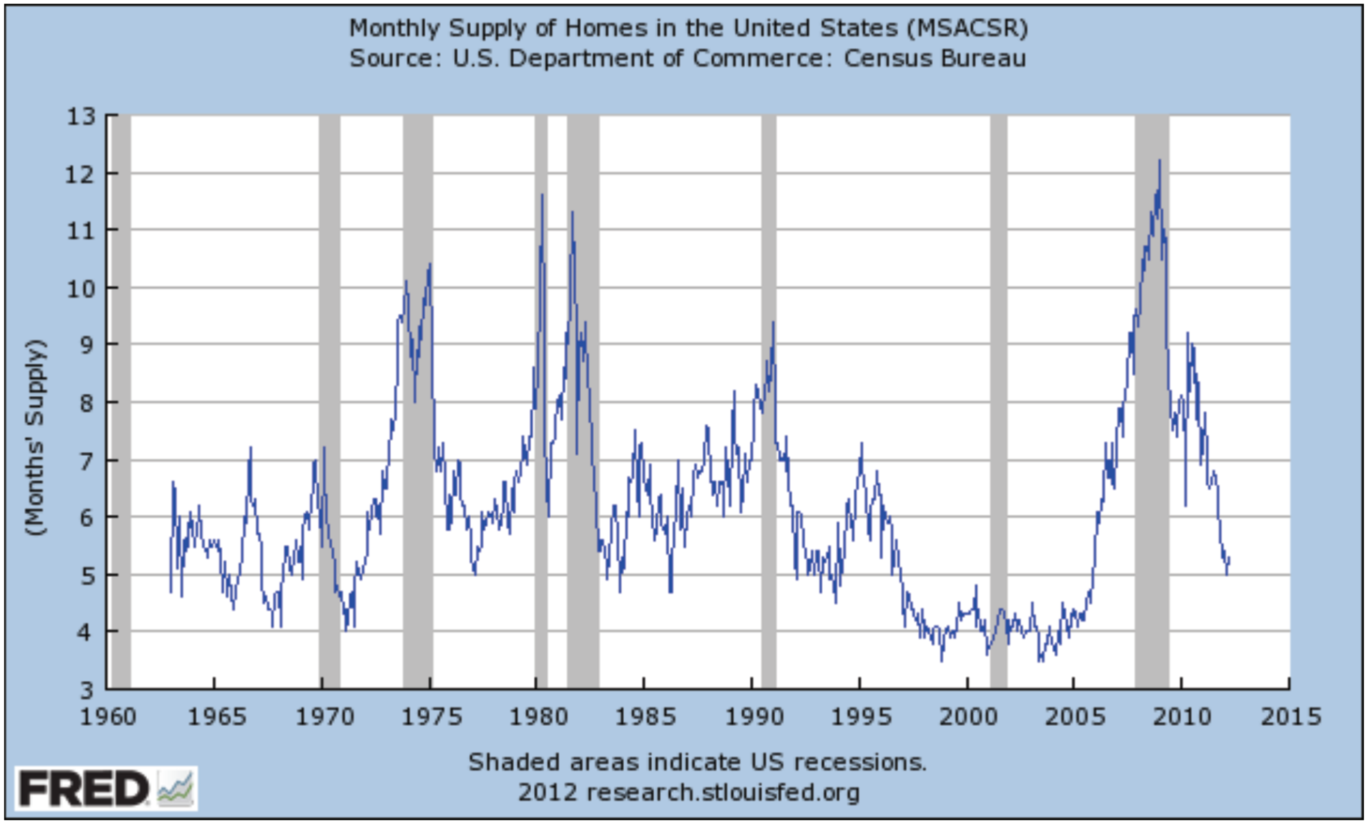
A somewhat under-reported development in the market is the relative decline in the supply of homes for sale.[3] The chart below shows how the existing stock of homes for sale is now approaching a level equal to 5–6 months of sales.[4] This is a very promising development. According to the Commerce Department, the housing inventory fell to just over 5 months of sales in the first quarter, the lowest level since the end of 2005 (see the chart on the following page).

[1] *http://www.lpsvcs.com/LPSCorporateinformation/NewsRoom/Pages/20120424.aspx*

[2] *http://www.corelogic.com/about-us/news/corelogic-march-home-price-index-shows-slight-year-over-year-decrease-of-less-than-one-percent.aspx* and *http://www.calculatedriskblog.com/2012/05/corelogic-house-price-index-increases.html*

[3] *http://online.wsj.com/article/SB10001424052702304723304577366294046658820.html*

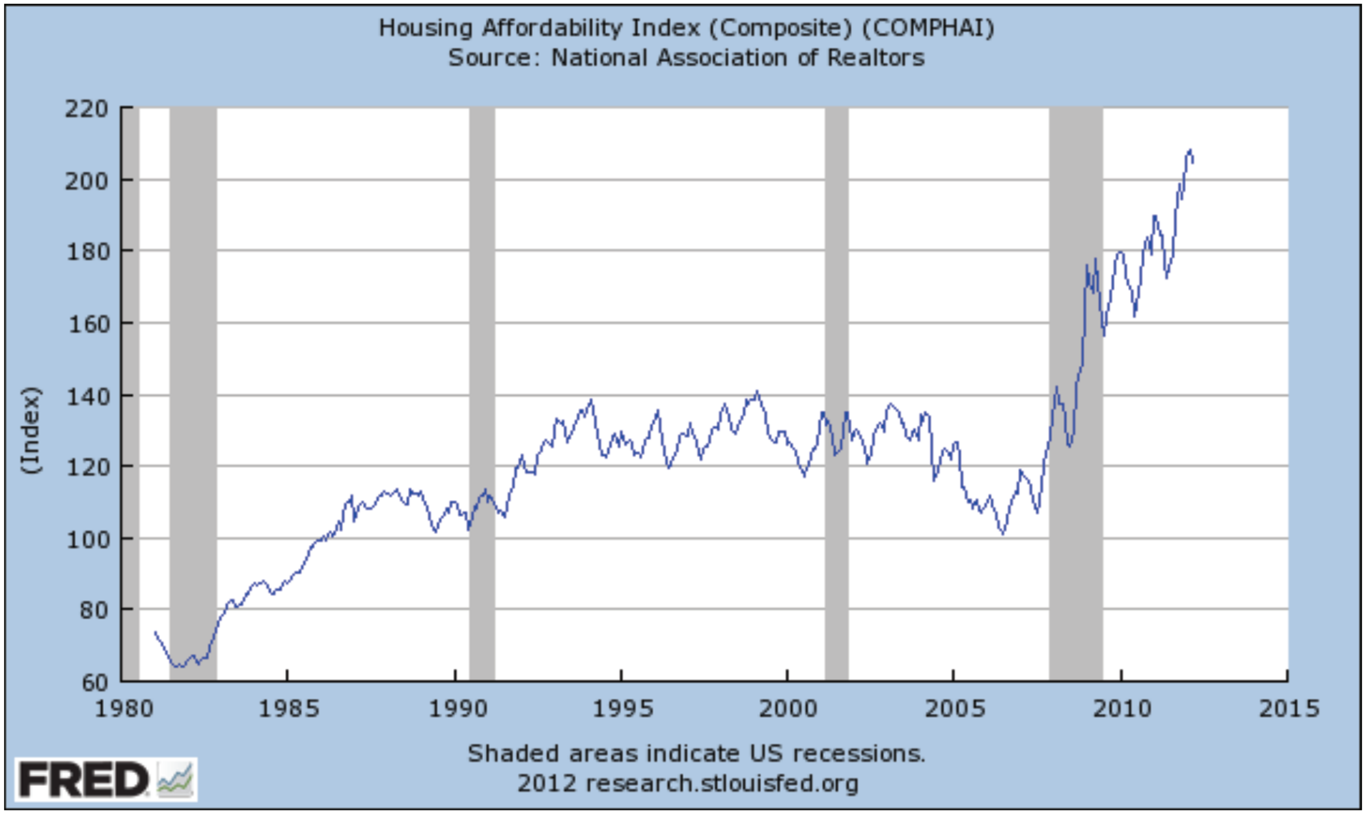
[4] Monthly Supply of Homes in the United States (MSACSR); Source: U.S. Department of Commerce: Census Bureau.


Monthly Supply of Homes in the United States (MSACSR)
Source: U.S. Department of Commerce: Census Bureau
(Months' Supply)
13
12
11
10
9
8
7
6
5
4
3
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate US recessions.
2012 research.stlouisfed.org
FRED

In short, the level of housing supply today suggests that the market is close to equilibrium, which implies house prices should rise at a rate consistent with rents. Market analysts often look at a level above or be low 6 months of sales as either favoring buyers or sellers respectively. It's not surprising then that the recent stabilization of home prices nationally has occurred as the existing inventory, or supply level, has declined.

A couple of important caveats should be kept in mind, however. First, almost any discussion of national inventory trends can gloss over regional problems, or acute supply challenges in individual State markets. Second, the transaction data around home sales suggests that any near-term demand–supply equilibrium is occurring off of an extremely low base. In essence, weak demand for single-family homes appears to have eclipsed the supply challenge moving forward for the housing market.

Consider that the National Association of Realtors Home Affordability Index is at its highest level in decades.


Housing Affordability Index (Composite) (COMPHAI)
Source: National Association of Realtors
(Index)
220
200
180
160
140
120
100
80
60
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate US recessions.
2012 research.stlouisfed.org
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The Realtor's index measures the "affordability" of a median-income family purchasing a median-priced home (using a 20 percent downpayment for a 30-year fixed rate mortgage). All of which is to say that house prices look low on a historical, user-cost basis.

So, this begs the question—why are existing home sales still so depressed? After all, the Mortgage Bankers Association has reported that their index for purchase activity is at an approximately 15-year low.

One of the major impediments to a rebound in demand for housing is tight lending or underwriting standards. Earlier this month, Federal Reserve Chairman Bernanke commented on this trend by reviewing information from the latest Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS):

> To be sure, a return to pre-crisis lending standards for residential mortgages wouldn't be appropriate; however, current standards may be limiting or preventing lending to many creditworthy borrowers. For instance, in the April SLOOS, we asked banks a hypothetical question about their willingness to originate GSE-eligible mortgages relative to 2006 for borrowers with a range of credit scores and available downpayments. The SLOOS found that even when the loans were accompanied by a 20 percent downpayment, many banks were less likely to originate loans to borrowers with given GSE-eligible credit scores, despite the originating bank's ability to sell the mortgage to the GSEs. Most banks indicated that their reluctance to accept mortgage applications from borrowers with less-than-perfect records is related to "putback risk"—the risk that a bank might be forced to buy back a defaulted loan if the underwriting or documentation was judged deficient in some way. [5]

Other analysts have presented evidence before this Committee on how credit availability remains tight, including Laurie Goodman of Amherst Securities. [6] Federal Reserve Governor Elizabeth Duke also gave a speech earlier this month on this theme, providing yet even more detail on the conclusions from the April SLOOS:

- Compared with 2006, lenders are less likely to originate GSE-backed loans when credit scores are below 620 regardless of whether the downpayment was 20 percent or not.
- Lenders reported a decline in credit availability for all risk-profile buckets except those with FICO scores over 720 and high downpayments.

When the lenders were asked why they were now less likely to offer these loans:

- More than 84 percent of respondents who said they would be less likely to originate a GSE-eligible mortgage cited the difficulty obtaining mortgage insurance as factor.
- More than 60 percent of lenders pointed to the risks of higher servicing costs associated with delinquent loans or that the GSEs might require them to repurchase loans (i.e., putback risk). [7]

Another important market development to acknowledge is that lenders are capacity constrained today. Anecdotal evidence suggests that some lenders are simply struggling to keep up with processing loan applications. Part of the problem appears to be the structural shift in the market towards full and verified documentation of income and assets, which has lengthened the processing time for mortgage applications.

But if lenders and servicers don't have enough capacity, why are they not just hiring more staff or upgrading their infrastructure so they can handle more loans or business? This seemingly innocent question is really important. Don't market participants still perceive this business as profitable over the medium to long-term with a comparatively good return on investment when viewed against other business lines?

Like Governor Duke, I believe that lenders or servicers are hesitating to make these investments in the near-term because they just don't have a good sense of how profitable the housing-finance and servicing business will be over the medium to long term.

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[5] *http://www.federalreserve.gov/newsevents/speech/bernanke20120510a.htm*

[6] Goodman: "In reaction to the extremely sloppy underwriting standards prevailing in the 2005–2007 period, the GSEs and bank originators have dramatically tightened origination standards. The average GSE origination for 2009–2011 has a 762 FICO, and a 68 LTV. The average bank portfolio loan has a 756 FICO, 67 LTV." *See: http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=Of96eOff-8500-41a5-aOf2-0139dOdf2e07.*

[7] *http://www.federalreserve.gov/boarddocs/snloansurvey/201205/fullreport.pdf*

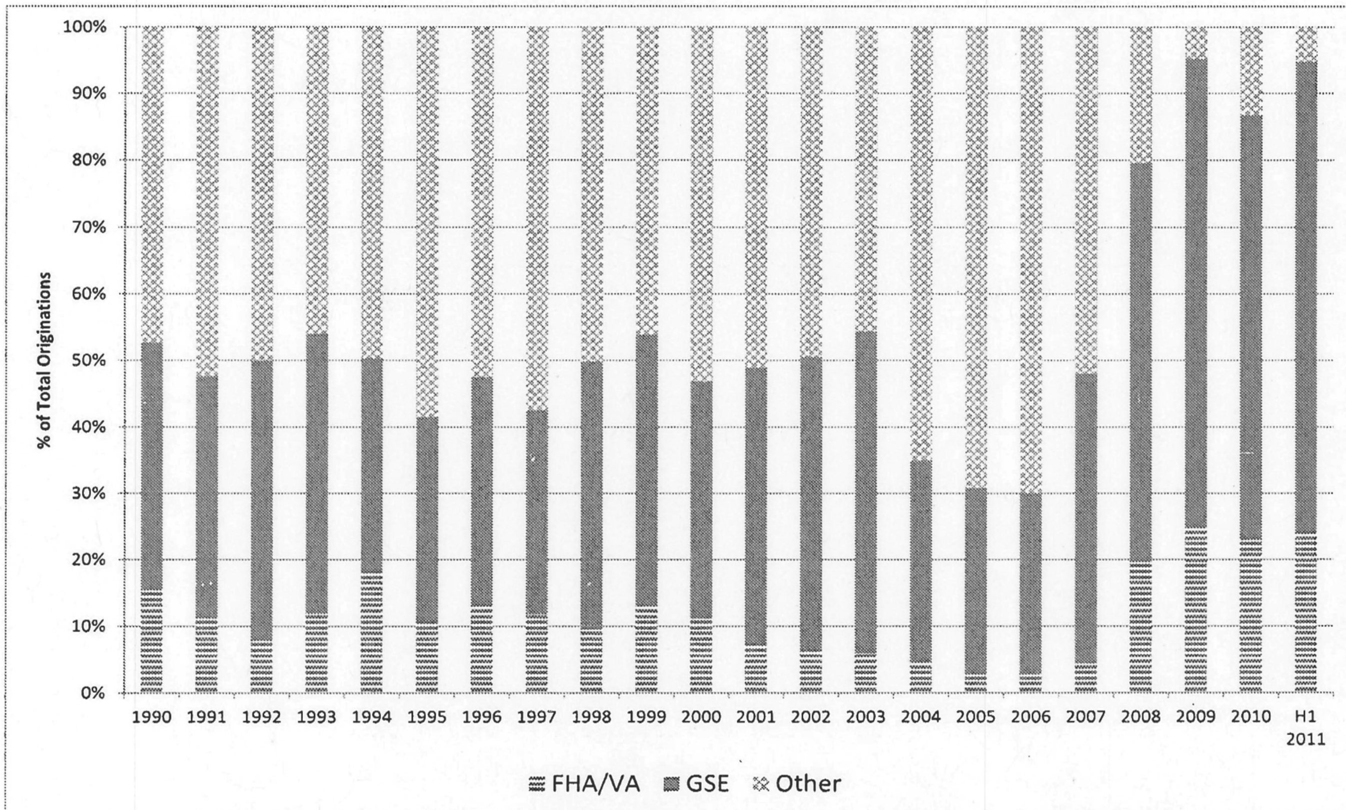
2. Micro-policy uncertainty.

Over the past few years, many analysts have held out the "uncertain" macroeconomic outlook as a key reason why business investment remains depressed generally and the labor market continues to be weak. The connection or ripple effects to underperforming sectors of the economy is fairly straightforward. For example, a liquidity shock like a job loss is one of the key triggers for mortgage delinquencies and it's reasonable to expect lenders to remain flexible, or on the sidelines and not "fully" invested, until the labor market improves.

That said, there is perhaps no other major industry that faces more micro-policy uncertainty than housing today. And, it's important to remember that basically all loans made today do not involve lenders actually assuming any of the credit risk in the event that a borrower defaults on their mortgage.[8] The following chart from CBO reviews mortgage originations by the entity that bears the underlying credit risk.[9]

[8] There is some private mortgage insurance—but the broader point still holds.

[9] Source data is from Inside Mortgage Finance. CBO Working Paper: An Evaluation of Large-Scale Mortgage Refinancing Programs. September 2011.


100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
% of Total Originations
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 H1 2011
FHA/VA
GSE
Other

If lenders are capacity constrained but are not even helping to originate mortgages that have them not taking on new credit risk, the implication is that there are probably other discrete micro-policy uncertainties that are holding back a broader recovery in housing, including the legal risk that mortgages are transferred back to the originator (along with the underlying credit risk). I group these micro-policy risks into three buckets: servicing, underwriting, and GSE reform.

A. Uncertainty within servicing

- The Consumer Financial Protection Bureau (CFPB) recently announced that it plans to propose new industry-wide servicing rules for all mortgages. The end result could certainly be a positive for all stakeholders over the long-term, but there is a lot of uncertainty about how this will impact the cost-structure of servicing in the future. In turn, this may be a factor in servicers delaying the decision to make new investments in their servicing infrastructure.
- FHFA has a pending initiative to change the way that servicers are compensated by the GSEs. Many industry stakeholders believe that this new compensation regime could quickly become the de facto industry standard, even for non-GSE loans. As servicers discovered during the crisis, they were not charging sufficient fees to cover the costs associated with large-scale modifications, which require a much more robust infrastructure.
- The Basel process has changed the capital treatment of the asset known as "mortgage servicing rights" (MSR), which in essence is the expected cash-flow or revenue that servicers expect to earn off a book of mortgages. In short, the implementation of the new Basel rules is set to limit how MSRs can be counted as regulatory capital. This means that banks or lenders may seek to sell or shrink their servicing business since MSRs will not have the same capital management advantages. [10]

B. Underwriting requirements and securitization

- The Dodd-Frank Act directed regulators to set requirements that ensure a borrower has the ability to repay a mortgage (also known as "qualified mortgage" or QM) and to establish the definition for a "qualified residential mortgage" or QRM, which is the subset of QM that would not be subject to risk retention requirements.

C. GSE reform and the future of mortgage finance

- By the end of 2012, more than 4 years will have passed since Fannie Mae and Freddie Mac were put into conservatorship. The Dodd-Frank law was enacted in 2010, but didn't address the two failed enterprises. It's key for the Government to announce a clear framework and timetable so homebuyers, sellers, and suppliers of capital can adjust and make plans for the future. [11] The counter-argument that today's fragile housing market should be left alone to heal is no longer sustainable. Congressional inaction still represents a choice, albeit one that assumes that the current degree of uncertainty around the future model of mortgage finance in this country is not holding back a housing recovery. Schedule and speed are two discrete issues. [12] Congress could establish a framework but then set a deliberate transition schedule that would allow for monitoring market conditions.
- GSE reform is also increasingly connected to the housing-demand problem. Rather than having the Government (through Fannie, Freddie, and FHA) so comprehensively involved in setting mortgage underwriting standards, it would be better for the private sector to take on the risk and rewards of credit decisions. While the temptation for public officials to involve themselves in the details of credit standards is logical given the current conservatorship arrangement, it's important to take a step back and at least question whether this trend is at least partly responsible for the lack of private sector interest in the space.

All of these elements affect the cost structure and opportunity cost associated with mortgage lending, which of course factors into the relative appeal of the mortgage

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[10] From the April SLOOS: 38.6 percent of banks mentioned new MSR capital treatment as a factor. This process could also impact perceptions of whether MSRs should be considered "tangible" book value for extra-regulatory capital assessments performed by analysts as part of their valuations.

[11] *http://www.bloomberg.com/news/2012-01-23/put-fannie-and-freddie-on-federal-books-papagiani s-and-swagel.html*

[12] *http:/Idailycaller.com/2011/11/10/time-to-end-the-taxpayer-guarantee-of-mortgage-investors/*

finance and servicing business. They also impact the future of house prices, as credit terms and availability are intimately linked to the user-cost of housing.

The urgency to resolve all of this uncertainty is all the more important because while there are clear short-term impacts on the market, there are also potential long-term consequences. For example, if lenders decide to hold off on making new near-term investments in their mortgage business, the long-term potential of a full rebound in housing may be diminished as the existing or legacy infrastructure and skills can be expected to atrophy further.

Mortgage servicers are not in business to lose money. Moreover, the total volume of societal resources devoted to performing this function—employees, investment in computers and telecommunications infrastructure, legal compliance officers, sales staff—is not static. It adjusts upwards and downwards based on perceived opportunities, expected future revenues, and Government involvement. Today, it is clear that investments that could be made are not because of concerns that regulations will impose cost burdens on the industry that cannot be recovered through servicing fees or other revenue streams that may look like "hidden charges" to regulators. At the same time, no one really knows who the ultimate purchasers of mortgages are likely to be 5 years from now. Since the ultimate holders of mortgages—currently the GSEs—are the servicers' client base, the current lack of clarity on who or what is likely to fund mortgages in the future has obvious ripple effects on servicers and all other professions exposed to mortgage finance.

A similar phenomenon is casting a shadow over the mortgage insurance industry. The difficulties in obtaining mortgage insurance are constraining lenders from selling to Fannie and Freddie, even if they have found buyers and are willing to originate the loans. Several mortgage insurance companies have failed in recent years, others are no longer offering insurance on a forward-looking basis and are just managing their existing exposures.

While I believe this backdrop is crucial to understanding the challenges that face the housing market moving forward, I don't want my comments to be interpreted as precluding any new legislative or regulatory action that is aimed at addressing a near-term friction in the market.

My view is simply that resolving the aforementioned uncertainty holds by far the greatest potential, on a comparative basis, for positively and responsibly impacting the housing market moving forward.

3. Overview—The Responsible Homeowner Refinancing Act.

The expansion of HARP (2.0) announced in October 2011 and fully implemented in March, along with the additional expansion contemplated under Menendez-Boxer, is meant to both reduce foreclosures (by improving affordability) and provide a stimulative boost to the economy. This stimulus effect would come from increased spending by borrowers who would have more money as a result of having to make lower monthly mortgage payments as a result of a refinancing.

I agree with the comments from Professor Phillip Swagel before this Committee earlier this year that these types of refinancing efforts are analogous to the stimulus plans that would send a monthly check to qualifying households. [13] My view is informed by the fact that the previous HARP expansion, and the one being contemplated today, would be limited to borrowers who have been in their homes for at least 3 years and have made all of their payments on-time over the preceding year (with an allowance for one 30-day late payment in the previous 6 months).

In short, HARP expansions are aimed at borrowers who have kept up on their payments despite a very challenging economic environment. While each additional HARP participant will receive a benefit that will help them on the margin, the broader point here is that the targeted population is not particularly "at-risk" of foreclosure on a comparative basis.

Approaching the issue from the other side, the households most in need of relief are also precisely the borrowers most likely to increase the credit risk exposure of the GSEs (on net). It's this conclusion that leaves stimulus as the main driver of the refinancing program—not foreclosure prevention.

4. Realistic expectations for "more" refinancing—HARP 2.0 to 3.0.

When HARP was first established in 2009, the Obama administration projected that 4–5 million people would be helped. Before HARP 2.0 really took effect in

[13] *http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=b56a771b-99a0-46ae-ad6b-ea7437c8a83d*

March 2012, the program had helped approximately 1.1 million borrowers refinance.[14]

It is still way too early to project with any real confidence how many additional people will be helped as a result of the HARP 2.0 expansion. Putting aside the challenge of properly categorizing beneficiaries as having only been able to participate as a result of the programmatic changes rolled out in March (versus 1.0), the recent spike in HARP applications suggests that HARP 1.0/2.0 could see a significant jump in take-up or participation.

Secretary Donovan commented to this Committee earlier this month that servicers have already started processing applications from nearly a half-million families. FHFA Director DeMarco estimated that by the end of 2013, HARP refinancings could double from their current level.[15]

Let me encourage this Committee to request specific data on these applications and projections to learn more about how lenders and borrowers are responding to HARP 2.0. In fact, its hard to recommend that policy makers move forward with additional changes to HARP without first reviewing this new data. After all, I'm not aware of any official presentation on how HARP 2.0 will impact total take-up for the program.

This exercise could also go along way towards narrowing the enormous range for potential take-up estimates that analysts are using for this HARP 3.0 proposal. Against this fluid backdrop around projections, I would also recommend that proponents of this bill remain cautious about setting unrealistic expectations with regards to the number of incremental borrowers that would be helped under a further HARP expansion.

For example, many commentators over the past few weeks have conflated the take-up projections from some of Professor Chris Mayer's plans in this area.[16] But an important distinction is that the Menendez-Boxer bill would keep in place the current delinquency standard for determining borrower eligibility. Under the version of Professor Mayer's plan that has received the most attention, borrowers would only need to have made their last three payments on-time in order to qualify whereas Menendez-Boxer would keep the requirement that borrowers must be current on their mortgage over the previous year (with one 30-day late payment allowed over the previous 6 months). It's reasonable to conclude that this difference would have a fairly dramatic effect on projected take-up, which means the Menendez-Boxer bill would likely fall considerably short of the projections that Professor Mayer has advanced.

Properly calibrating take-up expectations is especially important given the poor track record of practically all of the major modification and refinance programs that have been launched to date. The Committee should request, if it has not already, a detailed take-up projection from both FHFA and CBO that specifically takes into account the trajectory for HARP 2.0 refinancings and then describes the incremental take-up that would be achieved by each of the provisions in the Menendez bill. To not ask for and then review this information would open up this Committee to repeating some of the more common errors that have occurred since the crisis around appropriately managing expectations.

5. Expanding the initial objective of HARP.

This HARP 3.0 proposal can be considered across two dimensions with regards to take-up and eligibility. First, what can or should be done to further increase the penetration of HARP—or the original pool of borrowers that were targeted. Second, should the scope of the HARP program get adjusted—to pull in new borrowers that would not have been eligible previously. My view is that the merits or case for the second objective is much more limited than the first.

For example, expanding the HARP program to help more borrowers that are not underwater, particularly those with more than 20 percent equity in their homes, will likely end up only "counting" borrowers who could have refinanced without the additional programmatic flexibility. The GSEs already have other streamlined refinancing programs for these borrowers.

If the Committee is set on blurring the line or the original intention of the HARP program with regards to borrowers with more than 20 percent equity, one idea to consider would be a combined loan-to-value ratio (CLTV), which could help target the additional programmatic flexibility to those borrowers who are underwater (when home equity lines of credit or second liens are factored in to the equation).

[14] *http://www.fhfa.gov/webfiles/23906/Feb2012 ForeclosurePrevention.pdf*
[15] *http://www.fhfa.gov/webfiles/22723/HARP%20release%20102411QandA%20Final.pdf*
[16] *http://www4.gsb.columbia.edu/null/download?&exclusive=filemgr.download&file__id=739308*

Consideration could also be given to further limits on the "cash out" allowance for borrowers who pursue a HARP refinancing. While the current allowance may help boost or incent borrower participation, it's questionable whether extracting any additional equity in the form of cash should be encouraged right now.

6. Addressing representation and warranty issues (i.e., putback risk).

The current system of relying on representations and warranties to help ensure quality originations should probably be revisited on a wholesale basis. Right now, lenders are concerned not only about assuming new putback risk when they refinance another lender's original mortgage, but also that some of their own new originations may eventually default and then add to their overall put-back exposure. Devising a system that verifies loan origination quality before an eventual default triggers a review of representations and warranties violations should be a common objective for all market participants.

In the near-term, it's important to acknowledge that FHFA has already made a lot of progress with regards to rep and warranty issues as it relates to HARP. The Menendez-Boxer bill attempts to wash away the remaining rep and warranty concerns so that lenders or servicers compete more for refinancing business—without having to consider whether they are assuming more putback risk in aggregate. The mission here appears to be to lower the prices or premiums that lenders are charging HARP borrowers compared with regular refinancings.[17]

I am not opposed to this action, but I do have concerns that the expected competitive benefits may not materialize. It is still very possible, if not likely, that the lenders competing for new refinancing business will still charge a premium to take on the new underwater borrower since it is generally more expensive to service these borrowers over the long-term given that they face a higher incidence or probability of delinquency. FHFA also indicated in a letter to Sen. Boxer (dated May 17th) that the data "clearly demonstrate that the rates for HARP loans are similar to those for other Enterprise-backed refinance products," a point which directly undermines the case for making this change. Deutsche Bank also did an analysis of HARP pricing as part of a research note published on April 18th that generally supports FHFA's claims.[18]

FHFA also made the case in this letter that the processes under same-servicer and new-servicer arrangements are comparable:

> [T]he lender is responsible for determining that the borrower meets the basic eligibility standards, based on the information available to them, and that the data used to make the determination is accurate. There are no higher-level demands on a new originator; in fact, the new originator may be at a slight advantage to an existing lender, because they have no responsibility whatsoever for the original loan, whereas the existing lender continues to be liable for any fraud or noncompliance with Federal and State laws, including the Enterprises' Charter Acts. As a result, in some instances, existing servicers choose to use the automated underwriting tools provided by the Enterprises, which are generally used by new originators, to extinguish any responsibility for the old loan.

Taking a step back, providing relief for representations and warranties can also be an expensive proposition for the GSEs (as reviewed or determined by FHFA). CBO described this very well in their working paper from September:

> A potentially important consideration is that a large-scale refinancing program may negatively affect the value of the GSEs' and FHA's contractual right to recover money from the originating lender in some instances. Specifically, they may "put back" a defaulted loan to the originating lender if the loan was closed in violation of the lender's representations and warranties, avoiding losses associated with those loans. Once a loan is refinanced, they forgo the right to put back losses associated with the original loan (as-

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[17] Laurie Goodman has made the case that the lack of servicer competition for refinancings has led to a large price differential between HARP and non-HARP refinancings and new purchase loans. FHFA's letter to Sen. Boxer on May 17 suggests this issue is not straightforward.

[18] "Analysts and policy makers have justifiable interest in understanding the profitability of mortgage lending these days, particularly if policy has inadvertently distorted the market. Any analysis of HARP has to account for the risk-based pricing that Fannie Mae and Freddie Mac have mandated for most of the life of the program through the LLPAs. Mortgage bankers may have captured some extra revenue from the program. But the lion's share of it looks like it has flowed from borrowers' risk-based coupons, through the hands of the mortgage banks and the agencies and into the pockets of taxpayers."

suming the refinanced loan does not also violate those representations and warranties).

CBO went on to describe how difficult it is to estimate the cost of providing this relief to lenders. Important factors include the number of outstanding legal disputes between lenders and the GSEs and also the scope of existing settlements. Here is the key line from CBO on this issue: "For the put-back option on the incremental participating loans to have value, the borrower must default on the loan, a violation of representations and warranties must be uncovered and the loan must be from a lender that has not already negotiated a settlement with the GSEs or FHA on violations of previously originated loans."

Before proceeding with this legislation, both FHFA and CBO should disclose how much the incremental representations and warranties relief under Menendez-Boxer would cost the taxpayer, or the GSEs.[19]

A more minor representations and warranties issue exists for loans with LTVs below 80 percent. Fannie has waived lenders' representations and warranties exposure for this cohort of HARP borrowers, but Freddie has not. I do not think there is a reason why the policies for Fannie and Freddie in this area should not be in alignment. Perhaps one factor that drove Freddie not to change their representations and warranties policy for loans below 80LTV, however, is that they purposely wanted to incent lenders to target borrowers with less or even no equity. This rationale or concern should be further explored by the Committee, especially since underwater borrowers are rightfully the focus of the program.

7. Loan level pricing adjustments and other fees.

While HARP 2.0 greatly reduced the loan level pricing adjustments (LLPAs), the Menendez-Boxer bill would eliminate them completely. Under HARP 2.0, LLPAs are capped at 75 basis points of the loan amount. The rationale is that the GSEs already own the credit risk on these loans. While I would want to hear why FHFA has not embraced this position, absent additional information this seems like an appropriate step to consider.

That said, it's also important to recognize that eliminating these fees would result in only a minor incremental benefit to borrowers and there could be some marginal lost revenue for taxpayers under the terms of conservatorship. A broader point is also worth keeping in mind here, namely that all borrowers or beneficiaries of a Government-backed mortgage should continue to expect to pay at least some amount for receiving a Government insured mortgage. If the long-term objective is for the GSEs to charge a market price for a Government guarantee—to reduce or limit the current and ongoing subsidy—then a change in policy that effectively eliminates even a modest risk-based fee should give policy makers some pause. There is also the issue that eliminating LLPAs would mean that the broader GSE business—and all of the other mortgage borrowers specifically—would indirectly be cross-subsidizing HARP refinancings.

8. Mortgage insurance and second liens.

In general, the Menendez-Boxer bill would require automatic transfer of mortgage insurance and second liens and use a fine as the mechanism to ensure compliance. The goal is to make these contracts portable under the same terms with regards to the original mortgage and the refinanced one. There was some concern when HARP 2.0 was coming together that the representations and warranties for mortgage insurers would not be re-validated through the refinancing process, but I believe that this issue has been largely resolved.

Given that I think the purported benefits (with regards to additional take-up) in this area are small, I am concerned about the signal this provision sends to private

[19] Some of the concerns in this area may be offset by how the loans from HARP-eligible borrowers are "seasoned" at this stage. See FHFA's comments from when they announced the representations and warranties relief under HARP 2.0: "Nearly all HARP-eligible borrowers have been paying their mortgages for more than 3 years, and most of those for 4 or more years. These are seasoned loans made to borrowers who have demonstrated a capacity and commitment to make good on their mortgage obligation through a period of severe economic stress and house price declines. Reps and warrants protect the Enterprises from losses on defective loans; typically, such defects show up in the first few years of a mortgage and so the value of the reps and warrants decline over time. By refinancing into a lower interest rate and/or shorter term mortgage, these borrowers are recommitting to their mortgage and strengthening their household balance sheet, thereby reducing the credit risk they already pose to the Enterprises. Therefore, FHFA has concluded that eliminating the reps and warrants that may have discouraged industry participants from taking greater advantage of HARP to-date will be good for borrowers, housing markets, and the Enterprises and taxpayers." *http://www.fhfa.gov/webfiles/22723/HARP%20release%20102411QandA%20Final.pdf*

suppliers of capital in the housing market. Remember, under HAMP—second lien holders are getting paid to resubordinate. If this provision were to take effect, then HARP would take the exact opposite approach by fining these same entities to achieve the same result. In the long-term, nearly every GSE reform proposal notes the importance of attracting more private capita l to bear credit risk. Provisions like this one, at least on the margin, will make that effort more difficult by further unsettling the market expectations by signaling that policy makers could continue to change the rules of road for private capital providers midstream.

9. Moving the cut-off date and "re-Harping" loans.

This is perhaps the most controversial change contemplated by the Menendez-Boxer bill. Moving the cut off date for eligibility from June 2009 to June 2010 could increase HARP take-up. But the incremental borrower pool would not be a cohort that could reasonably expect to receive a sizeable reduction in their mortgage payment through a refinancing (at least on a comparative basis). This simply acknowledges that for most of these borrowers the rate differential would be fairly marginal in comparison to other HARP beneficiaries.

One concern is that changing the date could indirectly crowd out other borrowers who would be eligible for HARP—a reflection of the fact that servicers are capacity constrained. Another concern is that the market has long worked off of this date—as it was the cut-off established when HARP was announced and it's also a date that FHA uses for some of its refinancing programs. Laurie Goodman has described this as breaking the "covenant with investors." I share her concerns and agree with her description of the issue:

> Investors have relied upon that date and developed a series of pay-ups on mortgages with this refinance friction. Changing the date would be very disruptive to this covenant. The Agency mortgage market is wide and deep, regarded as the second most liquid market in the world behind the U.S. Treasury market. We believe that "breaking the covenant" with investors would be very damaging to the health of this market; if the date is moved once, market participants (investors, borrowers, and originators/servicers) will assume it will be moved again. [20]

The exact consequences from a date change are difficult to predict. If lender expectations change such that they now believe that new refinancings or originations might be eligible in the future for relief from representations and warranties, then they might be incentivized to process more loans with questionable underwriting in the meantime. At minimum, I would recommend that policy makers consider whether to explicitly prohibit the re-harping of loans to limit the negative effects of changing market expectations.

I want to be clear here that buyers of MBS—and in this case GSE-backed MBS—rightfully assume any refinancing risk. They are compensated for this in the spread that is charged on rates or yields for GSE MBS above Treasury debt securities. But, when refinancing programs are continually expanded, investors may be forced to adjust their expectations about future prepayment speeds, effectively assuming that future mortgages will have an embedded policy-risk function that could give borrowers easier access to a lower rate mortgage. While that may sound like a good policy objective, the net effect could be that market participants simply demand higher yields on MBS moving forward—negating any of the near-term benefits to a change in this area over the medium to long-term. Put another way, current homeowners might benefit at the expense of future borrowers as the premium associated with the refinance option is revalued upward prospectively.

In the case of allowing for loans to be re-HARPed, the market should be expected to fold into the price that borrowers pay an additional premium to account for this additional prepayment risk. In short, it's possible that the effect of a date change could be that the prices for HARP refinancings actually go up. And it's unclear to say the least at this point if making HARP more expensive on the margin is worth the trade-off of boosting volume, again on the margin.

10. Efforts to increase homeowner awareness of HARP.

The Menendez-Boxer bill would require the enterprises to notify all eligible borrowers of their opportunity to participate in HARP. While I have some concerns that families and borrowers are now being inundated with "awareness" campaigns, the objective is clearly admirable.

[20] *http://banking.senate.gov/public/ index.cfm?FuseAction=Files.View&FileStore__id=Ob61bedc-00 17.-4a06-9798-29b55f7f63bc*

PREPARED STATEMENT OF MOE VEISSI

2012 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

MAY 24, 2012

Introduction

On behalf of more than 1.1 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for giving us an opportunity to share our thoughts on how to help responsible homeowners save money through refinancing.

My name is Moe Veissi, and I am the 2012 President of the National Association of REALTORS®. I have been a REALTOR® for over 40 years, and am the broker-owner of Veissi & Associates, Inc,. in Miami, FL. Since 1981, I have served the REALTOR® community in many capacities, from local association president, to State association president, to regional Vice-President, and now on the national stage as the NAR President in 2012. My life and my passion are real estate. So, it is my honor to be here today to lend voice to NAR's 1.1 million members, and the millions of Americans who own a home, want to sell a home, or just provide rental opportunities to those who require a home.

It's no secret our Nation's housing markets remain in a tenuous state. While no one thought the crisis would carry on so long, markets are slowly recovering, but remain in need of immediate policy solutions to address the myriad challenges in order to stabilize housing and support an economic recovery. REALTORS® have long maintained that the key to the Nation's economic strength is a robust housing industry. And, we remain steadfast in our belief that swift action is needed to directly stimulate a housing recovery. In particular, bringing relief to the millions of homeowners who have remained current on their mortgages in the face of declining home values and rising inflationary pressures will go a long way to kick starting not just the housing sector, but the overall economy.

The Responsible Homeowner Refinancing Act

The National Association of REALTORS® supports the "Responsible Homeowner Refinancing Act" because it offers relief to homeowners who continue to meet their mortgage obligation during this ongoing period of economic unrest. Many homeowners have maintained their mortgage payments even as the economy stalled and prices of other consumer goods rose, squeezing their discretionary income. Unfortunately, these same consumers have not been able to take advantage of the low mortgage interest rates fostered by policy aimed at stimulating the economy because of constraints embedded in the Government-sponsored enterprises (GSEs) mortgage refinance guidelines.

That sentiment was acknowledged by Federal Reserve Chairman Benjamin Bernanke during comments he made to the Federal Reserve Bank of Chicago on May 10th. Chairman Bernanke indicated that, although "conditions in the financial system have improved significantly" lending remains strained in the U.S. home-mortgage market. He went on to note that "tighter lending standards and loan terms remain especially evident in the mortgage market," though banks are seeing growing demand for consumer credit and they are lending more easily in the credit card and auto loan sectors. The Chairman acknowledged that "while a return to lax lending standards that prevailed before the housing bust would not be wise, current standards may be limiting or preventing lending to many creditworthy borrowers."

The "Responsible Homeowner Refinancing Act" will encourage lenders to return to the home mortgage market by removing impediments and allow "current borrowers," whose loans are owned by Fannie Mae and Freddie Mac, to take advantage of record low interest rates. Effectively, this places more money into their pockets and gives them the confidence they need to participate in our Nation's economy. According to NAR's analysis, based on data gathered by Lender Processing Services, this effort would support over 3 million refinances, reduce average annual payments by $2,800, and save borrowers between $4.5 billion to $4.8 billion per year, after tax considerations (see Appendix A).

Moreover, helping these responsible homeowners lower their payments reduces their risk of default and aids the recovery of the GSEs, Fannie Mae and Freddie Mac. According to NAR's white paper, Cutting Through the Red Tape, "the CBO estimates that a similar program extended to loans securitized by the GSEs and FHA might result in 111,000 fewer defaults." Finally, the economic activity spurred on by these consumers' ability to meet an affordable loan payment will act as a mechanism to begin moving our Nation out of recovery.

The GSEs, under the guidance of the Federal Housing Finance Agency (FHFA), have recently made improvements to their refinance guidelines. This legislation codifies many of those improvements, and offers enhancements to others in an effort to ensure that hard-working, diligent mortgage payers, who are "current," have options available to them to relieve some of their economic burden during this tumultuous period.

The proposed legislation does a number of things that REALTORS® believe are necessary to entice both consumers and lenders to pursue refinancing in this environment. First, it eliminates unnecessary consumer costs associated with a refinance that tend to keep homeowners who need a refi on the sidelines. These would be the up-front risk-based fees charged by the GSEs that could cost consumers up to $4,000 on a $200,000 loan, as well as costs associated with the appraisal. Also, underwriting guidelines that restrict eligibility due to loan-to-value (LTV) ratios would be waived for existing, performing GSE loans in order to ensure all "current" borrowers have access to affordable refinancing rates. In our present economic environment, many consumers may not have the discretionary capital required to close a refinance. However, many of these same consumers are current on their mortgage indicating their ability, and desire, to observe their obligation. The removal of these barriers will help reward those diligent mortgage payers by allowing them to achieve a reduced mortgage payment.

Second, the legislation improves competition for lenders looking to compete with the existing mortgage servicer. The proposed legislation directs the GSEs to require the same streamlined underwriting and associated representations and warranties for the new servicer that are in place for the existing servicer. This will level the playing field in a manner that yields increased competition for the consumer's business. Ultimately, this competition will lower the cost of refinancing for the consumer, again benefiting the stability of the GSEs and the overall economy.

An additional lender concern is addressed in the provision that directs FHFA to align the refinance guidance of Fannie Mae and Freddie Mac. Confusion over the standards applied by each GSE has caused lenders to remain on the refinance sideline out of concern for misunderstanding the guidance offered by the appropriate organization and being subject to "repurchase" risk.

Finally, the legislation establishes penalties for servicers of second liens and mortgage insurers who thwart the refinance process. Establishing the ability for consumers to overcome the obstacles of second liens and mortgage insurance will increase the number of households that can take advantage of the Administration's, Regulators', and Congress' efforts to help alleviate existing housing costs pressures, and stimulate the economy.

Utilization of GSE Guarantee Fee as "Pay-for" for Non-housing Programs

A final issue that has the ability to prevent consumers from refinancing, or to keep potential homebuyers on the sideline, is the use of GSE guarantee fees (g-fees) as a means to "pay-for" nonhousing programs. Just as the proposed legislation will make refinances more attractive by removing some cost barriers associated with the refinance process, the potential for Congress to increase the GSEs' g-fees for nonhousing purposes effectively re-erects a cost barrier. NAR applauds the Menendez-Boxer legislation for not utilizing the guarantee-fee as a "pay-for" to support this legislation.

Our members were deeply troubled by the use of a 10 basis-point increase over the 2011 average g-fee to pay for a 2-month extension of the payroll tax relief. That increase will impact homebuyers and consumers looking to refinance their mortgages for the next 10 years. Therefore, when Congress began negotiating the 10-month extension of the payroll tax relief and the potential use of the g-fees to cover that expense, you can understand why our members emphatically let Congress know that housing cannot, and will not, be used as the Nation's piggybank. Though they are only rumors about the potential use of g-fees to cover another nonhousing expenditure, we would like to use this opportunity to indicate the counter-productivity of such an increase in the face of the proposed legislation, "the Responsible Homeowner Refinancing Act".

The Nation's housing sector remains in a precarious state. Though we are seeing signs of improvement, we are cautious of taking any steps that may retard that recovery and ultimately send our overall economy into another tailspin. Increasing the g-fee, even just extending the current fee increase, effectively taxes potential homebuyers and consumers looking to refinance their mortgages, at a time when the housing sector can least afford it. The unintended impact of any proposed fee increase would be to keep housing consumers on the sideline, preventing the absorption of our Nation's large real-estate owned (REO) inventory, as well as curtailing refinance activity that is needed to keep responsible consumers in their homes.

Lastly, please note that g-fees currently are calculated by the Enterprises as a function of the costs of guaranteeing the securities they issue, i.e., the risk of underlying loans. We strongly believe that fees charged by the Enterprises to manage risk and enhance capital should not be diverted for purposes unrelated to the safety and soundness of the housing finance system.

Conclusion

Home ownership matters. Either fostering new home purchases or helping consumers remain in their homes must be a priority if we are going to move our Nation from tenuous recovery to prosperity. Home ownership represents the single largest expenditure for most American families and the single largest source of wealth for most homeowners. The development of home ownership has a major impact on the national economy and the economic growth and health of regions and communities. Home ownership is inextricably linked to job access and healthy communities and the social behavior of the families who occupy it.

In this period of tenuous housing recovery, we must utilize all available tools to encourage lenders and consumers to take the steps necessary to successfully support home ownership.

We can accomplish this by supporting efforts like the "Responsible Homeowner Refinancing Act" that is aimed at helping "current homeowners" lower their monthly payments, and by creating confidence in the housing finance system that encourages lenders to reach out to creditworthy borrowers.

The National Association of REALTORS® sees a bright future for the housing market and the overall economy. However, our members are well aware that the future we see rests on the industry's and the economy's ability to successfully navigate some continuing and persistent obstacles. Congress and the housing industry must maintain a positive, aggressive, forward-looking partnership if we are to ensure that housing and national economic recoveries are sustained. The National Association of REALTORS® believes that the proposed legislation will foster and encourage steps in that direction.

APPENDIX A

Cutting Through the Red Tape

By Ken Fears
Manager, Regional Economics and Housing Finance Policy

The concept of utilizing a large scale refinance program to aid the ailing housing market and to stimulate the economy has been floating around since 2008.[1] Since then, rates eased below 4.0%, yet millions of Americans have not taken advantage of the opportunity because of the upfront costs of refinancing and other frictions unique to the current market. On May 8th Senator Robert Menendez (D-NJ) and Senator Barbara Boxer (D-CA) proposed a bill that would attempt to deal with these issues.

The proposal by Senators Boxer and Menendez follows several of the recommendations made by President Obama earlier this year and includes:

- Extending streamline refinancing for Fannie and Freddie borrowers
- Elimination of up-front fees on refinances
- Eliminating appraisal costs for all borrowers
- Allowing lenders not currently servicing a loan to refinance the loan with the same representations and warranties and streamline ability as the current servicer, thereby creating competition and lower costs to the consumer
- Requiring second lien holders who unreasonably block a refinance to pay "restitution to taxpayers"
- Requiring mortgage insurers who unreasonably fail to transfer coverage to refinanced loans "to pay restitution to taxpayers"

To analyze the impact of the proposal, data generated by Lender Processing Services[2] was used to estimate the universe of mortgages held by Fannie Mae and Freddie Mac that are both eligible and likely to refinance under such a program. An average 30-year fixed rate mortgage of 4.0% along with a Federal tax rate of 25%, a state tax rate of 5%, and an average loan balance of $150,000[3] were used to estimate the effect of the refinance program in the first year. It is assumed that borrowers with a current mortgage rate of 5% or higher will refinance[4] and there is no change in mortgage insurance premiums. The proposed changes would result in:

- Just over 3 million refinances
- Reduce the average annual payment by roughly $2,800
- Save borrowers $4.5 billion to $4.8 billion per year (after tax considerations) and more than $45 to $48 billion by 2022
- Some of the reduction in payments might result in increased savings, but much would be spent on goods and services.[5] The lower payments would have a multiplier effect resulting in an injection to the economy of possibly the full amount of the money saved by borrowers or perhaps more.

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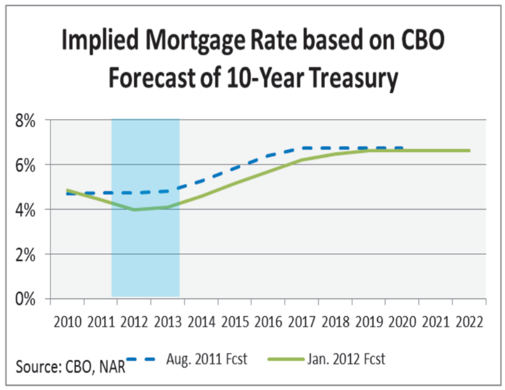
[1]See Hubbard and Mayer (2008) and Greenwald (2010)
[2]Lender Processing Services, Mortgage Monitor; February 2012 Mortgage Performance Observations
[3] Based on 4th quarter 2011 10k filing from Fannie Mae and Freddie Mac
[4] Relaxing this assumption to a minimum reduction in monthly payment of 5% like the FHA's streamline program would enable 560,000 additional refinances with a savings of $423 million in monthly payments.
[5] Canner, Passmore, and Dynan (2002) assume that 100% of the reduced payment is devoted to personal consumption expenditures and McConnel, Peach and Al-Haschimi (2003) point out that households who refinance tend to have higher propensities to consume due to income constraint.



The impact of a refinance program would extend beyond the savings to the consumer. The CBO[6] estimated that a similar program extended to loans securitized by the GSEs and FHA might result in 111,000 fewer defaults. Given the significant proportion of likely GSE refinances, the large number of loans held in portfolio that were not included in the CBO analysis, and lower subsequent CBO forecast for Treasury rates (and thus mortgage rates), it is reasonable to assume that the number of foreclosures averted by the GSE refinance plan would be substantial.

While the number of REO sales, modifications, and short sales have risen in recent quarters, the number of loans in foreclosure or REO remains high, thus underlining the need to staunch the flow of properties into this bucket. REOs are a significant problem for home sellers, the market and local communities:

- NAR estimates a price discount of 20% on REOs relative to non-distressed properties and some groups estimate this to be as high as 30%
- By one estimate, the sales price of a home was lowered by approximately 2.5% for every percentage increase in foreclosures in the same census tract, other factors constant.
- Homes that are vacant for an extended period impose costs on municipal governments ranging between $5,000 and $35,000, depending on length of vacancy, maintenance requirements, and damage to the home.
- Another study found a one percent increase in county foreclosure rate, increased the burglary rate by 10.1 percent. Impact also significant on larceny and aggregated assault.

Finally, resurgent concerns about European financial conditions as well as the impending fiscal cliff in the Unites States will weigh on the 10-year Treasury and mortgage rates in the near term, allowing more time for consumers to take advantage of a refinance program.

While the estimated $4.5 to $4.8 billion in savings and reduced defaults may seem like small figures, these refinances could have a significant impact in the local areas where the refinances would be concentrated. Furthermore, the relaxation of representations and warrants and loan level pricing adjustments sets an important precedent that could help to ameliorate the tight lending conditions on the originations side of the market.

[6] Remy, Luca, and Moore (2011), "An Evaluation of Large-Scale Mortgage Refinancing Programs".

PREPARED STATEMENT OF MARK ZANDI

CHIEF ECONOMIST AND COFOUNDER, MOODY'S ANALYTICS

MAY 24, 2012

The U.S. economy has made significant progress since the Great Recession ended 3 years ago. Payrolls have increased by 3.75 million since job growth resumed, and the unemployment rate has fallen by nearly two percentage points from its peak. Businesses and households have reduced their debt loads significantly, and the financial system is much better capitalized.

Despite this progress, the recovery is still struggling to take root. The U.S. economy is growing, but at a disappointing pace, and the unemployment rate remains uncomfortably high at more than 8 percent. The economy also faces significant threats, including turmoil in Europe and the Federal Government's rapidly approaching fiscal cliff. Policy makers also need to credibly address the Nation's long-term fiscal challenges.

Another significant impediment to stronger growth is persistent weakness in the housing market. Home sales and construction are off bottom but still extraordinarily low, and house prices remain weak in many parts of the country. With millions of foreclosures and short sales certain to hit the housing market over the next several years, prices could fall further.

The economy will not be in full swing until house prices are rising consistently. For most Americans, the home is still the most important asset, and consumers will be reluctant to spend while their wealth erodes. Many small-business owners use their homes as collateral for business loans, and local Governments rely on property tax revenues, which are tied to housing values, to fund schools and other important public services. Other serious longer-term effects of falling house prices include a reduction in labor mobility and the erosion of retirement savings for low- and middle-income homeowners.

There are some reasons to be optimistic that the housing slump is ending. Prices have fallen enough to make single-family housing affordable and attractive compared with renting. Investors are putting up cash to purchase distressed properties. Overbuilding remains a problem, but a diminishing one, given a record low pace of construction and increased household formation.

But this optimism will be easily overwhelmed if house prices fall further, risking a vicious cycle that puts more homeowners underwater, accelerating foreclosures and distress sales and driving prices lower still. During the recession, only an unprecedented monetary and fiscal policy response short-circuited that cycle.[1]

In light of the risks, policy makers should consider additional temporary help for housing. Once expectations for home prices turn positive, the foreclosure crisis will abate quickly and the recovery will gain traction. Given that house prices in many parts of the country are already low relative to incomes and effective rents, it wouldn't take much additional effort to accomplish this. The key is to reduce the number of properties in delinquency or foreclosure before they reach the market as distress sales. House prices will rise significantly once the distressed share of home sales declines definitively.

Moving more properties out of the foreclosure pipeline before they go to distress sales would reduce the downward pressure on home values. A key to doing this is to get private investors and property managers involved in converting distressed properties to rentals. Investors show a healthy interest in doing this, attracted by the combination of low purchase prices and sharply rising rents. Most investors are not house flippers looking for quick profits—considering the state of the housing market, this wouldn't be a winning strategy—but have investment horizons of 3 to 7 years. Such investors will likely be willing to rent properties purchased from Fannie Mae, Freddie Mac, and the Federal Housing Administration for at least several years, selling them after house prices begin to rise again.

Facilitating more loan modifications, including those involving principal reduction, would be a much larger and costlier step but would bring the housing downturn to a quicker and more definite end. Principal write-downs have economic positives and negatives, but are a net positive if well designed. The main concerns are moral hazard and fairness. To deal with these, modifications must be well targeted, with clearly articulated eligibility requirements. A long vesting period and some type of clawback provision for future capital gains to guard against potential fraud would also be helpful. The number of modifications and the amount of principal reduction necessary to stabilize house prices can be reasonably financed with funds from the

[1] An estimated 14.1 million homeowners are underwater, 6.2 million by more than 30 percent.

recent mortgage settlement and the president's proposals to expand Home Affordable Modification Program, or HAMP.

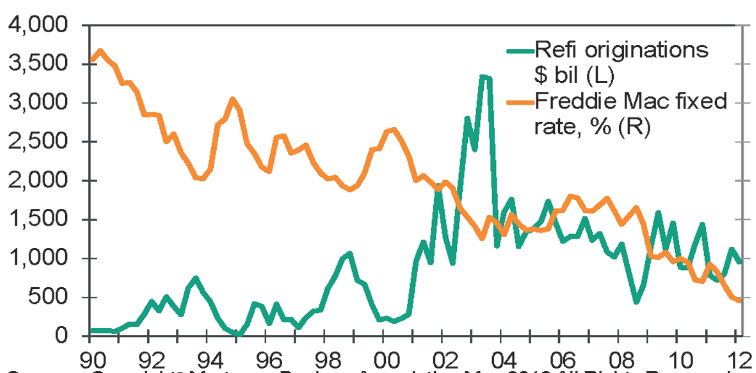
Arguably the most straightforward policy step would be to provide further support to mortgage refinancing. Despite record low mortgage rates, many homeowners continue to have difficulty refinancing. Recent changes to the Home Affordable Refinance Program appear to be helping more of these households, but policy makers can take further steps to encourage refinancing. Legislation being considered by Congress, including the Responsible Homeowner Refinancing Act, the Expanding Refinancing Opportunities Act, and the Rebuilding Equity Act, would be very helpful in this regard. More refinancing will mean fewer borrower defaults and more money in the pockets of homeowners, supporting the recovery through a quick and sizable cash infusion at no meaningful cost to taxpayers.

More Mortgage Refinancing

Policy makers should act to substantially increase mortgage refinancing activity.[2] This is a propitious time for homeowners to refinance, as mortgage rates have fallen to record lows. The 30-year fixed mortgage rate for prime borrowers is currently below 4 percent and likely to remain low for some time in light of the Federal Reserve's stated resolve to keep interest rates modest for several years. The central bank is also keeping open the possibility of additional quantitative easing, which would likely include more purchases of mortgage-backed securities by the Fed.

Despite record low borrowing costs, refinancing has been disappointingly slow. In 2003, when fixed mortgage rates were between 5.5 percent and 6 percent, home loans were being refinanced at an annualized rate of more than $4 trillion. The current level is about one-fourth of that (see Chart 1). The 2003 boom was fueled by the large number of mortgages that had been originated when rates were much higher, making a sub-6 percent rate very attractive. Yet even today, some two-thirds of all outstanding mortgages carry coupons above 5 percent. Millions more U.S. homeowners should be refinancing, significantly cutting their monthly payments. This would be a boost both for individual household finances and for the economic recovery.

Chart 1: Rates Plunge, Refis Putter…



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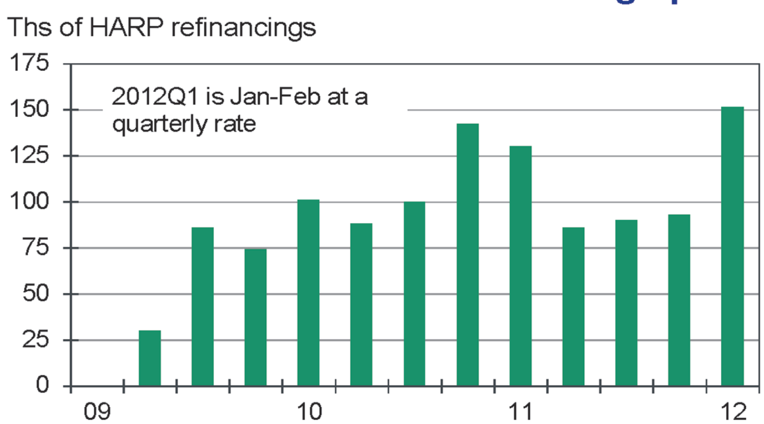
The Obama administration has worked since the introduction of the Home Affordable Refinance Program in mid-2009 to encourage refinancing among homeowners with little or negative equity whose loans are insured or owned by Fannie Mae and Freddie Mac. Originally, the Administration said HARP would allow between 4 million and 5 million homeowners to reduce their interest rates to market levels. But

[2] Calls for policy makers to enable mortgage refinancing have steadily increased since late 2010. *See,* Mark Zandi and Cristian DeRitis, "Restringing HARP: The Case for More Refinancing Now", Moody's Analytics Special Report, October 7, 2010. *http://www.economy.com/mark-zandi/documents/HARP__100710.pdf*

so far, only about 1.2 million homeowners have refinanced using HARP, and just more than 100,000 underwater homeowners have refinanced.[3]

The disappointing results prompted the Administration to make a number of important changes to HARP late in 2011. These included relaxing eligibility requirements, allowing loan-to-value ratios higher than 125 percent, streamlining the appraisal and underwriting process, persuading mortgage insurers to drop recession rights, and requiring Fannie and Freddie to relax their reps and warranties. It has taken a few months for mortgage servicers and insurers to implement the new HARP rules, but the benefits have become evident.[4] HARP refinancings in early 2012 appear to have run close to 50,000 per month, up from 30,000 per month since the program's inception (see Chart 2). Also encouraging has been a more recent pickup in applications for refinancing as reported by the Mortgage Bankers Association. Mortgage servicers appear to be particularly enthusiastic about the possibility of reducing their put-back risk.[5]

Chart 2: …But HARP Refis Are Picking Up…



Sources: FHFA, Moody's Analytics

In February 2012, the Administration proposed even more aggressive steps to support refinancing, affecting all mortgage loans including those insured by Fannie, Freddie, the FHA and nongovernment lenders.[6] Congress is working to implement these proposals in legislation being considered, including the Responsible Homeowner Refinancing Act, the Expanding Refinancing Opportunities Act, and the Rebuilding Equity Act.[7] With a few changes, this legislation should be enacted. If passed quickly, it should meaningfully boost refinancing, speeding the recovery in housing and the broader economy.

For Fannie and Freddie loans, the Responsible Homeowners Act would apply the new HARP rules to all loans, not just those with loan-to-value ratios higher than 80 percent, as is now the case. For nongovernment loans, the Expanding Refi-

[3] The FHFA tracks HARP refinancing activity on a monthly basis. The most recent data are available at *http://www.fhfa.gov/webfiles/23906/Feb2012ForeclosurePrevention.pdf*

[4] See Mark Zandi and Cristian DeRitis, "Improved HARP Will Expand Refinancing and Boost Recovery". Moody's Analytics Special Report, October 31, 2011. *http://www.economy.com/mark-zandi/documents/2011-10-26-Zandi-Improved-HARP-Will-Expand-Refinancing-Boost-Recovery.pdf*

[5] Put-back risk is the chance that Fannie and Freddie will require the servicer to take back a loan that was improperly originated. There is also a risk that mortgage insurers will rescind insurance on a poorly underwritten loan. The cost to servicers of having loans put back has been considerable.

[6] A fact sheet describing the President's housing plan can be found at *http://www.whitehouse.gov/the-press-office/2012/02/01/fact-sheet-president-obama-s-plan-help-responsible-homeowners-and-heal-h*

[7] Recent versions of this legislation can be found at: *http://www.opencongress.org/bill/112-s3085/text; http://www.feinstein.senate.gov/public/index.cfm/files/serve/?File_id=7c86b21c-6466-4684-b8ab-543c76d23ff3&SK=12CACF0005BFD88B9D24F3FC7528118F; http://www.gpo.gov/fdsys/pkg/BILLS-112s2909is/pdf/BILLS-112s2909is.pdf*

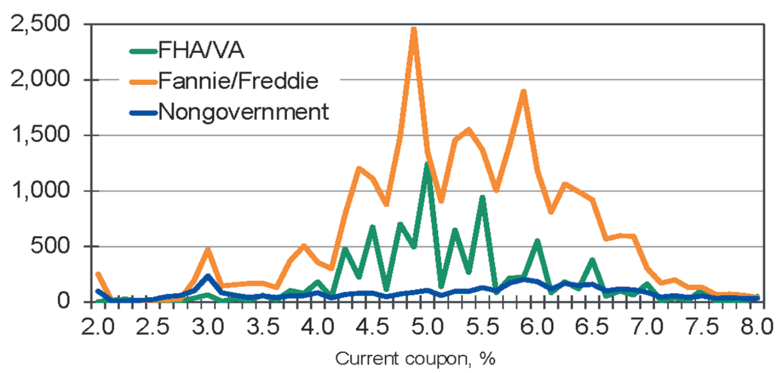
nancing Opportunities Act would allow servicers to refinance into FHA loans. The FHA would drop these refinanced loans from its "compare ratio" process by which the performance of lenders is assessed (analogous to Fannie and Freddie's reps and warranties). The Rebuilding Equity Act would require the Government-sponsored enterprises to pay closing costs when homeowners agree to loans of 20 years or less with monthly payments equal to those on their current loans. This would allow homeowners to build equity more quickly.

This legislation would substantially increase the pool of homeowners eligible to refinance and remove impediments to more refinancing. Significantly reducing the put-back risk faced by lenders on refinanced loans would encourage lenders to aggressively compete for refinancing business. Lowering borrowers' closing costs would increase the incentive for them to participate as well.

If fully implemented, this legislation would increase the number of homeowners eligible to refinance and "in the money" to nearly 21.5 million, covering almost half of all loans outstanding (see Chart 3).[8] Of these loans, 18 million are Fannie or Freddie loans and the remaining 3.5 million are nongovernment loans. The legislation could potential benefit mortgage loans on owner-occupied single family homes with a current mortgage rate above 5 percent and which have been current over the past 6 months. For nongovernment loans to qualify for the expanding Refinancing Opportunities Act, borrowers would have to have been no more than 1 month past due in the prior 12 months, be within the conforming loan limits, and have a credit score above 580. There would be no restriction on when the loans were originated, unlike HARP's current limitation to loans originated before mid-2009.

Chart 3: …And Prospects for More Are Good

First mortgage loans outstanding by coupon, ths



Sources: McDash, LPS, Moody's Analytics

For all this, many homeowners would still not refinance. Yet under reasonable assumptions—including that the legislation is implemented by the fourth quarter of this year and that mortgage rates remain near their current 4 percent through the end of 2013 and rise gradually after that—we estimate that the legislation would result in 4.2 million more refinancings. That comprises 2.9 million Fannie/Freddie borrowers and 1.3 million nongovernment borrowers.

Economic Benefits

The benefit to borrowers will be meaningful. Assuming the average homeowner can refinance into a 4 percent fixed-rate, 30-year mortgage loan, the interest saving would exceed $2,500 a year. Collectively, borrowers' mortgage payments would decrease by more than $10 billion a year (4.2 million borrowers x $140,000 average mortgage balance x 1.8 percent average rate reduction). This would provide a quick cash boost for mostly middle-income homeowners. Some of the money saved would be used to repay other debt, but the bulk would likely be spent on home improve-

[8] This is based on an analysis conducted by LPS using the McDash servicing database and the LPS-AA HPI.

ments or other needs. This would provide only a small boost to overall economic growth, but the U.S. recovery can use all the help it can get.

More refinancing would also further the Federal Reserve's short-term monetary policy goals. Monetary policy makers are considering a new round of quantitative easing—a process in which the Fed purchases long-term securities in an effort to bring down interest rates, including fixed mortgage rates. Indeed, the recent decline in mortgage rates is due in part to expectations that the Fed will resume quantitative easing. If it does, arguably the most significant benefit would involve increasing the pace of home-loan refinancing. Anything fiscal policy makers can do to support the Fed's efforts would be a plus.

Taxpayer Costs

There should be no cost to taxpayers for the additional Fannie and Freddie refinancing. While the agencies would lose some interest income on their $1.2 trillion in mortgage securities and whole mortgage loans, under reasonable assumptions that would be offset by lower default rates on refinanced loans. Borrowers are more likely to stay current if their monthly payments drop by $100 or $200. Indeed, under reasonable assumptions, Fannie and Freddie would break even if the probability of default on the loans and securities they own and insure falls by about 25 basis points. [9]

As the FHA refinances loans of nongovernment borrowers, it will take on added credit risk. [10] Given the FHA's fragile finances, this cost should be paid for. A reasonable way to do that would be a 1-year extension of the higher guarantee fees currently being paid by the GSEs to fund this year's payroll tax holiday. Policy makers should limit any additional increase in guarantee fees solely to support the housing and mortgage markets. It also makes sense to create a separate FHA fund for this purpose, independent of the FHA's Mutual Mortgage Insurance Fund.

The closing costs associated with refinancing into shorter-maturity mortgages to accelerate the building of homeowners' equity should be very modest and borne by the GSEs. The costs will depend on the take-up by homeowners, but under most assumptions the cost to taxpayers via the GSEs should be in the hundreds of millions, and not billions of dollars.

Economic Costs

While homeowners would clearly benefit from more refinancing and taxpayers would be largely unaffected, global investors in agency mortgage-backed securities would be hurt financially. As more loans are refinanced, higher-yielding MBS would be retired and replaced with lower-yielding MBS. To be precise, if a more effective HARP resulted in 4.2 million more refinancings, private investors would receive approximately $6.5 billion less in annual interest income. [11]

MBS investments are held by a wide array of institutions. Through its credit easing efforts last year, the Fed quickly became the largest owner of agency MBS, amassing $1.25 trillion, or about a fourth of the total outstanding. The Nation's central bank can easily absorb the lost interest income from increased prepayments, but this may put pressure on the Fed to be more aggressive in its quantitative easing efforts to forestall a counterproductive rise in mortgage rates. The interest-rate spread between MBS and Treasury yields will increase regardless, but MBS yields need not rise if the Fed buys a sufficient amount of Treasury bonds.

Although other private MBS investors won't be happy to get their money back when interest rates are low, they were aware of this prepayment risk when they purchased their securities. Indeed, investors are likely surprised that their securities have not been retired already, as they would have been in a more normally functioning mortgage market. The updated HARP can thus be seen as a way to correct a serious market failure. It is also important to note that MBS investors have been significant beneficiaries of the monetary and fiscal policy response to the financial panic and Great Recession. The Fed's massive purchases of agency MBS during a previous round of quantitative easing was a windfall. Myriad Federal policies aiming to stem foreclosures have also significantly benefited investors through reduced prepayments.

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[9] The break-even change in the default rate equals the lost interest income divided by the product of the mortgage debt owned and insured and the loss from default, which is assumed to be 50 percent of the mortgage balance.

[10] The credit risk associated with refinancings these homeowners may be relatively low. These homeowners have been paying on their mortgages in a timely way despite the tough economy, their lack of equity, and their inability to refinance.

[11] This excludes the interest income that would be lost by Fannie, Freddie, and the Federal Reserve.

Policy makers may be nervous that overseas investors, who constitute a sizable and growing source of capital for the U.S. Treasury, will be annoyed by faster prepayments. Policy makers may also worry about implications for the financial health of the Nation's depository institutions and pension funds, who also are big investors in agency MBS. While not unreasonable, these seem marginal concerns, given the magnitude of the losses that will be widely distributed among investors.

Another potentially unwelcome side effect from more refinancing today could be less labor mobility in the future. Borrowers who lock in record low mortgage rates now will be less willing to move when rates start to climb. Considering that homeowners are more likely to be skilled workers than are renters, this impediment to labor mobility could aggravate the U.S. economy's current skills mismatch. However, it is difficult to know the scale of this consideration; it seems small against the sizable near-term benefit of a refinancing program. It is also worth noting that homeowners who switch from adjustable-rate to fixed-rate mortgages will be protected when interest rates ultimately rise.

Suggestions

The Responsible Homeowner Refinancing Act should drop monetary penalties on second lien holders and mortgage insurance companies for nonparticipation. The largest mortgage servicers have agreed to subordinate their second liens on mortgages refinanced via the HARP program, and mortgage insurers, except for United Guaranty, have agreed to give up their rescission rights on HARP refinancings. Indications are that second lien holders and MI companies are not a meaningful impediment to more HARP refinancing activity.

Policy makers may also want to consider adding a provision in the Responsible Homeowner Refinancing Act requiring the GSEs to provide timely information regarding approval rates for streamlined refinancing via the automated tools provided by the GSEs to servicers. There is some concern that cross-servicer refinancing is being impeded by low approval rates, and this information would be useful in determining whether this is a significant problem.

The still-fragile housing market remains a serious threat to the economic recovery. Home sales and housing construction are off bottom, but remain at exceptionally low levels, while house prices are still falling in many parts of the country. Millions of families have lost homes, and millions more are likely to follow them, given the unprecedented number of loans in or likely to soon enter the foreclosure pipeline.[12] It is hard to be enthusiastic about the U.S. economy's prospects as long as housing is weak. One of the most effective and straightforward policy steps to ensure that the housing market gets back on track is to facilitate more mortgage refinancing. The legislation currently before Congress to support more refinancing activity would be very helpful to this end.

[12] More than 5 million U.S. homeowners are believed to have lost homes through foreclosures, short sales, or deeds-in-lieu since the housing crash began in 2006. Another nearly 5 million more homeowners are expected to lose homes before foreclosures return to levels consistent with a well-functioning housing market, which we expect to happen in 2015.