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HOUSING FINANCE—WHAT SHOULD THE NEW SYSTEM BE ABLE TO DO?: PART II—GOVERNMENT AND STAKEHOLDER PERSPECTIVES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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HOUSING FINANCE—WHAT SHOULD THE NEW SYSTEM BE ABLE TO DO?: PART II—GOVERNMENT AND STAKEHOLDER PERSPECTIVES

Wednesday, April 14, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Velazquez, Watt, Moore of Kansas, Hinojosa, Baca, Lynch, Miller of North Carolina, Green, Cleaver, Klein, Perlmutter, Donnelly, Foster, Carson, Adler, Driehaus, Grayson, Himes, Maffei; Bachus, Castle, Royce, Manzullo, Biggert, Hensarling, Garrett, Bachmann, Marchant, Posey, Jenkins, and Lance.

The CHAIRMAN. The hearing will come to order. This is the second hearing we are having on the restructuring of the housing finance system, and I stress that because it is not just Fannie Mae and Freddie Mac; to do this thoughtfully, we want to look at the interactivity and interoperability of Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, the FHA and Ginnie Mae, and the private sector.

I think there's general agreement to the extent that we can have the private sector returned to a more vigorous role. We're all for it. And I will begin. We have a Cabinet officer, so we have 8 minutes on each side, and I will start off with 4 minutes for myself, so put me to 4 minutes. Thank you.

The consensus is very broad that the existing system of housing finance has to be changed. The question to me that is at the heart of it is, what do we put in place of the current system? That means legislation, and I hope we can proceed to start drafting that very soon. We had the Secretary of the Treasury testify and now we have the Secretary of HUD. Originally, our plan was to have them both together, but I think this has worked out well.

The Secretary of HUD is always accommodating to us. Having a second hearing is important, because it also gives us a chance to hear from a wide range of people. We will have had in both hearings people from all aspects of the housing field from the producer side, the Realtors and the homebuilders, and mortgage vendors as well as the bankers. We will have had advocates for low-income

housing. We will have had academic commenters on this and all those are relevant.

And it might be contentious to replace the current system, not simply abolish it, and then figure out what is the mix that goes beyond that. There will be some public sector entities, I believe, and some private sector entities. I think one thing that is clear is that the mix of public and private shareholder corporations with a public purpose that was embodied in the Fannie Mae and Freddie Mac model did not work in the end, and tension between those two contributed to the problem. I certainly am convinced of that, going forward.

We shouldn't have that kind of a hybrid situation, and, obviously, there's a lot to be done by the private sector. That may mean nothing more than for the Federal Government to get out of the way, but there are questions that have been raised by Realtors, by homebuilders, by mortgage housers, and others about whether or not some sort of backup authority is there. We want to make clear that the Federal Home Loan Banks, which I think have worked very well, are also squared away in this.

So the task of the committee is to take the lead in figuring out what the new mix of private and public entities should be in housing finance, and I think there is agreement that we need both. We have the FHA. We have Ginnie Mae. We have the Home Loan Banks. One thing I think is clear now is that mix should consist of separate institutions, that the hybrid, private shareholder corporation with a public mission contributed to this problem and we need to untangle that.

I am pleased to see that the Administration has been responding to our requests that we get some movement here, and I know the Secretary will be talking about the statement that was released today from the Departments of Treasury and HUD, asking for comments. There were questions that they put out, and I'm going to ask unanimous consent to put this into the record. I believe the statement has been distributed. If the statement has not been distributed to all members, it should be, and I would ask the staff to distribute it.

So I, at this point, will reserve the minute and 10 seconds left out of the 5 minutes, and I will recognize the ranking member for 3 minutes, according to his formulation.

Mr. BACHUS. Thank you, Chairman Frank. This is an important hearing on the future of housing finance and the Federal Government's role in that. It has been nearly a year-and-a-half since the bailout of Fannie and Freddie, and the Administration has just released today what can only be considered as their plan for housing finance. The chairman referred to it, and that plan is basically to poll the American people to ask them what they want to do about housing finance and the GSEs. So they're simply asking seven questions.

I don't think we need polls. We need leadership. The press release accompanying this list of questions says their goal is to be transparent. What's abundantly clear is that the Obama Administration has no real plan for dealing with housing finance or the GSEs. During the last year-and-a-half, Republicans, on the other hand, have introduced a number of concrete measures to imme-

diately address the failures of Fannie and Freddie, and have issued a strong set of principles and proposed reforms to protect taxpayers from further losses and future bailouts, and to build a stable housing finance system.

One goal I believe we can all agree on is to start with re-establishing a housing finance market characterized by long-term stability and to which private capital is a primary source for mortgage financing. It also means restoring liquidity to the secondary market for residential mortgages and preventing significant disruptions to the financial market. We must encourage innovation and diversity in housing finance that provides more choices for consumers, not less. Just as importantly, reform must protect taxpayers from future losses and future bailouts, and require that taxpayers be made whole on outstanding loans, guarantees, and capital infusions made by the government.

Mr. Chairman, it's long since past-due to deal with these bailout companies, which were the center of the mortgage market meltdown and cause a financial crisis. It's inexplicable that the Administration and the Majority in this House have no plans to deal with Fannie and Freddie and have failed to meet their self-imposed deadlines to come up with any sort of response other than to issue seven questions.

So far, the Administration's answer has been to lift the caps on the bailout of the GSEs, guarantee the GSE's debt, pay the executives multi-million-dollar salaries, and hide the cost. So far, the American people have contributed more than $127 billion to bail out Fannie and Freddie on at least 80 percent of these companies, and have explicitly guaranteed more than $1.7 trillion of their debt and more than $5 trillion in their mortgages.

The CHAIRMAN. The gentleman's time has expired. If you want to give yourself more time, it would come out of the other members' time.

Mr. BACHUS. No, that's fine.

The CHAIRMAN. The gentleman from California is recognized for a minute and a quarter, a minute and 15 seconds; is that right?

Mr. ROYCE. A minute and a quarter.

The CHAIRMAN. Yes, a minute and 15 seconds.

Mr. ROYCE. Thank you, Mr. Chairman.

The CHAIRMAN. 25 means 15—excuse me. I'm doing my math here—a minute and 15 seconds.

Mr. ROYCE. Okay. Mr. Chairman, I think going forward, the mortgage finance system should be based overwhelmingly on private investment. If it is the will of Congress to continue subsidizing affordable housing, which I think would be a mistake, it should be done through direct Federal appropriations. It should not be done through these institutions.

I believe that, because I believe that government intervention was a major contributor to the mortgage crisis and that Fannie and Freddie were primary culprits in this. And I think that part of the problem, already, we see these calls for releasing Fannie and Freddie back into the market as quasi-private institutions. Part of the problem is that when the government creates a duopoly like this, it has enormous power, and it has power to come into the market, but also power to lobby Congress.

So when Fannie and Freddie did not want to be regulated with respect to overleverage, what did they do? They came to Congress and they quashed that legislation, which the Federal Reserve had requested to allow the Feds to deleverage these portfolios. They were leveraged a hundred to one, a trillion dollars was lost.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Pennsylvania is recognized for 3 minutes.

Mr. KANJORSKI. Mr. Chairman, we meet today to continue our discussions about the functions which the new housing finance systems should perform. I appreciate your efforts to focus the Financial services Committee on this complex set of issues and share your interest in these important matters.

Today's hearing is just one of many conversations with stakeholders that we will need to have before determining what legislative actions we should take to achieve the end goal of re-establishing a healthy, stable housing finance system. I approach these debates with an open mind and no preconceived notion of what the solution ought to be. Through careful deliberation, however, I do believe that we can ultimately find the right policy approach.

In late 2008, then-Secretary Paulson placed Fannie Mae and Freddie Mac under conservatorship. Since then, the Treasury Department is committed to the purchase of more than $125 billion in preferred stock of the Enterprises. Government agencies have also purchased in excess of $1.3 trillion in mortgage-backed securities. All of these actions have preserved the availability of housing credit through these difficult times. The government, however, has further scaled back its commitments in our mortgage market since our hearing last month on this same topic. Specifically, on March 31st, the Federal Reserve ended the program to purchase mortgage-backed securities.

As our markets recover from this financial crisis, we must return to the private sector those functions that properly belong with the private sector. Although we must continue to carefully monitor what happens to mortgage rates and investor demand, I am, so far, pleased with the results of this separation.

In thinking about where we should go, we must also consider where we have been. In good times and in bad, Fannie Mae and Freddie Mac have historically proven vital to increasing liquidity and improving the distribution of capital available in home markets. Together, these institutions have helped tens of millions of middle-class families share in the American dream of owning their own homes. I want the new housing finance system to continue to achieve these goals.

While I look forward to hearing the testimony of all the participants today, I am especially eager to learn the thoughts of the Secretary of HUD. His thoughts would help to guide the Capital Markets Subcommittee, as we continue with the explorations begun last June regarding the housing finance system. In our forthcoming hearings, I anticipate that we will explore specific questions like the need for mortgage insurance, the housing finance systems of other countries, and the structure of guaranteed fees. In sum, Mr. Chairman, these important matters are ripe for debate and represent the next big mountain that our committee must climb.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Texas, Mr. Hensarling, is recognized for 1½ minutes.

Mr. HENSARLING. The principal reason we have experienced economic turmoil is Federal policy that has incented, mandated, and cajoled financial institutions to loan money to individuals to buy homes that they could not afford to keep. By most estimates, ⅔ of all the bad mortgages in our system today were either bought by government agencies or required by government regulations with the CRA, FHA, HUD best practices, and perhaps, worst of all, the GSE's affordable housing mandate, all of which combined to wreak havoc in our residential housing market.

So far, the American citizens can think of 127 billion reasons to terminate the GSE's government-sanctioned monopoly status. Clearly, I'm talking about their cost to the taxpayer. I see no economic, practical historical, compassionate or reasonable rationale why our housing markets need Government-Sponsored Enterprises. As they further monopolize our housing markets and hemorrhage taxpayer money, the Administration wants to take at least another year or so to monitor them. The Senate implicitly exempts them from their financial markets' regulatory bill, and the House explicitly exempts them. Enough is enough.

That's why I have introduced H.R. 4889, the GSE Bailout Elimination and Taxpayer Protection Act, that over 5 years would phase-out their monopoly status, give them a level playing field, provide market competition, market discipline, and market innovation. And I would encourage the consideration of this committee. I yield back the balance of my time.

The CHAIRMAN. The gentleman from New Jersey is recognized for 1½ minutes.

Mr. GARRETT. I thank the chairman for holding this hearing. I thank the Secretary for your testimony today. I wish I could also say I would like to thank both of you for actually presenting a plan to this committee that would actually reform the housing finance system and end the taxpayer-funded bailouts of Fannie and Freddie, but I can't do that, because they have not presented that plan.

After the trillions of dollars that Congress and the Federal Reserve has committed to the credit crisis to bail out basically large financial institutions, most Americans who are watching would probably think that Congress would prioritize things, and prioritize things by fixing the most significant problems first. In this case, that would be Fannie and Freddie, the GSEs, which have cost the taxpayers the most money, and, as most experts would agree, are the central cause of this crisis.

Fortunately, that's not the case in this instance. The price tag of bailing out Fannie and Freddie is currently close to $400 billion and counting, with no limit. This is more than all of the other bailouts combined, and, yet, this Administration and this Majority have remained silent and has not even proposed a plan to end the ongoing bailouts and reform the housing finance system.

Worse, and some would say, they are using these two companies as a slush fund, if you will, to support an existing failed housing policy. Mr. Secretary, this cannot stand. This is unacceptable. We

must end the bailout of these entities right now. And with that, I yield back.

The CHAIRMAN. I will yield myself my one remaining minute and 15 seconds, and then the gentleman from Alabama has 45 seconds left. And I want to reiterate that we agree that the system needs to be changed.

Where we have a disagreement between our two sides is that I agree with the Realtors, the homebuilders, the mortgage lenders, the low-income housing advocates, and a wide range of people who are on all sides of the housing industry that simply ending Fannie and Freddie with no idea of the replacement would do damage at a time of economic difficulty. We are in the midst of recovering from a very deep recession, but we are clearly not fully out of it and have much to do, and the housing sector is a part of it.

I have read the Republican plan. I read the plan that they submitted in the bill that we did on financial reform, although we will note in their recommittal motion, which was the last vote that they offered in the Financial Reform bill, the proposed to kill their proposal. That is, they offered a recommittal motion that if it had passed would have led to no action in this area. So they have been on again, off again.

I also regret they didn't join us in trying to limit the salaries, so the key question then is not whether or not we abolish them, but whether we at the same time work to put something in their place.

The gentleman from Alabama is recognized for 45 seconds.

Mr. BACHUS. Mr. Chairman, it is time to quit asking questions and introduce legislation. I yield the balance of my time to Mr. Royce.

Mr. ROYCE. Well, the other point I would just like to make is that I am hoping that we learn something, and my worry is that we erased market discipline in this equation by this government backing or implied government backing of Fannie and Freddie. And unless we figure out a strategy that brings the market back, I don't know how we avoid a situation in which Fannie and Freddie will again grow into a powerful duopoly, come up here, lobby Congress to get out from under the regulators and avoid the kind of regulation of the portfolios that we saw. Thank you.

The CHAIRMAN. Mr. Secretary. And let me say we have the Secretary here. We do not hold Cabinet officers generally to a strict 5 minutes. We hope you talk faster than the Chairman of the Federal Reserve generally talks, but we won't be cutting you off at 5 minutes.

STATEMENT OF THE HONORABLE SHAUN DONOVAN, SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary DONOVAN. I will endeavor to do so, Mr. Chairman. Thank you.

Mr. Chairman, Ranking Member Bachus, and members of the committee, thank you for inviting me to talk about Fannie Mae and Freddie Mac, together often referred to as the GSEs and the Obama Administration's efforts to reform our housing finance system.

As Secretary Geithner reviewed during his testimony before this committee last month, there were many contributing factors that led to the housing crisis of the past few years. I will not revisit those factors in detail, but suffice it to say that there is plenty of blame to go around from Wall Street to government to consumers and, of course, the GSEs.

The Obama Administration's comprehensive response to the crisis has helped restore stability to the housing market, easing the very painful fall in home prices and contributing to our broader economic recovery. According to the Federal Reserve Board, stabilizing home prices and lower financing costs nationwide have supported the recovery of homeowner wealth. Homeowner equity started to grow again in the second quarter of 2009, and to date has increased over a trillion dollars or $13,000 on average for the Nation's nearly 78 million homeowners.

Over 4 million borrowers have refinanced their homes in the past 15 months, saving an average of $1,800 per year on housing costs, pumping an additional $7 billion annually into local economies and businesses, and generating additional revenues for our Nation's cities, suburbs, and rural communities. And, just last month, our economy started creating jobs again—162,000 of them.

At the end of 2009, quarterly economic growth increased at the fastest pace in 6 years. For all this progress, however, it is important to recognize that the housing recovery remains fragile. And, while the current status of Fannie Mae and Freddie Mac in conservatorship is a temporary one, they are playing a critical role in these still uncertain times. That is why as we think through the next steps in reforming our housing finance system, we must proceed carefully to avoid undermining the stability that has been achieved.

As we consider housing finance reform and the role of the GSEs, I would like to speak today in more depth on three particular subjects. The first is the importance of maintaining equal access to housing credit. The second is facilitating a responsible, sustainable form of homeownership that involves safe, easily understood products. And the third is ensuring that reform creates a sustainable and stable market for rental housing, which is directly related to and influenced by the single family ownership market.

America has a long tradition of leveraging capital markets to make long run investments that produce significant benefits. In recent decades, we witnessed a great democratization of credit. This broadening of access allowed many families who had previously been shut out to make investments in homeownership, and we subsequently witnessed the dramatic growth in ownership among underserved groups. Though the current crisis reminds us that great care is needed to promote homeownership that is sustainable over the long term, the Obama Administration will remain committed to providing access to underserved groups so that they can make long-term, sustainable investments in housing.

Responsible homeownership can be a critical foundation upon which American families build wealth and stability. At the same time, we must also make sure that our commitment to access does not encourage the taking of imprudent risks. Consumer behavior was a contributing factor to the housing crisis, and we have seen

the devastation that such risk-taking has inflicted upon families and communities across the country.

Many borrowers simply used their homes like ATM machines without sufficiently considering the risk involved. Ultimately, we need a housing finance system that will help us once again see housing, not simply as a tool for investment returns, but as the platform for stability that it has been throughout our history. That will mean that for some, homeownership will not be the right answer. As you have noted on numerous occasions yourself, Mr. Chairman, while we continue to promote affordable homeownership, for many Americans, renting will continue to be the only or the preferred option.

Therefore, the next generation housing finance system must also facilitate a healthy rental market as part of a comprehensive, balanced national housing policy that supports responsible homeownership and affordable rental housing alike. That requires ensuring that those renting have a real choice, meaning affordable housing that is close to schools, work, and amenities. A well-functioning rental market also will be particularly important in the immediate future as rental markets will absorb a larger than usual number of families who owned homes during the bubble, but will be renting in the near future.

We thus cannot consider reforms to the ownership market without also factoring in the effects on rental markets. Those families with the fewest assets and resources, namely those who rely on the rental market, or are tenuously attached to homeownership, would potentially be exposed to greater volatility and turmoil absent a stable rental market infrastructure. We therefore must be careful to promote policies that provide countercyclical support for rental markets as we have for single family ownership markets. All of these issues point to the need for fundamental, but careful reform. Transition from where we are today to where need to be, however, presents several important challenges.

The Administration is committed to supporting the continued activities of the GSEs in ensuring they have sufficient capital to honor any guarantees issued now or in the future and the ability to meet any of their debt obligations. Given the nascent state of our recovery, the Administration will take care not to pursue policies or reforms that would threaten to disrupt the function or liquidity of these securities, or the ability of the GSEs to honor these obligations.

We recognize the central importance the mortgage finance market plays in the broader capital markets and we will ensure that this market is not allowed to be disrupted. Maintaining the GSEs' current securitization operational flow, TBA liquidity, secondary MBS market liquidity, and their ability to issue corporate debt securities during the transition will remain key priorities for the Administration. In his testimony before the committee last month, Secretary Geithner announced that we would be releasing a series of questions to solicit the public's thoughts on housing finance reform. In keeping with that commitment, HUD and the Treasury have today released a copy of these questions, and they will be submitted tomorrow to the Federal Register to be published for formal public comment. The questions are as follows:

"How should Federal housing finance objectives be prioritized in the context of the broader objectives of housing policy? What role should the Federal Government play in supporting a stable, well-functioning housing finance system, and what risks, if any, should the Federal Government bear in meeting its housing finance objectives? Should the government approach differ across different segments of the market, and if so how? How should the current organization of the housing finance system be improved?

How should the housing finance system support sound market practices? What is the best way for the housing finance system to help ensure consumers are protected from unfair, abusive or deceptive practices?" And, finally: "Do housing finance systems in other countries offer insights that can help inform U.S. reform choices?" These questions will help us consider what functions should be served by different factors in the system, the structure or structures that they should take, how they should fit within both our broader housing finance system and housing policy goals, and the best steps to get from where we are today to a stronger system.

The public's input will be invaluable as we think through these difficult and complex issues, so we will take that input in two forms. First, we will ask the public to submit written responses to the questions. The Federal Register notice will contain guidance on where and when the public should submit their responses. Second, we intend to hold a series of public forums across the country over the summer, and follow this year to give the public an additional opportunity to share with us their thoughts on reform.

Together, these opportunities for input will give the public the chance to deepen our understanding of the issues and shape our response as we move forward over the coming year. This is both in keeping with the Administration's commitment to openness and transparency and the careful, deliberative way that we have approached our housing recovery today. We are committed to ensuring that all the stakeholders around GSE reform are heard from.

And, so, Mr. Chairman, Ranking Member Bachus, and members of the committee, the Obama Administration is committed to building a next generation system of housing finance that meets the diverse housing needs our country requires while building on the nascent housing recovery we have established to date: protecting the taxpayer, and above all, ensuring we prevent a crisis of this magnitude from ever happening again. Given the challenges we still face, we must take a responsible approach to housing finance reform in which transition is not marked by hasty changes that could threaten another breakdown in the market, but by care and deliberation as we work with Congress to develop proposals, to support the institutional structure for the next generation of housing finance.

In the months to come, I look forward to working with you, Mr. Chairman and the members of the committee, to make this charge a reality. Thank you.

[The prepared statement of Secretary Donovan can be found on page 67 of the appendix.]

The CHAIRMAN. Mr. Secretary, as I said, I believe there was agreement that we should abolish Fannie Mae and Freddie Mac, and there was reference only to their lobbying power. I would refer

people to Secretary Paulson's book in which he describes how he became Secretary of the Treasury in 2006. And he then describes the relationship he had with this committee in particular from then on, in which Fannie Mae and Freddie Mac were not successful in efforts to slow things down.

We worked with him, as he noted, and he points out that at the point when he was determined that they had to be put into conservatorship because of the serious problems, that he anticipated they might resist, and he notes that he checked with Members of Congress, including me, and was reassured that we would be fully supportive of his efforts. So from the time he became Secretary, he was in charge of this for the Bush Administration and as he notes, received pitiful cooperation other than what he was looking for, and so I think people here are projecting to an earlier period when they conjure up this image of an irresistible Fannie Mae and Freddie Mac.

They had a pretty good run for a while, but as Secretary Paulson points out, in 2006, when he became Secretary, because of the unhappy consequences the Administration felt it encountered in the Congress at the time, he said he wanted to approach the Congress to reengage on this reform effort and most of the White House advisors said no, but he, at the advice of Karl Rove, went to the President. Mr. Rove told him that the President would listen to him. And he went to the President, got the mandate to make the changes, and was unable, he said, to make some very real progress that came too late. He was then obviously—it had been done years earlier.

But from the time he became the Secretary, he was able to move fairly quickly, so I didn't want to put that one I think to rest. The question I would have for you is this, and you talked about it. If we were to abolish Fannie Mae and Freddie Mac and not do anything else, not legislate for the structure going forward, what would be the result, in your judgment?

Secretary DONOVAN. Let me address that question in two parts, Mr. Chairman. First of all, if we were to do that quickly and the long run effects of that to the market—I can't emphasize this enough: I believe, given our strong actions around housing, we have made significant process, and I have detailed that progress in my testimony. But this recovery remains fragile. Let's remember that the loans that have caused the devastation to the GSEs to taxpayers were loans that were on the books at the time the prior Administration took them into conservatorship, and anything that we would do that threatens this housing recovery that would push housing prices down again will only increase the losses on those loans. And hasty action to quickly change the composition of the GSEs or to eliminate them, I have no doubt would further drive down this housing market and cause taxpayer losses to increase.

The CHAIRMAN. Because we are talking about the sunken cost, in the current ongoing activities of Fannie Mae and Freddie Mac, new activities, new communities, are we incurring losses?

Secretary DONOVAN. Every indicator that we have of new loans being made, given the increased fees that they have put into place, the higher underwriting standards, and the fact that we have seen home prices—Case-Shiller index up or flat, 8 months in a row—has

meant that these new loans at this point appear to be high quality loans that will make money—

The CHAIRMAN. So, the ongoing activities are not causing further losses?

Secretary DONOVAN. The losses that they are experiencing are due to loans that were on their books at the time of—

The CHAIRMAN. And apologizing does not make that obligation go away.

Secretary DONOVAN. That's exactly right. In fact, hasty action would have the effect of potentially increasing those losses as well as putting newer loans at risk. So, let's be very clear here that while there were enormous mistakes made, that doesn't mean that the GSEs are not playing an important role in stabilizing the market. One only needs to look at the difference between the jumbo market today and what is happening in the market where FHA, Fannie Mae, and Freddie Mac are providing credits. The enormous difference is in interest rate costs and availability of credit to see the important role they are playing.

Let me just add one other thing. Going forward, I also believe that while there are very difficult complex issues in balancing the role that the Federal Government takes in the housing market, if we look at this crisis and imagine if you will, not having the ability of the FHA or the GSEs or other institutions to step in to the market, if we eliminated them entirely or at least eliminated the ability for the Federal Government to support the market during these times, I would think that we would have had a much worse housing crisis than what we have seen today at this point in this market.

The CHAIRMAN. Thank you.

There are plenty of seats, so if people would just take a seat—let me just say there are also seats in the front row. Some Administration officials who testify need more backup than others. Secretary Donovan comes to us with some knowledge of housing. The benefit of that is there are a lot of empty seats behind him, because he doesn't need 18 people to answer questions for him. So people should feel free to take all the seats and that would—let's get everybody in quickly, please, and take some seats. Well, this is not hard sitting down. Thank you. The gentleman from Alabama.

Mr. BACHUS. Thank you. Secretary Donovan, I think we all agree that the GSEs will continue to hemorrhage losses as the government uses them to support expensive foreclosure mitigation programs and advance other Obama Administration housing priorities. I think you are aware the Federal Reserve Chairman, Ben Bernanke, has urged immediate attention to resolve the GSE's future. Do you agree that there needs to be immediate action?

I noticed that Secretary Geithner told the Budget Committee recently that the Administration is not prepared to address the GSE's long-term future even though Chairman Bernanke told our committee that he believes the plan for reform should come as soon as possible, "The sooner you get some clarity about where the ultimate objective is, the better." Would you like to comment on his statement?

Secretary DONOVAN. I would say two things. First of all, if you look in detail at the way the GSEs are implementing their loan

modification programs or other efforts, it very carefully looks through the use of net present value tests and other tools at modifying or reducing principal on loans where that will have a net present value positive to the GSEs. So I believe strongly and I think if you look at the details of it, the actions that they are taking on modifying mortgages are not only good for homeowners, but they are good for the GSEs and for the taxpayer as well.

Mr. BACHUS. Do you think we need a reform proposal for the GSEs as soon as possible?

Secretary DONOVAN. I would say that we need a reform proposal for the GSEs as soon as possible, given the need to maintain the stability of the current market. As I said just a moment ago—

Mr. BACHUS. When do you think—right now we just seem to be—your all so-called plan that was released just today, it just asks questions. I guess you're hoping that somebody else will give you the answer but—

Secretary DONOVAN. I laid out in my testimony, Congressman, four goals for the housing finance system, nine different principles that we see as critical. You talked about principles in your opening statement. We laid out nine principles in my testimony that we think are important for the system, and we believe that the public should have the ability to have input and to learn, to benefit from their knowledge about this system. We cannot move hastily on an issue as complex as this or as important as this to the housing market and risk a downturn that as I said a moment ago, could end up costing the taxpayer millions of additional dollars if you take a wrong step.

Mr. BACHUS. Well, let me ask you this, and I don't mean to interrupt you, but it has been 18 months since the Obama Administration took over, and these questions could have been asked 18 months ago. Why did it take 18 months to come up with a group of questions? You look at these questions; one of them just says, "Do housing finance systems in other countries offer insights that can help inform U.S. reform choices?" Couldn't we have answered that 18 months ago, with just a "probably" or "possibly?"

Secretary DONOVAN. Congressman, we believe it is time to engage in a full and thoughtful dialogue leading to a likely legislative proposal that would get moved through Congress this year—

Mr. BACHUS. Well we have had—

Secretary DONOVAN. If I could finish answering the question, please. We believe that—and we have been completely focused on healing this housing finance system and the housing market and the economy more broadly. We have made substantial progress on that and we feel strongly that had we embarked on this process a year ago, we would have put that recovery at significant risk. And so, we believe this is the responsible way to engage in a process on a timeline that is responsible in terms of making sure that American homeowners and the taxpayer are not put at further risk.

Mr. BACHUS. Okay, well, let me ask you this. There is time for action, the time for questions and dialogue—we have been doing this for 18 months. The Republican plan has been out there for 18 months; we have made our proposals. And here today to just ask

some more questions, don't you agree that the time for just asking questions is over and the time—

The public has had input for 18 months. You could have asked them those—and I'm not criticizing you personally, but let me say—when can we expect legislation? That will be my last question.

Secretary DONOVAN. As Secretary Geithner said in his testimony, our expectation, particularly given the full legislative calendar that you have, is that we would have full discussion with the public, with the committee, with the Senate as well, and that we would move to legislation in the following year that would reform—

Mr. BACHUS. The following year?

Secretary DONOVAN. I think—I would certainly expect it will be difficult to move legislation and complete that legislation this year. And we believe again, that the housing market at this point is fragile enough that we need to—and let me just be clear, we have taken substantial actions on the housing market.

Just as an example, as you know and I very much appreciate the constructive work that you have done with us around FHA to improve the underwriting that we have taken—extensive actions, we have on a number of different fronts, whether it is ensuring low interest rates, ensuring continued availability of mortgage capital, keeping homeowners in their homes, helping communities hurt by this housing crisis. We have taken extensive actions on the housing crisis and on the housing finance system. We simply do not feel that moving in a way that could hurt this housing market further is responsible at this point.

Mr. BACHUS. Thank you.

Mr. KANJORSKI. [presiding] Thank you, very much. I know the gentleman from Alabama is careful with his facts and figures, but I just want the record to reflect that we can't count the Obama Administration in office for 18 months, unless I am radically mistaken, as the best I calculate is something like 15 months.

Also, I think we—and the reason I bring it up is that we have just gone through a horrible example of misrepresentation of pertinent facts in the healthcare act. Having returned from my break period, I was overwhelmed by how much information, misinformation, and disinformation has been put out to the public over the last year on healthcare. I would hope we do not do the same thing on financial reform, regulatory reform, or housing and GSE reform. Let us try to hold to the real facts, and the facts are the Administration has not been in office 18 months, do we agree with that?

Mr. BACHUS. I would say maybe 15 months, I just say that is long enough to ask questions—

Mr. KANJORSKI. Mr. Secretary, there are a few things that disturb me. We have, of course, a bifurcation of legislative responsibility, and we have some very important pending legislation that has been passed by this committee and the House of Representatives that seems to go to "no-no" land when it gets over into the other side. Do you have any insight as to what may happen on housing reform bills? I have several of them that are pending there. Have you had some inside information or intelligence as to what the Senate is going to do on those pieces of legislation, or can we just assume they are going to do nothing?

Secretary DONOVAN. I am sorry, Congressman, could you be more specific about which pieces of legislation? Is this financial regulatory reform or other housing bills?

Mr. KANJORSKI. Well, as part of a regulatory reform we have included in some of the housing reform legislation in the House, and that is presently pending. However, the Senate bill does not include that, so we can assume that they have abandoned that reform in the regulatory reform bill. Then, we have a freestanding bill with the same information of appraisals, etc., and how we should handle that. Are you getting any insight as to whether or not they are going to move forward with that reform bill?

Secretary DONOVAN. What I can tell you is the entire economic team has been working closely with the Senate committee. Obviously, they have moved a bill at the committee level and we continue to work with them. I can't give you any insight into their legislative calendar in terms of bringing those to an actual vote.

Mr. KANJORSKI. Do you see a possibility that we can actually strive to accomplish something here, as opposed to just having political objectives over the next 7 to 8 months, since we are in the silly season? Can we just anticipate that nothing serious is really going to transpire and that is why you are saying we have to wait until next year to get serious reform in GSEs?

Secretary DONOVAN. What I believe—first of all, let me say that serious reform is not only possible; it is absolutely necessary. There is no question that we cannot allow the crisis we witnessed to happen again. That is why the President has been so focused on broader financial regulatory reform and it is why we are absolutely committed to making sure we have a housing finance system in the long run that creates the right incentives and provides the right opportunities.

What I will also say is we are absolutely committed to having a full and thorough examination of these issues, and whatever the discussions may be in Congress about what could move or couldn't move, we will be moving forward with a thorough process which I discuss today to ensure that we think through all of the potential implications as well as the complexities of the transition from the system where we are today to what it should look like going forward.

Mr. KANJORSKI. Mr. Secretary, I am joined as a co-sponsor on a piece of legislation involving covered bonds commonly used in Europe but not in the Unites States. We are looking at the best practices around the world in creating a situation for liquidity and responsibility for mortgage market expansion in the United States, and we have not even held hearings yet on the covered bond bill that is pending here; the ranking member sponsors that legislation, too. Therefore, I just want to make the point that we certainly could not be adopting best practices around the world if we had not had the chance to consider that type of legislation; would you agree?

Secretary DONOVAN. Absolutely. I think it is an area that is worth looking at, and in fact, we do have certain structures in this country already that are similar to and function similar to the kinds of structures that you are talking about. I think the issue is really going to be thinking seriously about whether a market of our

scale and our sophistication can adopt practices like that in a way that they would be equally functional here. And I think there are some mechanical as well as institutional issues about whether in fact those examples are replicable or the right examples for here. And I look forward to discussing that further with you.

Mr. KANJORSKI. Thank you very much, Mr. Secretary. The gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. Secretary Donovan, in your written testimony, you lay out the four priorities for the Administration for a well-functioning mortgage market in the future. You say a widely available mortgage credit, housing affordability, consumer protection, and financial stability. And I think in principle, these are worthy goals. In practice, we found that these can be competing interests, right? So looking back, would you agree that too much of an emphasis was placed on housing affordability and too little of an emphasis was placed on financial stability?

Secretary DONOVAN. I do not agree that an overemphasis on housing affordability was the primary cause of the crisis that we saw. I believe that the affordability goals lacked clarity and that too often we mixed certain affordability goals without either clarity or precision with broader mandates, and that for affordability going forward we need to have a much clearer set of objectives and mechanisms to achieve them; I think that is laid out in the testimony.

However, I think if you look really at the facts of—for example, take the affordability goals of the GSEs. Our recent study which we presented to Congress on the causes of the financial crisis looked in detail at the full range of loans that were eligible for the GSE affordable goals; it discounted all of the high costs or riskiest loans. So just within the pool of good, low interest rate loans that would have qualified for the affordable housing goals, the GSEs only purchased about a third of those loans. And so what does that mean? That means that they were not forced to go into risky lending to able to achieve those goals.

Mr. ROYCE. Now, wait a minute. Let me stop you there, because we had Secretary Geithner here last month, and he described how the GSEs used those goals to justify their purchases of subprime and Alt-A loans. He went over this, and over the years, those total roughly one trillion dollars. Now, many have attributed those loans to making up the bulk of the losses of the GSEs. Numbers that I have seen show that it is the vast majority of the losses.

So based on Secretary Geithner's testimony and based on economists that have looked at this, they have come to a different conclusion there and they see the trillion dollars in meltdown that the GSEs were either holding in their portfolio or had guaranteed as a real problem. And he made the observation that the whole financial calamity started in this housing sector and it started with the collapse of Fannie and Freddie.

Secretary DONOVAN. There are two things I would say about that. First of all, the large majority of the worst loans that led to this crisis were PLS Private Label Security loans that were not ultimately GSE loans. They did buy a portion of those but I don't think—

Mr. ROYCE. Let me ask you this, because I have looked at that—Countrywide.

Secretary DONOVAN. If I could just—I don't think it is right to say that the GSEs led into this crisis, there were plenty of other—

Mr. ROYCE. Let me quote somebody from within Fannie who said, "We went out and we bought Countrywide, and the reason we were doing it every quarter was to a send a signal to the market that if the Government-Sponsored Enterprises were buying this and putting it in their portfolio, and if it were half of their portfolio—these subprime and Alt-A loans—half of $1.5 trillion, that was then a message to the rest of the market to do the same."

Getting back to my opening statement, my worry here is that what wilted on the vine here was the market discipline. And one of the ways that we ran off-market discipline and due diligence was that we implied a government backing and that we knew what we were doing in government when we put these goals out there and we said, yes, these were safe purchases. The junk that was Countrywide was held by Fannie and Freddie, and everybody else then began buying it, that is the concern I have.

Secretary DONOVAN. And you and I agree Congressman, first of all, that those—you call them junk loans—

Mr. ROYCE. Yes.

Secretary DONOVAN. And I can't disagree, were the primary cause of the downfall of the GSEs; I agree. And Secretary Geithner and I agree on this as well. They were an enormous problem and it was when they began buying those loans that we ended up heading down the path that we had. Where I am disagreeing—and Secretary Geithner and I do not disagree about this point—the primary cause of their buying those loans was not—and I think if you look at the record, if you look at the report we did to Congress—was not driven by the affordable housing goals. They were chasing profits; they were allowed to buy those loans—

Mr. ROYCE. Look, I carried the legislation to stop them from doing—

The CHAIRMAN. The gentleman's time has expired. We are well over, and have a Secretary here, so everybody wants to ask questions. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. I would like to thank the Secretary for being here. And I thank him also for being in Charlotte in my congressional district during the break, and for the very positive visit he had there.

Mr. Secretary, one of the things that you said in your statement is that we have to do this GSE reform in a way that doesn't have an adverse impact on affordable rental housing. Can you give me a brief statement on the extent to which the GSEs if any, were involved in rental housing finance as opposed to homeownership finance?

Secretary DONOVAN. I would say really over the last decade the GSEs have become an increasingly important presence in the multi-family markets with the—as we saw in the single-family market, during the recent, during the crisis that we have experienced, their role growing significantly as has FHA to ensure that mortgage capital remains available at a time when the private market had withdrawn. And so, it is a very similar kind of role that ensures that there is capital significantly available.

In addition to that, the other very important role that they had historically and that grew over the last decade was providing equity for low income housing tax credits, and that is something that has been really eliminated in terms of their purchasing new tax credits since they went into conservatorship, which has been a major challenge for the rental housing finance market.

Mr. WATT. And going forward, would you think that separating whatever the new model's responsibilities are for homeownership should be separated in some way from rental? Would that make our tasks simpler or would it complicate matters, from your view?

Secretary DONOVAN. That is something in fact if you look at the questions that we are examining that we released today, that is one of the specific areas that we are very focused on, is the segmentation of the market; and I see this at FHA as well.

What I will tell you is that there are significant benefits of having those two functions aligned, but I think it is an important question of how much they need to be aligned and which pieces of housing, rental housing finance and support, mission support, should be brought together. So I can't give you at this point a specific answer about whether we should keep them together, but I will say that there are real benefits to that. And I also think we need to look very carefully at the question of the more deeply targeted affordability and where real subsidies are needed, how we ensure that continues. And that, I think is more likely something that remains a mission of HUD at FHA rather than being mixed into the GSEs missions.

Mr. WATT. You mentioned that you will, when you put these questions out to the public, put a timeline on it, and I—one of the concerns that I do have and share with my Republican colleagues is making sure that the Administration's timeline for getting responses to this series of questions corresponds with the timeline on which this committee and Congress is moving. When do you anticipate the cutoff date for responding for the public's response to the questions that you will be—you and the Secretary of Treasury will be posing?

Secretary DONOVAN. As I said, we will be transmitting them to the Federal Register. I expect that they will be published next week, given the time that they work on. And we would—our expectation is to set a 60-day timeline for responses on those questions.

Mr. WATT. So you think it is realistic for this committee and Congress to be thinking about this as a next-year project to deal with the GSEs? Is the Administration going to have a specific proposal by that time early next year, do you think?

Secretary DONOVAN. That is why we are setting up the forums that we talked about, in addition to the public comment process on the questions.

Mr. WATT. When will those be completed?

Secretary DONOVAN. Those will be happening through the summer and the fall, so I would certainly expect that the timeline you talked about to be able to have a legislative proposal next year would be one that we could work towards.

Mr. WATT. My time has expired. I thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you Mr. Chairman, Mr. Secretary.

Forgive me, I had an appointment outside, so we may be covering some old ground here, as I think I heard you say that in your opinion, it was the profit seeking of Fannie and Freddie that caused their demise as opposed to their affordable housing goals. Did I understand that correctly?

Secretary DONOVAN. What I was saying is that if you look at the facts about the broad pool of loans that qualified for the GSE goals and the fact that the GSEs only bought about a third of the save loans that would have qualified for GSE goals, I think it is pretty clear that the goals didn't force the GSEs to start buying the subprime and riskiest loans that ultimately caused their demise. Based on our investigation of the causes there had to be—

Mr. HENSARLING. Then what did cause their demise?

Secretary DONOVAN. I believe—and this is what our report showed—that the lack of strong controls on their reserve requirements, their ability to purchase those loans, and put them into their portfolio was—and chasing substantial profits, as much of the rest of the market did at that point in these subprime, highly risky loans was ultimately what lead to their demise. That is why I think it is so clear that as we think through this system, we have to be very, very careful about how we construct this blend that existed or how we replace the blend that existed of private entity with public mandate. That—

Mr. HENSARLING. Mr. Secretary, I think I agree with something the chairman said earlier. I hope there is a consensus that this neither private nor public model has worked, that it has failed.

But if you say that to some extent it was profit seeking of the GSEs, why is it that the Administration hasn't taken any action to reduce the portfolio limits, which have traditionally been the huge profit center of Fannie and Freddie? And as you well know, in earlier legislation we increased the conforming loan limits that has created, again, more revenue stream for Fannie and Freddie and created more taxpayer—why has the Administration not taken any initiatives in this regard?

Secretary DONOVAN. In fact the requirement was for FHFA to reduce their portfolios, and we have—FHFA has begun reducing those portfolios along the lines that were required by Congress. So that is, in fact, happening. Those actions are being taken by FHFA, and—I'm sorry, in terms of your second question?

Mr. HENSARLING. It was portfolio limits and conforming loan limits.

Secretary DONOVAN. The conforming loan limits, just to be clear—and we had this discussion before while you had stepped out. I want to be clear that what is driving the losses at the GSEs is the bad loans that were on the books, in the portfolio at the time they were taken into conservatorship. Every indication is—and obviously this depends on the strength of the housing market going forward—that new loans that they are taking onto the books, given the improved underwriting that they have implemented, the higher fees, and a rage of other steps, is that new loans are not the biggest risk to the taxpayer.

What is the biggest risk, at this point, is if we were to have a double dip in the market, the market were to go in the wrong direction, that would have the effect of significantly increasing losses

to the taxpayer, and that is why we believe it is so important that we take a measured, careful approach to reform that would not cause the housing market to be sent into a double dip.

Mr. HENSARLING. I'm not sure how careful it is. Certainly, the Administration is not rushing into this, I would say, having spent lo these many months still monitoring the situation.

I think you mentioned stability in the marketplace. Frankly, what I see in the marketplace now is that if we want a mortgage in America, there is a 90 percent chance I have to go to the Federal Government. It is either controlled by the GSEs or FHA. I see taxpayers are hemorrhaging at roughly $6 billion a month. If that is stability, I think I might want to look at something else. I would hope that this is not what the ultimate Administration goal is, is to have 90 percent of the American people have to go to their Federal Government to get a mortgage.

Secretary DONOVAN. So, there are two things I would say. First of all, again, we have to be very clear about loans that are on the books versus new loans that are being made. If you look at our expectations of FHA's new lending reflected in our 2011 budget, we expect to return more than $5 billion to the taxpayer based on new loans that we make in 2011. So these are good loans.

But more importantly, I think we have to look at the fact that these loans that were made, if we do not stabilize this market—we have had 8 months in a row of increasing or stable house prices. We have had significant positive impacts on the market. We cannot do something that would cause this market to fall further. We are absolutely committed, and I couldn't agree with you more, that our goal is to bring the market back, and we have begun to do that by—

The CHAIRMAN. That is all your time.

Secretary DONOVAN. —the Fed and other steps. FHA is raising its pricing—

The CHAIRMAN. The time has expired.

The gentleman from Indiana.

Mr. CARSON. Thank you, Mr. Chairman, and Mr. Secretary.

First, Mr. Secretary, can you definitively say reform will serve underserved populations and communities; and second, how can housing and finance reform offer access to capital by as wide a variety of institutions as possible, including small business, community banks, and credit unions?

Secretary DONOVAN. To go back to the chairman's opening statement, I think it is very important as we are engaging in this process—and this has been a focus of ours—that we look not just at the GSEs, but more broadly at the housing finance system to look at the impacts that FHA can have, the Federal Home Loan Banks, other institutions, but also CDFIs, other institutions that can—so I think it is very important as we engage on this that we do look at broad availability and access to capital. I think that in part can be through the direction we take with reform of the GSEs.

But I think equally and perhaps more importantly, the creation of a strong consumer financial protection agency as a part of financial regulatory reform to ensure that we are offering safe products across the board, and that those are widely available, is a critical part of ensuring that we do that.

So I do think as we move forward—and this was emphasized in my testimony today—that broad access to capital is critical, as well as ensuring standardization in the market and broad availability of entry into the market so that we get small businesses and others being able to participate. Absolutely important. But I don't think that we can put all the weight of that on whatever the reform process for the GSEs looks like. We have to look more broadly at the financial regulatory system and efforts we make there in financial regulatory reform.

Mr. CARSON. Thank you, Mr. Secretary.

Mr. Chairman, I yield back my time.

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman, and welcome, Secretary Donovan.

Secretary DONOVAN. Thank you.

Mrs. BIGGERT. It seems to me that the GSEs have exposed the fallacy of bifurcated mission or consumer protection regulation from the safety and soundness oversight. When HUD oversaw Fannie and Freddie's affordable housing mission, and OFHEO served as its safety and soundness regulator, it seems the result was a $127 billion and growing bill for the American people.

Do you think that the—I'm worried that the Obama Administration is poised to make the same mistake by creating a consumer financial protection agency. Can you explain how the financial institution supervision would be more effective when one regulator has a focus on consumer protection and might potentially conflict with the safety and soundness?

Secretary DONOVAN. I guess I would have to disagree. The fact of the kinds of loans that were made that led into this crisis—if we had had a stronger consumer protection focus rather than within the mortgage space having seven different regulatory agencies that had some piece of responsibilities for consumer protection—a single agency focused on that task—that would have made a real difference in terms of the lack of focus on consumer protection and the types of loans that were being made.

I think there is no question that we also need stronger safety and soundness, that there was not adequate focus, but I don't agree that it was—the fact that those two might have been together interagency. I think it was the very disperse nature and fragmented nature of that system that led to the problem, and that is exactly what financial regulatory reform is intended to resolve.

Mrs. BIGGERT. I guess there is the difference with regulators and OFHEO, not that seven regulators that were really involved with the GSEs. But let me just ask another question, and that is we need transparency. And the public I think really does deserve easy, accessible information about the actions of the FHFA, which runs the GSEs, and they need information about the actions of the Fed and the Treasury that are supplying the funds. Would you support legislation to increase the GSE transparency?

Secretary DONOVAN. I would—first of all, I think that increasing transparency broadly is a very important goal that we have, an objective. It is actually reflected in my written testimony. I didn't talk about it in the oral testimony, but it is absolutely a critical piece of what we need to achieve with the new system. And one of the

real problems that we had was the pricing of guarantees and the transference of risk was not transparent in the system. That included the GSEs, but more broadly within the market.

And any direction we take with reform of the broader housing finance system and the GSEs must achieve greater transparency in terms of the way the guarantees are priced so that—and the risks that are inherent are priced. So more information, more transparent information, is absolutely a central part of achieving that.

Mrs. BIGGERT. I would ask you to consider legislation that I have introduced. It is H.R. 4581, and it is for the audit by an inspector general and a report back to the Congress, and I hope that you would take a look at that.

Secretary DONOVAN. I would be happy to take a look. Thank you.

Mrs. BIGGERT. That would be helpful.

Then, we have on the losses issue in a letter, February 2nd, from FHFA Director DeMarco. He said that since the establishment of the conservatorships, Fannie Mae has realized losses of $111 billion and Freddie Mac $63 billion. Now they have drawn down $127 billion. How much more should we expect that the taxpayer is going to have to expend before there is some decision? You have the—

The CHAIRMAN. The gentlewoman's time has expired. If you want, we will give him about 30 seconds to answer—remember, if you ask questions right at the time, we are not going to have time for long answers. But Mr. Secretary, in about 30 seconds?

Secretary DONOVAN. Let me go back to something I said earlier in the testimony. The reason—the primary thing driving those losses is loans that were on the books at the time of conservatorship, and anything we do going forward to further strength and stabilize the market will lessen any losses that taxpayers have.

And so it is critical that as we engage in this debate that we continue to focus on the broad set of measures that we have been focused on to stabilize this market with significant results. The market is still quite fragile, and so we must continue to focus on the immediate results of being able to stabilize the market, to improve performance of those loans.

And what that means is going forward, moving quickly to reform, whatever we do, that doesn't change the fact that these loans were made, they are already on the books, and the losses are coming from those. That is important.

The CHAIRMAN. Your time has expired.

The gentleman from Massachusetts.

Mr. LYNCH. Thank you, Mr. Chairman, and thank you, Mr. Secretary for your willingness to help this committee with its work.

I want to take the opportunity to focus on question number five that the Administration has put out here in its list of questions to the public, how should the housing finance system support sound market practices? The gentlelady from Illinois just talked about transparency, and I agree wholeheartedly, and I know in your remarks you have emphasized that as well.

But I want to point out a couple of gaps in that push for transparency. The Administration has not addressed the problems with the rating agencies, and I think they help greatly. They are one of the factors here. They allowed triple A to be stamped on some very

questionable loans, and to have that triple A stamp accepted by the markets as a credible mark, I think, and so that continues to be unresolved.

And secondly, the existence of the over-the-counter derivatives market and the continuance of a black box model. Now the housing finance system, as you know, is greatly served by the securitization process, and if we allow this black box model to exist for over-the-counter derivatives, many of which consist of asset-backed securities of these mortgages that we are generating, and also CDOs that replicate the performance of these blocks of mortgages.

How do those—the lack of rating agency reform and the existence of a black box model in over-the-counter derivatives, many of which are real estate related and housing related—how does that help the system support sound financial practices in the housing industry? I don't get that.

Secretary DONOVAN. I think you raise two excellent points, and I would say just broadly that securitization can be an effective tool for raising capital—

Mr. LYNCH. Oh, I agree.

Secretary DONOVAN. —and introducing benefits broadly across the market in terms of more affordable lending and more affordable home mortgages for the American family. But without the transparency we just talked about with Congresswoman Biggert, as well as a focus on ensuring the rating agencies are accurately reflecting risk in their ratings, as well as the over-the-counter market, it is difficult to get an efficient and effective securitization market.

Frankly, that is why, as you know, this committee has worked hard to get to an effective set of reforms as part of broader financial regulatory reform there. So I think it emphasizes, again, why broader financial regulatory reform is critical, broadly for the economy, but also for the housing market as well.

Mr. LYNCH. I just agree with you on that last point. The opaque and complex nature of the derivatives market, especially in this OTC market going forward, allows—it actually enhances mispricing of risk, and that was the root of our initial problem, and I just think we are making that same mistake again in this. But I thank you for your testimony. I yield back.

The CHAIRMAN. The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Secretary, just to follow up on the questions that were asked by the gentleman from North Carolina, Mr. Watt, on the timeline. And I don't know if this is a comment or a question, but I'm concerned about that. I worry when questions are put out and you wait for the public to respond and that kind of thing from a time point of view, but I think it is well and good, and I think the questions are fine and we should do that. But we asked the same questions of Secretary Geithner, and it is uncertain to me what exactly the final timeline is. I heard your comments that probably by the time this is all done, next year for legislation or something of that nature.

My question is, is the Administration working on something now? It is fine to get all these comments, etc., but this has been going on for about a year-and-a-half, and you have been around

dealing with it for over a year now. And I am concerned that we need to have some sort of final answers by the people who are going to be in charge who know a lot about this, and I consider you do. And I hope that is being worked on, even at the same time that we are waiting for answers to questions, etc.

Secretary DONOVAN. Absolutely, and I didn't talk about it in my oral statement today, but in my written testimony, we have laid out a series of four key goals for the housing finance system, nine different objectives that we think are important to achieve.

And we have obviously begun a process of putting a lot of thought and effort. These are not simple questions, particularly as we think is right and the chairman laid out at the beginning of the hearing, that you have to do this in the context of FHA, the Federal Home Loan Banks, and other pieces of the mortgage finance system, because what you do with the GSEs affects and is affected by what is available in other parts of the market.

So we have embarked on that. We will continue to do that in a thorough way, and I look forward to a thorough dialogue of it with you and the committee going forward.

Mr. CASTLE. My next point is discussions you have in your written statement and your oral statements—I think you have said here today—but the whole business of democratization of credit and housing affordability. We are all for being able to put people in houses if they can pay for those houses or whatever, but obviously those issues were a major factor in some of the loans that were being made, the no doc loans, etc., in some of the problems that exist today.

I would hope that we are going to impose strong requirements, though, with respect to credit and the issuance of mortgages, not only with the GSEs but with the companies that originally issue mortgages to make sure we are preventing this problem as far as the future is concerned. Will that be a part of the consideration of what will come forward?

Secretary DONOVAN. Absolutely, and I want to—just to give you an example of that, we have, within FHA, begun a process, we have implemented a number of reforms raising standards, particularly for the highest-risk borrowers and a range of other steps. It has to be. It is one of the central issues that led us into the problem that we are in, and I do think that we have, as I said in my testimony, too often emphasized homeownership at the detriment of rental housing as an option.

But let me just say one thing. I think too often we confuse, in the discussions about this, the idea that somehow low- to moderate-income people can't be homeowners, and in fact, if the home is affordable to them, if they get a decent mortgage at the right cost, they can very effectively become homeowners and it is still and will remain one of the primary wealth building vehicles in this country. So access to homeownership done right is important across the economic spectrum.

And I know this from my own experience in New York where I was housing commissioner. We had created about 17,000 units of homeownership with about 5 foreclosures. The reason for that? Because we ensured that families could afford the home, we ensured they didn't get piggyback or exotic mortgages, there was counseling

that made sure they were prepared for homeownership. If it is done right, a broad spectrum of the economic groups in this country can be homeowners, but we have to ensure, as you said rightly, that it is done the right way with the right standards.

Mr. CASTLE. You probably won't have time to answer this question fully, but I'm concerned about rental housing. And I think about apartment housing when I say that—and some of the problems they are having. I have met with Delawareans, and they are becoming increasingly concerned with vacancies, etc. Are you hearing more and more about that?

Secretary DONOVAN. It is not—

The CHAIRMAN. A very quick answer, please.

Secretary DONOVAN. Yes. There is no question in the multi-family markets, but more broadly in the commercial markets, that there is still significant distress out there, and FHA as well as the GSEs—it doesn't get focused on as much. I tried to do it in my testimony. That is a significant part of the liquidity that is being provided into the market today on multi-family to ensure that there is reasonable priced credit available.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. My recollection from March of 2004 when Mr. Watt and I introduced legislation to regulate, restrict subprime lending to require that anyone—any lender make sure the borrower had the ability to repay the loan—my recollection is that was a lonely position, that not many people were supporting it. But I'm struck by how many members now remember that they were right there with me all along.

My questions, though, are about securitization that follows up largely on Mr. Lynch's questions. One of the reasons the rating agencies ratings meant so much was there was essentially no other information available to investors for securitized debt, in contrast to the kinds of disclosures or procedures required for issuing stock, which requires standardized disclosures, waiting periods so investors could do their own due diligence.

Typically, an investor would get a call saying, we are going to market in 3 hours with a collateralized debt, an asset-backed debt security. It has a triple A rating. Are you in? Investors are not real happy about the idea of going back to that, and the securitization market has pretty much collapsed.

We have spent a lot of time in this committee trying to figure out how to revive lending by regional and community banks, but that was 20 percent of bank lending, and bank lending was 20 percent of lending. The securitization market which has largely gone away—I think the first residential mortgage backed securities issue is probably going to come out in the next month or two, and no one quite knows how it is going to do.

Why should there not be disclosures and procedures that allow investors to do their own due diligence that is comparable to what the SEC requires and the securities laws require with respect to stock issue?

Secretary DONOVAN. First of all, let me just say I'm not an expert on the SEC disclosures and I don't want to get into too much detail

on that. I think it is important to have those discussions with those within the Administration who are most focused on it.

Mr. MILLER OF NORTH CAROLINA. But the—

Secretary DONOVAN. But I will say there is no question that transparency, disclosure, more information has to be a central part of getting to a more efficient and effective market. Information about the performance, there is no question, will be critical to a better functioning housing finance system.

The other thing I would say, though, is ensuring—and this is a key part that you are looking at in the reg reform bill—looking at what kind of risk retention is required is also a piece of this as well. It is information, but it is also effectively ensuring that those originating loans' brokers, originators, others—we ensure their interests are aligned with us as the public and the taxpayer to make sure that they have the right interests at heart as they are originating them as well. So I think information is a piece of it in disclosure, but also aligning incentives properly when you have securitization as the primary vehicle.

And in fact next week we expect—I think it is Redwood—to do the first securitization. We have seen the first one in the commercial mortgage backed securities side. So we are hopeful with our efforts to try to bring the private market back. We had this discussion earlier. We are absolutely committed to do that, and we do see early signs that is beginning to happen.

Mr. MILLER OF NORTH CAROLINA. And have you heard the same objections I have heard from investors that they need to be able to do due diligence and not just rely on rating agencies and something has to change? They are not going to invest in asset-backed securities that were issued the way the ones were that caused this problem.

Secretary DONOVAN. I have heard similar concerns.

Mr. MILLER OF NORTH CAROLINA. Okay. I yield back.

The CHAIRMAN. If the gentleman would yield to me—

Mr. MILLER OF NORTH CAROLINA. I yield to the chairman.

The CHAIRMAN. —because the SEC has proposed some rules that should pick up where we started in our bill and that is relevant to what my colleague from Massachusetts said. I think one of the best things we did in our bill was to repeal these requirements that people rely on the rating agencies, because the best we can do is to tell people, don't get this false sense of security, and we did it where it was statutory.

The SEC has proposed two things. First of all, a risk retention and securitization, and secondly—in the mortgage area—and secondly, no requirement of a rating so that they have to do some of their own and I intend to express our support for that.

So those are two areas where we have in fact moved in this same direction, mainly—and this was bipartisan. The gentleman from New Jersey and I felt very strongly that there was this false sense of security people got from ratings, and they won't be able to get that anymore. It used to be required, and it won't be.

The gentleman from Texas, Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. Secretary, I would like to talk briefly about the failure of the private mortgage insurance industry and how it affected the GSEs.

Do you have an opinion on that, and has there been any study as to what the financial impact on the losses to the GSEs—

Secretary DONOVAN. FHFA has done extensive research in looking at the issue, not just of the losses that have resulted, but I think in some ways equally or more importantly, looking forward, the strength of the mortgage insurance companies that exist and still hold a portion of the risk on existing GSE obligations. So it is an important issue, not just historically, but going forward in terms of the risks to the GSEs, and ultimately to the taxpayers. So it is something that I think FHFA could provide significant detail on.

What I would say is, it is important, as we talk broadly about reestablishing the private market, which we are very much focused on, and the Fed steps, Treasury steps, our own steps have helped to begin to encourage, we are beginning to see the private mortgage insurers begin to step back into the market so that FHA can begin to step back in the GSEs.

And I think the bill we have before this committee to reform FHA and our insurance premiums is a very important step, and I want to thank you and the committee for working very effectively with us on that. If we can move quickly, I think, and get our pricing structures right, it is one of the most important things we can do to encourage the private market to return.

Mr. MARCHANT. Has the issue of the 85/15 and the 80/15 loans that were being made primarily to get around the private mortgage insurance industry so that many of the loans made by Fannie Mae and Freddie Mac were actually zero down loans—because in fact if closing, they were obtaining a 15 or 20 percent second lien to put the first lien down, primarily to cut out the private mortgage insurance premium, and I guess to qualify them. Has that practice stopped?

Secretary DONOVAN. Their underwriting has changed substantially on those issues, so yes, that practice has stopped. And I would say more broadly, we have been very focused at FHA on similar concerns about past products, as you know, seller-funded downpayments and other issues. We recently increased our downpayment requirements for the riskiest borrowers. So in a range of ways, we are ensuring that those kinds of practices don't recur.

Mr. MARCHANT. I missed the hearing yesterday afternoon, but watched it last night on C-SPAN concerning the companies that are currently holding these same second liens and have the first liens. Do we have a handle on how many of the delinquent borrowers out there who are facing foreclosure are trying to participate in these other programs, where in fact the servicer has the first lien and the second lien, and that second lien is not anything more than just the downpayment?

Secretary DONOVAN. We have a lot of detail on this and would be happy to follow up with you and your office with more specifics. But what I can say generally is for borrowers at risk—if you look, for example, at broadly borrowers who are deeply underwater, say more than 120 percent LTV—about half of those borrowers have second liens and that as you go to more and more risky deeper and deeper underwater, the share of the underwater debt that is made up by second liens increases. So the second liens are a significant

part of the problem for those borrowers, and it makes up a large share, about 50 percent, of troubled borrowers.

Mr. MARCHANT. Thank you.

The CHAIRMAN. Let me go to the gentleman from Colorado, then the gentleman from Texas.

Mr. PERLMUTTER. Thank you, Mr. Chairman. It is good to have you here, Mr. Secretary.

Secretary DONOVAN. It is good to see you again.

Mr. PERLMUTTER. Just a couple of questions, I was visited by the mortgage bankers this morning—they are on the Hill—and they raised a couple of points. Let's see how you react to them.

One is FHA, which has gone from 3 percent of the market to 30 percent or—everybody is getting an FHA mortgage. They were complaining that the computer systems or the technology there is antiquated and it really is having trouble keeping up. And I think within your budget there has been a request to update the system. Can you tell us what is happening or whether you all are looking at that?

Secretary DONOVAN. Thanks to Congress, we, in our 2010 budget, got significantly increased resources to invest in improved technology, and we are in the process of implementing that. I would be happy to provide you a more detailed update.

One of the things I would mention on that is we are investing heavily generally in systems, but particularly in fraud detection and risk evaluation systems as well. We have taken 6 times more enforcement actions in the past year than HUD took in the 10 prior years combined.

Mr. PERLMUTTER. Okay, good.

Secretary DONOVAN. And ensuring that we are making good loans and that we are not allowing lenders that shouldn't be making FHA loans to make FHA loans. We have an $80 million procurement that is under way now on a broad range of fraud and risk systems. So that is one particular example of what we are doing.

Mr. PERLMUTTER. Second question, second point. When I think the chairman carried a bill a year or two ago on Fannie Mae, Freddie Mac kind of restructuring, we were talking about skin in the game and the 5 percent retention. We did get some resistance from the mortgage bankers, the independent guys who are really more or less agents, and then they sell the loan into the secondary market somehow or to Fannie Mae/Freddie Mac. And I think at least in one of the bills was a carve-out for vanilla products such as a Fannie Mae, Freddie Mac, FHA-approved loan document, a HUD form.

When we started into the bigger bank bill where we were dealing with the consumer financial products agency, there was initially a section on vanilla products which I think ultimately—either we passed it out of the House or it got changed. Do you—what is the Department's position on, in effect, carving out from the risk retention component a 5 percent skin in the game thing if it is a vanilla—

The CHAIRMAN. Would the gentleman yield briefly please?

Mr. PERLMUTTER. Yes sir.

The CHAIRMAN. Because what we have is that we—the Administration had asked for an ability to require certain projects. That is where the vanilla came in. We threw that out so there was no—

Mr. PERLMUTTER. Right so—

The CHAIRMAN. What we have is in our securitization requirement, the expectation is 5 percent, but the appropriate regulator for each entity can go up to 10 or down to zero based on this. And while we didn't write it in specifically, the assumption was that a fixed-rate 30-year mortgage with a significant downpayment would probably be rated a zero. So that is what is in the bill.

Secretary DONOVAN. And what I would say, I think it is a very important point broadly, and I think a piece of this is direct risk retention, but there are other elements that I think are important to look at as well that can align incentives at the broker level, at all different levels in the chain.

So given the discussions that are going on, I think it is very important that we continue with the Administration more broadly. We have had significant conversations internally that we continue to discuss this and find ways to ensure that we are aligning those incentives at every step, not just on the—not just a loan with a risk retention requirement.

Mr. PERLMUTTER. Thank you. I yield back.

The CHAIRMAN. The gentleman from Illinois.

Mr. MANZULLO. Thank you, Mr. Chairman, and Mr. Secretary, thank you for coming here this morning.

I have a couple of questions, but let me start with this. Every time we open up the paper, there is yet another program to help out people who are underwater on their home mortgages or behind, etc., knowing full well the reason they are behind is because we have lost so many jobs in this country. In many cases you can take somebody's home mortgage and cut it in half, and they still can't make the payments because the job isn't there anymore.

But then I read of yet another new program—I think it would be appropriate to call it that—that would somehow "encourage" private lenders to forgive a principal debt of tens of billions of dollars worth of home mortgages as to which the homeowners have negative equity. Are you familiar with that program?

Secretary DONOVAN. Yes.

Mr. MANZULLO. What is that?

Secretary DONOVAN. So what we have done with FHA is to encourage, as you said, private lenders to cut principal—

Mr. MANZULLO. They would eat it.

Secretary DONOVAN. Yes.

Mr. MANZULLO. All right.

Secretary DONOVAN. And just to be clear, what we are finding more and more—the GSEs are seeing this in their own portfolios and as are other lenders—we are beginning—we are seeing increasingly that lenders are cutting principal because financially they will see improved performance in those loans and improved recovery. So this is something that is happening in the market broadly without any government incentives.

Mr. MANZULLO. That was my issue. That is a voluntary program?

Secretary DONOVAN. Yes.

Mr. MANZULLO. So there is no official, for lack of a better word, non-bankruptcy cramdown that is being given to the banks to force them to do this. Would that be a correct statement?

Secretary DONOVAN. In the program we announced, it is not a—it is a voluntary—

Mr. MANZULLO. It is voluntary.

Secretary DONOVAN. That is correct, yes.

Mr. MANZULLO. And the banks are not penalized for not participating in this? Would that be also correct?

Secretary DONOVAN. In that—yes, in that specific program.

Mr. MANZULLO. The reason I say that is that we have been through these cycles before where property would sell for $200,000, say, in 1987, new, drop in value 8 or 9 years later to $160,000, $170,000, and then go up to half a million dollars 7 or 8 years later. We do have cycles in this country, do we not, where people who put on—put down relatively modest downpayments find themselves underwater from time to time. Would that be a correct statement? Obviously, it is correct, or I wouldn't have asked the question in the first place.

Secretary DONOVAN. I think it is hard to compare what we have seen in this country, perhaps since the Great Depression, to the cycle that we have been through. The extent of negative equity—

Mr. MANZULLO. And the length.

Secretary DONOVAN.—scale of it is unlike anything we have seen since then, and what I would say is reducing negative equity is an important piece of helping to get us—

Mr. MANZULLO. If I could—

Secretary DONOVAN. And that banks do, I believe, need to start doing more of that.

Mr. MANZULLO. Mr. Secretary, the other issue is, as you stated in your testimony, where GSEs were encouraged to buy Alt-A and subprime private crap that had been generated for the purpose of increasing affordable housing goals, and that it says that underwriting standards were lessened in order to buy these portfolios that really were not intended to sell to the GSEs in the first place. This occurred, I think, between 2003 and 2005. It is about $190 billion worth.

And the issue there is—and I know you weren't there. It was a different Administration. But it is a fact, is it not, that even with that mandate or Executive Order or pressure—call it what you want—is that GSEs still have the authority to say even though these instruments were never intended to be sold to us, that we could have imposed our underwriting standards and made it stricter in not buying them?

Secretary DONOVAN. Just to be clear, there was a large pool of safe loans—not Alt-A, not subprime—that would have met the goals that the GSEs didn't buy. So I don't believe that the goals forced them to buy the Alt-A or subprime. They did so for other—our evidence shows they did so for other reasons, and that is what led them down that path. The affordable housing goals did not require them to buy Alt-A or subprime loans.

Mr. MANZULLO. Thank you.

The CHAIRMAN. Let me just—to answer his question, there is no program anywhere in the Federal Government that I am aware of

that compels any holder of paper to write down the principal. None whatever.

The only thing we have done in that regard is we did pass, I think virtually unanimously, tax legislation—not out of this committee—that said that a homeowner who was a beneficiary of such a write down would not owe taxes on that amount. So that was an encouragement, maybe, but there was zero requirement that anybody who holds this write down any part of either the interest or the principal.

The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman, and thank you Mr. Secretary for appearing.

A quick comment before I get to what was my initial agenda. We find that businesses—they do have an opportunity to write off losses by way of something called bankruptcy, and continue to function, as permitted. The unfortunate circumstance for most Americans who happen to be holders of primary homes is that they don't have that as an option such that bankruptcy can benefit them to the extent that they can maintain their residences. If you have a secondary residence, a tertiary, or quaternary, you can with those. Anything beyond your primary, bankruptcy can benefit you.

But we don't have that for homeowners. Homeowners don't have the benefit of bankruptcy to the extent that businesses do. That is just a fact. They do not. And there are some who make the argument that it would be beneficial for homeowners to have the same opportunity that businesses have to reorganize and stay in business, and homeowners can do that to a limited extent with debts other than the primary home, the primary mortgage. And that was just a comment so that I could at least say to the people who are viewing this that there are other means by which we can achieve a goal of dealing with this negative equity that are not in place simply because the laws don't permit homeowners, people who have their primary residence, to go into bankruptcy court and save their primary residence.

And there is more that can be said on this, but let's go back to the Great Depression, because it was during the Great Depression that we—I think is a good point of departure for us in this brief dialogue that you and I will have. We didn't have 30-year fixed-rate mortgages. We had 3- to 5-year mortgages. People would refinance and refinance again.

And it is the evolution through the years that got us into Fannie and Freddie such that we have 67 percent of Americans who own their own homes, and over 70 percent of these, of course, have mortgages, so when you say mortgages, they are buying. They are in a position to own at some point.

And while Fannie and Freddie are not perfect, and while they have not served us as well as I would like for them to serve us, I don't think that we can overlook the fact that a good many Americans who have homes now, who are legitimate, hard-working people who have 30-year mortgages or some longer period than 5 years—they have these because of the evolution that took place with Fannie and Freddie. And just as we have friends and I have friends who would favor keeping credit default swaps and who would favor some sort of negative amortization in products, they

don't want to end all of the things that created the circumstance, they want to make them work better.

I think that there has to be a way for us to deal with this and not just obliterate Fannie and Freddie and do nothing, and that is my concern. The option that some seem to put forth is that of doing nothing more than ending Fannie and Freddie. A bad idea becomes a really bad idea when you try to implement it, and it is unfortunate that we have to have the good sense not to let that happen. We have to have the good sense not to let this bad idea become an actual facility to the extent that it exists.

What do I mean? If we literally allowed for the departure of Fannie and Freddie—just overnight, let's just get rid of it—what a thing—this bad idea would become a really bad idea when the experiences that we would have to encounter would manifest themselves.

So tell me, if you would, if we eliminated Fannie and Freddie right now, what would be some of the effects of doing so?

Secretary DONOVAN. I think that the risks to the housing market and the economy more broadly would be substantial, and if you look at the jumbo market, other forms of lending, you look at the enormous gap in interest rates and availability of credit in those other markets, there is no question that whatever mistakes Fannie Mae and Freddie Mac made, which were substantial, that currently they are playing a very important role in stabilizing our housing market and the economy more broadly.

So we do need to reform them, there is no question, and we have embarked on that process, but we have to do so in a responsible, measured way so that we don't end up doing more damage to the housing market, and in fact damaging the taxpayer through increased losses at Fannie Mae and Freddie Mac.

Mr. GREEN. Thank you, I yield back.

The CHAIRMAN. The gentleman from Florida, Mr. Grayson.

Mr. GRAYSON. Thank you, Mr. Chairman. It is nice to see you, Mr. Secretary.

What percentage of mortgages in the United States are underwater? In other words, how many households owe more than they own, where the balance of their mortgage is more than the value of their property?

Secretary DONOVAN. There are varying estimates that are in the range of 15 percent to as high as 25 percent. About a third of all underwater mortgages, the estimate is, are close enough to being above water that with a few years of modestly increasing house prices, they should be back above water, but there are about ⅔ of those who are severely underwater, typically beyond 115 or 120 percent LTV.

Mr. GRAYSON. Do you happen to know what the percentage is in Florida and other hard-hit places, like Nevada?

Secretary DONOVAN. They range as high as above 50 percent in the hardest-hit places.

Mr. GRAYSON. For people in those circumstances, particularly the ones who have dramatically more debt than the property is worth, and in many places where there are a lot of empty houses—in Orlando, for instance, 10 percent of all the houses are now unoccupied. In situations like that, do you think that people should con-

tinue to pay their mortgages or should they just move across the street and start over again?

Secretary DONOVAN. I believe that we have a system that depends on consumers paying their mortgages, and I would not, here or elsewhere, recommend to people that they not pay their mortgages.

What I would say is—and this is why we announced changes and new initiatives just a couple of weeks ago—I do believe, the Administration believes, that negative equity is a significant problem in our market. Given the fact that we are seeing increasing write downs by lenders in their own portfolios, taking negative equity, I believe that it is increasingly clear to lenders that writing down negative equity in specific cases actually benefits lenders—homeowners as well as the lenders themselves, because they are not going to recover on those, and loans will perform better.

And that is why we announced a series of initiatives that try to accelerate what we are seeing as a trend already, and to get rid of some of the misalignments. There are accounting treatments in a range of ways that currently I think we have financial institutions that are reflecting the value of second liens or other loans at unrealistic levels that will not be recoverable in a foreclosure or in other actions. So we are beginning to see some movement on that, and we are trying to accelerate it with the efforts we have under way.

Mr. GRAYSON. We live in a market economy where we expect businesses to maximize profits and minimize losses. Why would we expect anything different from consumers, and in particular, homeowners? Why would we expect them to keep paying on a mortgage where the mortgage value is far more than the value of the property that underlies the mortgage?

Secretary DONOVAN. I think—and this is one of the reasons I work in housing—a home is much more than an investment, and they are—those are complex decisions that involve negative impacts to families themselves in terms of their credit, displacement of families and children. There is a whole—it is a very complex set of decisions that a family makes when they buy a home or when they decide to give up a home. So I don't think it is as simple as saying that this is a purely rational economic decision that is only based on investment rather than the other values of a home.

Mr. GRAYSON. My own impression—and you can correct me if I'm wrong—is that for at least 90 percent of the people in that particular circumstance where they owe more than they own, there is no policy of the Federal Government at this point that has, in any way, ameliorated their problems. Is that a fair statement?

Secretary DONOVAN. I don't think that is a fair statement, actually. First of all, a significant number of those homeowners, if they remain and pay about a third, based on our estimates, will be above water within a few years.

Second, we have taken a series of steps with the announcements, changes to our modification program that prioritized principal reduction, the FHA refinancing effort that we talked about earlier, those are all efforts to try to attack the problem of negative equity, recognizing that we cannot nor should we put the burden of writing down that negative equity on the taxpayer. We would be talking

about hundreds of billions of dollars, and those losses must remain and should remain the responsibility of the private lenders who made those loans to absorb the bulk of the losses.

Mr. GRAYSON. My time is up.

The CHAIRMAN. Your time has expired.

Mr. GRAYSON. Thank you.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much. Thank you, Mr. Secretary, for being here today.

I know this hearing is focused on housing finance. I want to talk a little bit about CDBG and section 108. In some ways, it is connected to housing finance because CDBG funds can be used to help fund housing and section 108 is more on the economic development side, but it is used to support maybe Choice Communities. I know that is an initiative that you have put a lot of time in on.

I have been concerned about CDBG for quite some time. I know that you have some ideas about some reform in CDBG. And I and some other members of this committee are concerned about the various ways that CDBG funds are used in cities that do not inure to the benefit oftentimes of those who we intend to benefit of it.

Many of us believe that CDBG funds are used almost like campaign funds out of the back pockets of local elected officials who find ways to get the money to those groups and organizations that basically are their supporters rather than plans that actually deal with providing a combination of housing opportunities and/or support opportunities for families, etc., etc. And of course CDBG has been revamped, cut back in ways that I don't think really accomplishes economic development.

And I also understand from my staff that you are envisioning some kind of fee for use of section 108 funds. So could you relate to both CDBG and section 108 a bit around those concerns?

Secretary DONOVAN. Just to start with the section 108 program, it has been an effective program, it has expanded, the use of it has expanded significantly, and as I think you have seen us do in a range of different areas in FHA and elsewhere, the proposal was to, now that we have a real history with 108, to be able to understand the true costs of the guarantees and to begin to set a pricing for that to reflect the actual performance of the loans so that the program effectively pays for itself rather than requiring appropriations. So that is what we had proposed for 108. And given the strong performance of it, it is a pretty modest fee.

On CDBG, more broadly what I would say is that it has been critical for us to improve oversight of the program. I don't think the kinds of things you have talked about are widespread in the program. However, where we have seen examples that CDBG funds have not been used appropriately, we have stepped up the actions that we are taking. We would be happy to give you more details on that. But I think CDBG is an important resource in many communities and we believe, particularly given the economic crisis that we have seen, that having a tool that can attack economic development and create jobs is important, but I would be happy to talk to you about further improvements that you think are necessary.

Ms. WATERS. Okay, my time basically is up, so I will be happy to talk with you further about both of those programs.

The CHAIRMAN. Thank you for your testimony, and we will now call the next panel.

Secretary DONOVAN. Thank you.

Ms. WATERS. [presiding] Thank you very much. I would like to call up our second panel: Mr. Anthony T. Reed, executive vice president, Capital Markets, SunTrust Mortgage, Incorporated, on behalf of the Financial Services Roundtable; Ms. Sheila Crowley, president and chief executive efficer, National Low Income Housing Coalition; Mr. Alex J. Pollock, resident fellow, American Enterprise Institute; Mr. Jack E. Hopkins, president and chief executive officer, CorTrust Bank, NA, on behalf of the Independent Community Bankers of America; Mr. Thomas Gleason, executive director, MassHousing; Mr. Anthony M. Randazzo, director of economic research, Reason Foundation; and Mr. Rick Judson, third vice chairman, National Association of Home Builders.

Okay. We will start with Mr. Reed.

STATEMENT OF ANTHONY T. REED, EXECUTIVE VICE PRESIDENT, CAPITAL MARKETS, SUNTRUST MORTGAGE, INCORPORATED, ON BEHALF OF THE FINANCIAL SERVICES ROUNDTABLE

Mr. REED. Thank you. Madam Chairwoman and members of the committee, my name is Anthony T. Reed. I am the executive vice president for capital markets with SunTrust Mortgage. I am appearing today on behalf of the Housing Policy Council of The Financial Services Roundtable.

Thank you for the opportunity to testify on the future of the housing finance system. Today, I would like to focus my remarks on reforming the secondary mortgage market for conventional mortgage loans. The secondary mortgage market is an essential feature of our system of housing finance. It has produced a steady supply of mortgage finance for home buyers. The secondary mortgage market has permitted the development of products with unique benefits to U.S. borrowers, such as the 30-year fixed-rate mortgage.

For many years, and even throughout the financial crisis, the GSEs facilitated this market efficiently and effectively. Yet, the crisis has revealed several fundamental flaws. Correcting these flaws presents Congress with an opportunity to make significant improvements in the operation of the secondary market that will benefit homeowners in the economy.

Reform should be based upon the following three principles. First, reform should continue to ensure a steady flow of reasonably priced housing finance for borrowers and should not disrupt the economic recovery. Second, reform should minimize risk to taxpayers. Third, reform should include some flow of funding to affordable housing.

The housing policy council proposes to achieve these goals in the following ways. First, creation of federally chartered but privately owned mortgage securities insurance companies or MSICs to perform the credit enhancement function currently performed by the GSEs; second, a strong Federal regulator; third, the establishment of a single MBS issuance facility to create and administer mortgage-backed securities guaranteed by the MSICs; fourth, in ex-

change for their Federal charter, MSICs would be required to contribute a stream of revenue to State and local housing finance agencies to support competitively-evaluated affordable housing programs.

Finally, the recent financial crisis has demonstrated that the Federal Government is fully capable of performing the liquidity function in times of market stress. Therefore, any successors to the GSEs should not be required or permitted to maintain large portfolios. MSICs would not be backed by the Federal Government. And I would like to repeat not be backed by the Federal Government. However, the Federal Government should provide an explicit backup guarantee on MBS still insured by the MSICs.

To be clear, this catastrophic guarantee would not apply to the MSICs themselves. It would only apply to the MBS that they guarantee. This exquisite guarantee for MBS is needed to give a broad range of MBS investors confidence in these securities and to help ensure consistent and reasonably priced mortgage finance to borrowers.

The government's guarantee should cover interest and principal payments on MBS only after all private capital backing and MBS is exhausted. And MSIC would pay a fee to the government for the government guarantee, and the fees paid by all MSICs would be placed in reserve that would provide an additional buffer between private capital and the Federal guarantee. In total, the layers of private capital standing before the government's guarantee would be downpayments made by homebuyers, private mortgage insurance, shareholders equity in the MSICs, and the reserve fund.

Moreover, this explicit guarantee is intended to be budget neutral. MSICs should be required to transfer a percentage of revenue to affordable housing programs, much like the Federal Home Loan Banks do today. The current numerical housing goal should be ended. The funds for affordable housing could be contributed under a competitive grant program similar to the FHLB program, or it could be transferred to HUD for subsequent distribution to State and local housing finance agencies.

We also called for the creation of a single MBS issuance facility to perform the securitization function. This issuance facility would support the creation of a single MBS. Today, there are some differences between the MBS marketed by the two GSEs, which can from time to time impair market liquidity. All MSICs should be required to adhere to a standard form of MBS that has the same terms and conditions in order to promote investor understanding of the MBS. This would help ensure homebuyers consistent access to reasonably priced home finance.

Thank you for the opportunity to testify on the future of mortgage finance. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Reed can be found on page 114 of the appendix.]

Ms. WATERS. Thank you very much.

Ms. Sheila Crowley?

STATEMENT OF SHEILA CROWLEY, PRESIDENT, NATIONAL LOW INCOME HOUSING COALITION

Ms. CROWLEY. Good morning, Ms. Waters, Mr. Hensarling and other members of the committee.

I am Sheila Crowley, president of the National Low Income Housing Coalition. The Coalition is dedicated solely to achieving socially just public policy that assures people with the lowest incomes in the United States have affordable and decent homes; thus, we are interested in the topic of today's hearing, because the housing finance system in the United States has failed miserably in assuring enough housing for all Americans and any reform that Congress undertakes must address this serious shortcoming.

In the United States today, there are 9.2 million extremely low-income renter households, and only 6.1 million rental homes available that they can afford—71 percent of extremely low-income renter households pay more than half of their income for their housing. That's an unacceptable situation. In the wake of the foreclosure crisis, some will assert that we have an excess supply of housing; and, while that may be the case for high-cost housing, the supply of low-cost rental housing continues to dwindle. Moreover, rents continue to rise.

The Coalition's annual study of housing costs called, "Out Of Reach" will show that the 2010 national housing wage, that is, the hourly wage that a full-time worker must earn in order to afford a two-bedroom rental home is $18.44 an hour. That is up from $17.84 an hour in 2009. A stable home is the platform for success and all other spheres of individual and family life, and all the other interventions we devise to help low-income people improve their social and economic well-being. Or, if not, if we do not first make sure they have safety in affordable homes, given this understanding of the housing crisis today, we offer several principles to guide reform of the housing finance system in the United States.

One, Federal subsidies to the housing sector should be directed to meeting the needs of those with the most serious housing problems first. In Fiscal Year 2009, the Federal Government spent $300 billion to support housing—80 percent of that subsidized homeownership, primarily with tax deductions, and the remaining 20 percent supported rental housing primarily through the HUD budget.

A truer picture of the Federal commitment to housing would also count the nearly $2 trillion in support for mortgage credit and other insurance through FHA, Ginnie Mae, the VA, Rural Housing Services, the Flood Insurance Program, Fannie, Freddie and the Federal Home Loan Banks. Despite this considerable Federal involvement in the housing sector, we have a persistent structural deficit of housing that the lowest-income people can afford. Clearly, subsidies are not being directed to where they are needed and where they could do the most good.

Second, all segments of the housing finance sector have a duty to contribute to solving the most serious housing problems. Some would argue that the conflicting goals of maximizing profits and serving a public purpose contributed to the downfall of Fannie and Freddie. We would argue that housing, like healthcare, is so essential to human well-being that any profit-seeking enterprise must be grounded by social responsibility that is assured by government

regulation. In 1992, Congress directed Fannie and Freddie to take a more active role in ensuring the availability of affordable housing by establishing affordable housing goals.

In July 2008, Congress added a further affordable housing obligation in the form of contributions to the National Housing Trust Fund, which was designed specifically to address the shortage of rental housing. Whatever form Fannie and Freddie or their successors take in the future the obligation to contribute to the National Housing Trust Fund must be renewed and expanded. And, further, we think all federally regulated financial institutions should be required to make similar contributions.

Third, Federal policy should not favor one form of tenure over another. Rather, Federal policy should incentivize balance in the housing market and the full range of housing choices in every community. Federal policy clearly favors homeownership of rental housing as indicated by the skewed nature of Federal housing subsidies. A more balanced Federal housing policy would make sure that rental housing enjoys the same advantages as homeownership in lending and in the tax code.

Assuring that all members of a given community have homes they can afford in the neighborhood of their choosing will also require strict enforcement of fair housing laws and the full implementation of the duty to affirmatively further fair housing is a condition of receiving direct and indirect Federal subsidies. I will close with three specific suggestions for dedicating funding sources for the National Housing Trust Fund that will help us take the trust fund to the scale that we recommend: at least $15 billion a year for 10 years.

These are things Congress could do right away. First, the Federal Government provides private financial institutions with low-cost funds through a variety of sources—a 5 percent basis point annual fee on outstanding low-cost funding balances could raise several billion dollars a year for the trust fund; second, Congress should levy a fee on the securitization of mortgages by any capital markets participant; and third, homeowners can gain a tax deduction for capital gains on the sale of their homes, a surcharge on the percentage of capital gains that a seller realizes at the time of sale would generate several billion dollars.

Thank you.

[The prepared statement of Ms. Crowley can be found on page 61 of the appendix.]

Ms. WATERS. Thank you very much.

Mr. Pollock?

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

Mr. POLLOCK. Thank you, Madam Chairwoman, Congressman Hensarling, and members of the committee.

I would like to propose for your consideration seven steps toward sound mortgage finance in the future for the United States. These are: to create a private secondary market for prime conforming mortgage loans; to transition to a world of no GSEs; to facilitate, but not require, risk retention by mortgage originators; to develop countercyclical strategies; should there be surviving GSEs, in spite

of my previous recommendation, to ensure that we do not use government insured banks to promote the financing of the GSEs; to develop clear, straightforward key information for borrowers; and to reintroduce savings as an explicit goal of mortgage finance.

I'll expand briefly on three of these points. First, a private, secondary market for prime mortgages of conforming size should have been a natural market development. Why did it never happen? It never happened because no private entity could compete with the government granted advantages of the GSEs. There could be no private prime conforming mortgage market while the GSEs used their advantages, both to make private competition impossible and to extract duopoly profits or economic rents from the private parties. This element of the old housing finance system should not survive.

Second, we should structure a transition to a world of no GSEs. I would like to commend Congressman Hensarling's bill, which he mentioned earlier, for suggesting how this might be done and how an orderly transition might actually be put in gear. Housing finance inflation was at the center of the financial crisis, and the GSEs were at the center of housing finance inflation. No mortgage system reform can be meaningful, which fails to address Fannie Mae and Freddie Mac. Everyone now agrees with this.

In my view, this is the core issue: you can be a private company with market discipline, or you can be part of the government with government discipline of which there are many kinds, but you can't be both. Fannie and Freddie or parts of Fannie and Freddie should become one or the other. This desired transition is somewhat easier now, because Fannie and Freddie are not now GSEs. They are government housing banks owned almost entirely and controlled entirely by the government.

Therefore, in my opinion, it's quite clear that as recommended by the Congressional Budget Office, they should be on the Federal budget. They should not get off balance sheet accounting treatment, which comes in for so much criticism in other areas. In this context, I would also like to commend Congressman Garrett's bill, H.R. 4653, the Accurate Accounting of Fannie Mae and Freddie Mac Act.

Third, we should develop countercyclical loan to value (LTV) requirements. Financial cycles, particularly in real estate, are inevitable, but they could be moderated by developing countercyclical elements of the mortgage system. Bubbles involve an unstable positive feedback loop between asset prices and credit availability. As asset prices inflate higher and higher in a boom, the risk of loans appears to be growing less when it's in fact greatly increasing.

As asset prices go further and further above their trend, the risk of their fall and the risk of the loans is becoming greater and greater. The logical and necessary thing to do is reduce the amount being lent against the current market price of the asset. But what generally happens, and always happens in a bubble, is the exact opposite. With increasing optimism, LTVs rise instead of being reduced. We need to create a mortgage finance system in which LTVs fall and downpayments rise as asset prices inflate. Then we would have countercyclical LTVs.

Congressman Foster, in a very interesting draft paper, has proposed some straightforward mathematical ways that inflating asset prices might define requirements for lower LTVs. It's clear that something along these lines would be extremely beneficial for our future mortgage system, and we ought to figure out how to do it.

I would be happy to address any of the other proposals discussed in my written testimony, and I thank you again for the chance to share these views.

[The prepared statement of Mr. Pollock can be found on page 100 of the appendix.]

Ms. WATERS. Thank you very much.

Mr. Hopkins?

STATEMENT OF JACK E. HOPKINS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CORTRUST BANK, N.A., ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. HOPKINS. Madam Chairwoman, members of the committee, thank you for the opportunity to testify today on the future of housing finance.

My name is Jack Hopkins, and I'm the president and CEO of CorTrust Bank, a $600 million community bank located in Sioux Falls, South Dakota. I am pleased to testify today on behalf of ICBA and its 5,000 members nationwide. The housing GSEs are very important to community banks. Fannie Mae and Freddie Mac provide a reliable secondary market for residential mortgage loans, and the Federal Home Loan Banks offer liquidity, asset liability management, and long-term funding.

My bank uses all three extensively. We are a seller servicer for both Fannie and Freddie, servicing more than 3,500 loans with a balance of more than $400 million, and we have used the Federal Home Loan Bank advances to fund lending activities with $34 million currently outstanding. Were it not for these finance options, our customers would be at the mercy of the big banks and brokers for mortgage services and we would not be able to compete.

That's why fixing the housing finance system and getting it right is so important to community banks. Our priority for this committee, either as part of housing finance reform or separately, must be correcting the injustice suffered by more than a thousand community banks when Treasury allowed the value of their GSE preferred shares to plummet when Fannie and Freddie went into conservatorship. Community banks invested in preferred shares with the encouragement of the regulators, only to have the rug pulled out from under them.

Even former Treasury Secretary Paulson, under whose watch this happened, called it an ambush. In my opinion this led directly to the failure of a large number of "too-small-to-save" banks by wiping out excess capital and making it almost impossible to raise new capital. This was unconscionable. Restoring the $15 billion to $20 billion in community banks' capital value that vanished as a result of the Treasury actions can foster $150 million to $250 million in new lending and help in the economic recovery. And that is not an insignificant sum.

I would like to thank the members of this committee who have spoken out in support of community banks on this subject. There is a wide range of proposals being considered to restore the housing GSEs and reform the housing finance system, and some would function better for community banks than others.

We believe any discussion should begin with the fundamentals and consider what the corporate ownership and governance structures of the secondary markets should look like, and whether the mission of the GSEs is still adequate or needs to be changed. Resolving these issues is an important part of the reform effort; ICBA is still in the process of examining these issues and others. However, as the matters are sorted out, ICBA has developed a set of core principles we feel should guide the debate. These principles are spelled out in my written testimony, and I will highlight a few of them here.

The secondary mortgage market must be impartial and provide equitable access and pricing to all lenders regardless of size or volume. The secondary market must have a limited mission focused on supporting residential and multi-family housing in all communities. The conflicting requirements of a public mission with private ownership must be eliminated. The accumulation of retained earnings must be an important component of the secondary market structure to help attract equity capital when needed. And there should be more than one secondary market to foster competition and provide better access for community banks.

The functions of Fannie Mae and Freddie Mac should not be incorporated into the Federal Home Loan Bank System whose focus must remain that of providing liquidity to their members. And Congress must ensure that the secondary market continues to have government ties. Whether the Fannie Mae and Freddie Mac charters are retained or a new secondary market is created, they must have some government tie to ensure continued, steady, and favorable access to the capital markets.

Finally, I would like to address the importance of the Federal Home Loan Bank System to community banks. Federal Home Loan Banks have not been immune from the financial stress that has affected the entire financial industry. Yet, throughout the financial crisis, they continued to provide advances to their members without disruption, while other segments of the capital markets ceased to function. Congress must ensure that this stable, reliable, and resilient source of funding, liquidity, and other products continues and is not diverted to other social goals.

For example, some are already coveting the Federal Home Loan Bank's Refcorp payments when the system's Refcorp obligations are satisfied. I understand how tempting this may be, but the Federal Home Loan Banks and their members, and consumers and businesses that they serve should not be penalized because the Federal Home Loan Bank paid off their debts early. These earnings should be kept in the system to build retained earnings for the system's financial condition and not be siphoned off for other programs.

Thank you for the opportunity to present these views on our Nation's community banks.

[The prepared statement of Mr. Hopkins can be found on page 84 of the appendix.]

Ms. WATERS. Thank you very much.

Mr. Gleason?

STATEMENT OF THOMAS GLEASON, EXECUTIVE DIRECTOR OF MASSHOUSING

Mr. GLEASON. Madam Chairwoman and members of the committee, thank you very much for this opportunity today.

My name is Tom Gleason. I'm the executive director of MassHousing based in Boston, Massachusetts, and I'm testifying today on behalf of the National Council of State Housing Agencies, which represents this country's housing finance agency system.

I want to thank Congress and the Administration for making housing a recovery priority. You provided HFAs with Federal recovery resources and did it in a way that allowed us to break through the barriers in the financial market. As a result, we are right now helping to fuel the country's economic recovery, financing hundreds of thousands of affordable homes for America's working people, and generating jobs and tax revenue.

Madam Chairwoman, I especially want to thank you and the members of this committee led by Chairman Frank for your efforts to keep tax credit resources flowing over these last few years, providing additional bonding authority in supporting the Administration's bond purchase initiative.

We appreciate your efforts to continue and expand several of these initiatives. Today, NCSHA calls on Congress and the Administration to require future GSEs to make a powerful commitment to affordable housing. We also recommend that Congress direct future GSEs to use the proven HFA delivery system to fulfill this commitment. We believe that a strong secondary market is an essential component of our housing finance system that must be preserved and strengthened, but Federal Government support of the secondary market is also necessary to finance affordable and sustainable homes and to reach underserved people. These public purpose obligations should be mandated and enforceable under Federal law and regulation, and not simply be aspirational goals.

Some would argue that GSEs should not make affordable housing investments, because that is what caused Fannie Mae's and Freddie Mac's financial demise. We strongly disagree. Buying affordable loans did not get the GSEs into financial trouble. Buying bad loans did. Unfortunately, Fannie Mae and Freddie Mac both made investments in subprime and non-traditional mortgages that contributed significantly to their financial woes. But this shouldn't negate the sound, affordable housing investments that they made in housing finance agencies. These investments have performed exceedingly well.

Further, while it's also true that the Federal Home Loan Bank System is experiencing its own financial distress, bank partnerships with FHAs have not contributed to it. In fact, recognizing the strength of HFA lending, Fannie Mae has entered into several exclusive arrangements with us, offering preferred mortgage pricing in terms. Fannie and Freddie have also purchased HFA mortgages based on their high quality, and several member banks of the Fed-

eral Home Loan Bank System have extended HFA's liquidity based on the strength of our portfolio.

HFAs have proven over many decades that affordable housing financing done right is not just good lending but good business. We do it the old fashioned way: flexible but prudent underwriting; fully documented and verified loans; extensive homebuyer counseling; and a commitment not just to put a family in their home, but to keep them there. I would like to give you one specific example from Massachusetts, if I may.

My agency's loan portfolio has a delinquency rate right now of 5.4 percent, compared to a 9.7 percent delinquency rate for the conventional market in Massachusetts. That's a 44 percent lower delinquency rate in our portfolio. Because of our proven track record, NCSHA urges you to turn again to the time-tested and consistently high-performing FHA delivery system to help future GSEs achieve their affordable housing mandates.

We urge you to direct the GSEs to prioritize their relationships with HFAs in designing their programs and rely on us to carry them out. These public purpose mandates for GSEs will require them to integrate a dedication to affordable housing throughout their business culture and not simply treat it as an niche business. Capitalizing the housing trust fund from GSEs is essential, however, it should not be used as a way to allow them to buy their way out of fulfilling their public purpose mandates.

Future GSEs should make low-cost capital available to support a broad range of housing finance for both homeownership and rental housing. The GSEs should have broad authority within prudent standards of safety and soundness to be innovative. They should be able to respond quickly and nimbly to changing market conditions and to take measured risks.

Finally, NCSHA recommends that HFAs play a key role in GSE governance and have a seat at the regulatory table. This will ensure that GSEs meet their affordable housing mandates by informing those efforts and evaluating their success.

I thank you for this opportunity to testify, and I ask that my full statement be included in the record. I would be happy to answer any questions that you have.

[The prepared statement of Mr. Gleason can be found on page 80 of the appendix.]

The CHAIRMAN. Without objection, any information that any of the witnesses want to provide will be made a part of the record.

Mr. Randazzo?

STATEMENT OF ANTHONY RANDAZZO, DIRECTOR OF ECONOMIC RESEARCH, REASON FOUNDATION

Mr. RANDAZZO. Chairman Frank, Congressman Hensarling, and distinguished members of the committee, thank you for the invitation to testify today.

My name is Anthony Randazzo, and I am director of economic research at Reason Foundation, a nonprofit think tank that advances the ways free market can be leveraged to improve the quality of life for all Americans. There are two overarching problems plaguing the housing industry today: uncertainty about the future; and crip-

pling price distortions that threaten to prevent sustainable housing recovery.

Housing finance reform must be focused on addressing these two issues. GSE reform is urgently needed and a plan should be put into motion this year instead of waiting until 2011 or beyond. As I discussed further in my written testimony, there is a growing shadow inventory of homes, houses for which foreclosure has only been temporarily delayed, rather than prevented, and this is creating an excess of supply.

If current Federal housing policies and programs remain in place, and the Federal reform process is dragged out, that supply is only going to expand in the coming months, indicating prices are artificially inflated and the market is distorted. The current policy of the Treasury Department, as Secretary Geithner has testified before this committee, is to wait until housing markets are more stable before reforming the GSEs. However, any such stable housing recovery will be artificial and susceptible to sudden declines, either from another bubble bursting, or from the emergence of a large supply of homes out of the shadow inventory hitting the market.

Fannie and Freddie's support of the housing market, backed by low interest rates from implicit government guarantee led to rapidly increased home sales in the last decade, which contributed to the spike in housing values from 2002 to 2006. Those perpetuate and pretend prices turned out to be unsustainable, since they were distorted by boom and bust government policies. As such, fixing the GSE problem is necessary before a real sustainable recovery can actually take hold.

Fannie and Freddie cannot immediately be eliminated, because virtually the entire mortgage market is dependent on them as a wastebasket for toxic mortgage debt, and this stems from the Treasury Department's bailout of the GSEs, propping them up as the main source of liquidity in the mortgage market today. But a strategy for dissolving them over the next few years can and should be created now.

My written testimony offers some suggestions on how they could be wound down in a prudent way without shocking the market, and allows the government to continue its affordable housing mission to the Federal Housing Administration. Some specific principles for reform: First, Congress should focus on encouraging and fostering a sustainable recovery not bailing out homeowners in the near term. Waiting to reform the GSEs would perpetuate the boom and bust cycle and risk the creation of yet another housing bubble that will eventually collapse.

Furthermore, waiting perpetuates the uncertainty in the financial markets that is largely frozen capital. Keeping lenders in perpetual limbo on what the future market for housing finance will look like and waiting increases risk to taxpayers. The longer the GSEs are allowed to operate in their current role as political rather than business entities, the greater the potential for financial losses will be for taxpayers.

Second, Congress should support a framework for mortgage financing that does not distort prices. In order for the mortgage and housing markets to be stable for lenders to act more responsibly,

perverse incentives must be removed from the system. Only when price distortions are removed and assets are more realistically and competently valued will private capital return to the market allowing the GSEs to wind down prudently.

Third, there should be an effective framework for the private sector to step into the current role that the GSEs play in the market. It is important to note that Congress cannot engineer the exact means for how the private sector will innovate and engage the mortgage and secondary mortgage markets. Congress should simply design rules to encourage private capital as the main source of mortgage financing, avoid market distorting policies, ensure transparency, and keep taxpayers from shouldering risk.

In conclusion, the housing market must be permitted to find its natural bottom, because that is the only real way to begin to fix it after years of distortion. While the housing market is weak is precisely the time to act in reforming the GSEs and promote innovation. GSE reform is not an ace of spades to trump all housing woes. Principal reform will mean short-term paying as negative equity and foreclosures get worse.

But, in the long term, homeowners and businesses will benefit from a soundly valued market and access to growing private capital. Meanwhile, taxpayers will be spared the inappropriate risks and crippling debt being taken on by the government. The result would be a stable foundation for growth that puts America on a path to a sustainable housing market.

Again, thank you for the opportunity to testify. I look forward to answering any questions you may have.

[The prepared statement of Mr. Randazzo can be found on page 105 of the appendix.]

STATEMENT OF RICK JUDSON, THIRD VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. JUDSON. The housing GSE system functioned well for decades, but the past few years have seen unprecedented turmoil, to say the least.

While we are here today to discuss the future of the housing finance system, one thing is clear. The status quo cannot be maintained. NAHB has had a strong and long-standing interest in the maintenance of an efficient secondary mortgage market system, and the role of the GSEs.

NAHB believes that it is crucial for the Federal Government to continue to provide some type of backstop for the housing finance system. Such conditions are underscored by the current state of the system, where Fannie Mae, Freddie Mac, and the Federal Home Loan Banks and the Federal Housing Administration and Ginnie Mae are the only conduits for residential mortgage credit.

NAHB believes a Federal backstop must be a permanent fixture, in order to ensure consistent supply of mortgage liquidity, as well as allow rapid and effective responses to market dislocations and crises.

With regards to the future of Fannie Mae and Freddie Mac, however, NAHB recommends major, major changes, in terms of structure and operations. NAHB recommends creating private companies called "conforming mortgage conduits," or CMCs, which would

be chartered to purchase conforming conventional mortgages that are originated by approved mortgage institutions such as banks, savings and loan associations, mortgage banking companies, and credit unions. These CMCs would issue securities backed by those mortgages, which would carry a Federal Government guarantee of the timely payment of principal and interest for the securities and their investors.

CMCs would guarantee the timely payment of the mortgages that are pooled in the government-guaranteed securities. However, CMCs and the mortgages themselves backing these securities would not have implicit or explicit support from the Federal Government. CMCs would be required to be well-capitalized, and to maintain reserves at levels appropriate for the risk exposure.

The CMCs would also pay fees in exchange for their securities receiving the Federal guarantee. Those fees would capitalize an insurance fund similar to what is maintained by the FDIC currently, which, along with the CMC reserves and private mortgage insurance coverage, would cover loss exposure on the mortgages and the CMC securities.

The Federal Government, therefore, would only be called upon to support conforming, conventional mortgage markets under catastrophic situations when the capital and the insurance of the securities insured and the resources of the CMC mortgage insurance companies' fund have been depleted.

NAHB believes that the mortgages eligible for inclusion in these securities and in an explicit Federal guarantee would be tested and well-understood features in the well-known risk characteristics, including fixed-rate mortgages, standard adjustable rate mortgages, and selected multi-family mortgages. Such standards could be set by Congress.

As this committee moves forward framing a new secondary market structure, NAHB urges careful consideration of the short-term and the unintended consequences that could occur during the transition to a new housing finance system. Any changes should be undertaken with extreme care, and with sufficient time to ensure that U.S. home buyers and renters are not placed in harm's way, and that the—efficiently and effectively, as the old system is being abandoned, a new system can be put in place.

Thank you for the opportunity to speak to you.

[The prepared statement of Mr. Judson can be found on page 92 of the appendix.]

The CHAIRMAN. Thank you. Again, as I said, I believe there is a consensus that we need to replace the current system. The question is whether that's all we need to do. There are some who say that's just—let me start with Mr. Reed.

Would it be sufficient, in your judgement, to pass legislation phasing out Fannie Mae and Freddie Mac, and take no other legislative steps?

Mr. REED. Thank you for the question, Mr. Chairman. I think that would not be sufficient. I think certainly something has to be done with the existing assets. An equitable and fair solution has to be arrived at for the existing assets.

The CHAIRMAN. Well, you talk, though, in your testimony about some other entities that you thought should be—let me—

Mr. REED. Yes, sir. That was—that would be the second point I would like to make, which is in our proposal there—we do call for the establishment of a single utility that would be responsible for the physical creation of the MBS, the transformation—

The CHAIRMAN. Well, that's my question. Should we legislate them so that they take effect simultaneously?

Mr. REED. I would, yes. I think—to your point, I think one could start to build out the infrastructure that we are describing while the current GSEs are in process.

The CHAIRMAN. Yes. I am concerned that if we them, and don't put that in place, then I don't know quite how we would carry out some of what they need.

Mr. Judson, let me ask you a similar question. Would it be sufficient simply to phase out the GSEs and then take no further legislative steps?

Mr. JUDSON. A transition to the new entity, whether that be a utility-type company or the conforming mortgage conduit that I referenced, whatever that transition would be, it does need to be a transition. And a dismantling of the GSEs would be appropriate, because they are not working under the current condition.

The CHAIRMAN. I understand. And, as I said, I think the dismantling of the GSEs is not in question, and we have to deal with the assets. But we're talking about some functions that are not performed there, whether or not you can simply put them out of business and not have this new utility. And that, when people ask about the delay, the issue is to make sure we get that right. That's what we're looking for, is some kind of input on that. So, I appreciate what you said.

Let me ask Mr. Gleason. What do you think? Can we just move to that, or would it be sufficient simply to phase them out as they—and you're speaking for the Council of State Housing Authorities, correct, not just Massachusetts?

Mr. GLEASON. Yes, Mr. Chairman, that's right. To your question, I don't think it would be appropriate to phase out the GSEs and not put anything simultaneously in their place. We clearly need a functioning secondary mortgage market. I don't think there is any doubt about that.

I think dismantling Fannie and Freddie without putting an alternative mechanism in place would not be the way to go.

The CHAIRMAN. Let me ask again from the supply side. Mr. Hopkins?

Mr. HOPKINS. My concern would be that if we didn't have a functioning secondary market, it would—without competition from the community banks, that the cost to the homeowners would go up. There would be no price competition. We help with the price competition, so there needs to be a functioning secondary market.

The CHAIRMAN. I appreciate that, and I think while, obviously, the private sector we hope to increase and encourage that, my own view is that simply abolishing Fannie Mae and Freddie Mac, which is going to happen, without making sure that we have taken steps to facilitate, if necessary, the creation and set the rules of the private secondary market, it would be a mistake.

Let me ask Mr. Randazzo. You talked about the further problems for the taxpayers if we don't immediately abolish them. The Sec-

retary testified that the ongoing activities are not causing a loss, that the losses result from the kind of sunken cost. Did you disagree with his analysis on that?

Mr. RANDAZZO. No, I think that's correct. I think that the future further tax losses will come from the fact that building a recovery on the way that the current policies and—the current way that we're funding mortgages today is going to create another bubble.

The CHAIRMAN. I appreciate—

Mr. RANDAZZO. Eventually that bubble is going to pop, and—

The CHAIRMAN. And that's a valid argument. But it's not that the activities of Fannie Mae and Freddie Mac, in and of themselves, are causing tax losses.

Mr. RANDAZZO. The activities of Fannie Mae and Freddie Mac, in what they are issuing right now into the—or not issuing. The mortgages that they are purchasing right now in their current portfolio, those have the potential, as the Secretary actually testified this morning, to actually have losses in the future. Those are the tax losses.

The CHAIRMAN. Yes, everything has the potential. But the ongoing activities are not now causing losses.

Mr. RANDAZZO. No, the ongoing activities—or the existence of Fannie Mae and Freddie Mac right now, the—what they had before, those are losses that are leaking into the system.

The CHAIRMAN. Right. And so no matter how quickly we abolish—

Mr. RANDAZZO. There will be losses, no matter how fast—

The CHAIRMAN. Those don't diminish because of that.

Mr. RANDAZZO. Absolutely.

The CHAIRMAN. Thank you. Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman. Earlier, I think many of you were here for Secretary Donovan's testimony, where he opined that the affordable housing goals of the GSEs played no role in their demise.

I note that in 1992, Congress required the GSEs to purchase CRA loans as part of its affordable housing mandate. In 1995, HUD authorized Fannie and Freddie to purchase subprime securities, including loans made to low-income borrowers. In 1996, HUD required that 42 percent of Fannie/Freddie mortgage financing go to borrowers with income levels below the median, later increased to 56 percent by 2008. In 2004, Fannie and Freddie purchased $175 billion in subprime mortgage securities, which accounted for almost half of the market that year. And the record goes on.

Mr. Pollock, do you believe that the affordable housing goals of the GSEs played any role in their demise?

Mr. POLLOCK. Yes.

Mr. HENSARLING. Well, I could not ask for a more clear answer there.

Let me ask another question. I have had a number of witnesses say that apparently we need government guarantees. We need some kind of GSE structure, and I didn't hear anybody talk about this in their testimony.

But it appears to me, as I look at the mortgage market prior to the meltdown, we had a fairly competitive mortgage market in the jumbo market. We had a fairly competitive market in subprime.

I look internationally, and I see countries like Denmark, who has—their housing prices have declined, similar to ours, but there has been no surge in delinquencies or foreclosures. They use a covered bond market. And, to the best of my knowledge, there are no government guarantees in that particular system. I see Canada has no housing GSEs. Their homeownership rate, I believe, exceeds our own. In Canada, loans are full recourse to the mortgage borrower.

So, I just question, when I look at our own historic experience, when I look at international examples, I am having a hard time believing that somehow you must have a government-sponsored enterprise, and the taxpayer hemorrhage that goes along with that, to have a functioning secondary mortgage market, much less high rates of homeownership.

So, if there is somebody who studied these examples and wants to push back, or—Mr. Pollock, yes, I will let you comment again.

Mr. POLLOCK. I don't want to push back, but I have studied these examples with some care, Congressman. What you say about Denmark is true. That's an exceptionally interesting housing finance system.

I gave a presentation in Denmark a few years ago about the American system of GSEs. When I was done, the CEO of one of the main Danish mortgage banks which issues their covered bonds said to me, "Everybody always says about us in Denmark that we are the Socialists and America is free enterprise." He said, "I see that when it comes to housing finance, it's the opposite."

Mr. HENSARLING. I appreciate that observation. I have also seen—I don't have it at my fingertips, but I believe there is a study by the Federal Reserve showing that the GSE benefit to the home purchaser was ultimately something like eight basis points, which means that, ultimately, maybe a purchaser was able to purchase at 4.92 percent, instead of 5 percent.

But on the flip side, when you pay your mortgage, you are also paying the principal, which means that if you artificially increase demand, you might drive up the cost on the principal side, and ultimately you're no better off, because what you gain, which, arguably, is very little on the interest side, you lose on the principal side. And now, as I said in my opening statement, there are at least 127 billion reasons that the taxpayers would not like to see the GSEs maintained, particularly with anything remotely resembling a Federal backstop.

Again, I ask, what is the necessity and what is the benefit, when we are a nation that is already on the road to bankruptcy, and Fannie and Freddie will obviously prove to be the mother of all bailouts?

Mr. Reed, I would be happy to let you comment.

Mr. REED. Thank you, Congressman. To be clear, our proposal does not call for a continuation of the GSEs in the current form. What we advocate is that the guarantee, if there is one, be placed on the MBS, not on the corporate entities themselves, which I think is an important distinction between the "GSE model"—

Mr. HENSARLING. And who is guaranteeing the MBS?

Mr. REED. The MSICs. Actually, there would be several layers of capital. First, the home buyer's equity mortgage insurance, the eq-

uity in the MSICs, and then a reserve fund that we propose be in between them, as well.

But to your point, it's an important question. Why have any government guarantee at all? And I think it is an important question. I think everyone would agree that—has agreed on the importance of the secondary market, as a means of financing the housing market that we have here in the United States. And I think—I have seen studies as well that have pointed to the past decade and said there has really been very little benefit.

The CHAIRMAN. Finish up.

Mr. REED. But I think that might miss the point, which is over the past decade perhaps investors—and lenders, and everyone in the process—were not evaluating the risks appropriately.

So, if you go back and you just use the past decade, and you say—and I agree with you, if you look at the spread between AAA, non-agency securities, and MBS securities, there has been a fairly—range. But the point of the policy, and the point of why Fannie Mae and Freddie Mac were created in the first place, was to ensure consistent access to reasonably-priced finance. And what you will see is that spread between AAA, non-agencies, and MBS could range somewhere—it has been as low as, say, 20 basis points. It has been as high as 200 basis points. And, in fact, the non-agency market has ceased to exist.

So, if the policy objective is to ensure consistent and reasonably-priced homeownership, then we would advocate the most efficient way to do that is to put private capital in the first loss, and a government guarantee on the MBS, only in the event of catastrophe.

The CHAIRMAN. Thank you, Mr. Reed. The gentlewoman from California.

Ms. WATERS. Thank you very much. Let me thank our panelists for being here today.

It is no secret that I was and I am a supporter of GSEs. I did not support and do not support the move to risky mortgages that our GSEs ended up involving themselves in. I think that the mission of the GSEs is a credible mission.

But the fact of the matter is, as I understand it, our GSEs started to compete with our private mortgage companies like the one that was—Countrywide, Mr. Mozilo, and they were putting a lot of risky products out on the market. They were—actually, Mr. Mozilo was the poster child for the ARMs and the other risky mortgages that were put out there. And it caused Fannie Mae—even though I don't support the fact that they tried to compete with them for it.

So, here you have a mortgage company like Countrywide and others which, instead of giving people prime loans who were deserving of prime loans, were giving them subprime loans and all of the exotic products that you could think of.

So, you had a private market, you had people eligible for prime loans. They were not getting them. They were thrown into subprime. GSEs started to compete to get that business, and of course that has created all of that debt, and I think the downfall of the GSEs.

How do you propose to have a private, totally private secondary market that could operate in the way Countrywide was operating

and take care of our needs with low- and moderate-income would-be home buyers? Mr. Pollock?

Mr. POLLOCK. Thank you, Congresswoman. I think the case is that with a private secondary market, Countrywide would not have been able to operate in the way that it did operate. Countrywide and Fannie Mae, for a long time, had a symbiotic, mutually supporting and mutually dependant relationship.

There are secondary markets in debt securities of all kinds—in corporate bonds, in municipal bonds, in charge card loans—which are pure, private secondary markets in debt. And that's what we should have for prime conforming loans. And I think that market would work quite well.

For loans which are non-market loans, that other part of the GSEs, that, if we wanted to have the government do it, should be honestly made into a government function, like the FHA is.

Ms. WATERS. So, I guess what I just heard was that the private market should be able to take care of all of the prime loans, the secondary prime loans, without any problem. Is that what I heard?

Mr. POLLOCK. Congresswoman, it's never the case in human affairs—and certainly not in financial affairs—that we operate without any problem. We always have problems. And finance has its own problems. But it is my view that if the GSEs were not there to dominate the market, and extract monopoly rents from it, that a private market in prime conforming loans would operate quite successfully.

Ms. WATERS. And so, your preference is to transition to no GSEs, period. Is that right?

Mr. POLLOCK. That is correct.

Ms. WATERS. Thank you very much. I yield back.

The CHAIRMAN. The gentleman from New Jersey.

Mr. LANCE. Thank you, Mr. Chairman. Good afternoon to you all.

If we move to a private secondary market, as I favor—and, Mr. Pollock, you indicate that, as I understand it, you favor that as well. How about you, Mr. Randazzo, could you explain your position regarding that?

Mr. RANDAZZO. I think it's important to understand that a private secondary market is going to look very different than what we have right now.

Mr. LANCE. Yes.

Mr. RANDAZZO. And it's impossible for this committee, for Congress, to engineer exactly what that's going to be. So it's—for us to sit here and explain exactly what it's going to look like to the detail would be impossible, and would be unwise.

What is important to understand is that without the GSEs there, there will be less distortions in the market, and there will be wider room for private capital to step into place, whether that's through the use of covered bonds, restarting securitization, or something that we don't even know or have heard of.

Mr. LANCE. And I presume it would be your position that the sooner the GSEs are wound down, the sooner the private market can be involved in this.

Mr. RANDAZZO. Absolutely. As I put forward in my written testimony, the longer, actually, that we have the GSEs around, the harder it's going to be to let the private sector into the market.

Mr. LANCE. Regarding the question Congressman Hensarling asked Mr. Pollock based upon the testimony of the Secretary earlier today, is it your position that the GSEs were involved to some extent in the financial situation that affected this country?

Mr. RANDAZZO. Absolutely. They were a driving force.

Mr. LANCE. I believe they were certainly one of the driving forces. There may have been—

Mr. RANDAZZO. Absolutely.

Mr. LANCE. —others, but they were certainly one of them.

Is there anybody on the panel who disagrees with Mr. Randazzo and Mr. Pollock, and agrees with the Secretary?

Ms. CROWLEY. Agrees with the Secretary, that the GSEs did not cause the financial meltdown?

Mr. LANCE. Yes.

Ms. CROWLEY. I would say that the supposition that the requirement that the GSEs participate in the affordable housing market is—and that was what led to the financial meltdown is not accurate, nor any of the other requirements that the financial institutions engage in meeting social obligations.

I think that Mr. Gleason said it best. It wasn't that they did affordable loans, they bought bad loans, and that those were loans that shouldn't have been purchased.

There is going to be a lot written about what it is that caused the financial meltdown—

Mr. LANCE. I know I wouldn't say the GSEs did it alone. I don't want to be interpreted as meaning that they alone were responsible. I think that's clearly inaccurate. I would say they, with others, but certainly not alone.

Ms. CROWLEY. I would say that there is—we had a culture, a message that was permeated throughout our country, that homeownership was the preferred form of housing tenure. Homeownership was idealized to the extent that if you weren't a homeowner, there was something wrong with you, and rental housing was demonized and had a very negative connotation.

And so, you couldn't turn on the TV without having somebody tell you how to become a homeowner, which would make you a better person, and how to do it cheaply, and how to get it—get that money very fast. And so I think that message, along with the availability of those kinds of very bad mortgages led us to this situation. And I think we all bear responsibility for that.

Mr. LANCE. Thank you. My own view is that the culture in this society is that we have far too much debt. The Federal Government is certainly a prime culprit in that regard. And the culture that somehow we can all get rich quick is something that, obviously, I disagree fundamentally.

I hope that the new culture of this country will be much more responsible, fiscally, across-the-board regarding various entities, including the successors to GSEs, I hope in the private market, and certainly, ultimately, getting our fiscal house back in order here at the Federal level.

Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. The gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I want to direct my questions to Mr. Judson and Mr. Pollock. Mr. Judson, I welcome him,

he is from my hometown, so I told him I was going to pick on him a little bit.

The chart that you have on the back of your testimony deals with—all the way on the last page of the testimony, there is a chart that looks pretty complicated. But it seems to me to deal only with conforming, conventional mortgages, nothing—so I assume one part of your approach would be to deal only with conforming, conventional mortgages in the Federal Government context of any kind.

Mr. JUDSON. That is correct, Congressman. Whatever entity is created to replace the GSEs, they would be conforming loans only.

Mr. WATT. Okay. And so, if one would not qualify for a conforming, conventional mortgage security, the government might set up some external entity to help that person qualify, possibly by providing downpayment assistance, or getting them ready to go into a conventional mortgage loan. Is that correct?

Mr. JUDSON. That is absolutely correct. That would help solve the problem that had occurred.

Mr. WATT. I took it to be. Now, Mr. Pollock, the approach that you advocated for in your answer to Ms. Waters's testimony would involve solely conventional loans also. Isn't that right?

Mr. POLLOCK. Congressman, what I was saying is for the market of conforming, conventional prime loans, which is, by far, the biggest part of the market—

Mr. WATT. And you think that can be done only in the private sector, without any government involvement?

Mr. POLLOCK. That is correct, Congressman.

Mr. WATT. Now, would you need, under your theory, this mortgage insurance fund? I gave you a copy of what Mr. Judson's organization, the Home Builders, have proposed. Would you even need the mortgage insurance fund part of that? Or what would happen if somebody defaulted? That would be just the cost of doing business for the lender, or would there be some mortgage insurance fund that would take up that slack?

Mr. POLLOCK. Congressman, this diagram which we have here is not too bad, in my view, as one possibility for how private conforming loan financing might work. We wouldn't need the Federal Government guarantee on there, in my opinion, since government guarantees always call forth the leverage which causes them to be needed.

Mr. WATT. So you would drop the government, Federal Government, guarantee part of it?

Mr. POLLOCK. I would drop that Federal Government guarantee. Whether or not you needed a fund would be a matter of design of the system. You can certainly design private systems that have back-up insurance funds. That is a—

Mr. WATT. But without the government guarantee, it might increase the premium in the fund, I take it.

Mr. POLLOCK. It might.

Mr. WATT. Okay. Mr. Judson, how do you react to what Mr. Pollock is saying? Do you need a Federal Government guarantee?

Mr. JUDSON. I think you do need a Federal Government guarantee.

Mr. WATT. Why?

Mr. JUDSON. To provide some security to the investor. Now this is for the mortgage securities. One of the problems has been in the past—

Mr. WATT. But if this is a private market situation, why do you need to provide that security? Why would the government be involved in this, if we are providing our subsidies or input from the borrower side, getting them ready for a conforming market, giving them—providing them possibly downpayment assistance so that they have an equity in whatever they are investing in from the outset, why would you need a Federal Government guarantee?

Mr. JUDSON. If these are non-conforming or non-qualifying loans under normal conditions, whether—

Mr. WATT. No, these are conventional loans.

Mr. JUDSON. The—

Mr. WATT. You said—that was the first question I asked you. This is a conventional market. That's the only way you get us involved, right?

Mr. JUDSON. That is correct. And it's only at roughly an 80 percent level. There are three layers of insurance, we will say, between you—between the Federal Government and that investor.

Mr. WATT. Okay. I yield back. I will ask you questions back in Charlotte.

Mr. JUDSON. Okay.

The CHAIRMAN. The gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman. Mr. Pollock, Mr. Donovan and I were discussing earlier the issue of the affordable housing policies implemented by the Federal Government, and whether or not that contributed to the housing boom and bust. What do you think on that issue?

Mr. POLLOCK. I think it did. I think housing booms are fed by credit. The more credit you push at an asset, the higher the price of that asset tends to be. As I said in my testimony, Congressman, there tends to be, in a boom, let alone a bubble, a positive disequilibrium feedback loop between those two factors.

And, as Congressman Hensarling suggested a minute ago, one of the problems when we try to make housing more affordable by increasing credit is we tend to push up the price of the housing. We need to consider both of those factors.

Mr. ROYCE. We are talking about the future of mortgage financing. But it appears that we may not have learned these lessons about the clear distortions in the market that can be caused by intervention by the Federal Government. That's part of the concern I have.

Getting every American into a home was the goal. The GSEs were the primary vehicle for that. But unfortunately, today our economy is dealing with the consequences of that misguided decision, along with other misguided decisions which helped get us into this predicament.

But, Mr. Pollock, why did a private secondary market for prime mortgages never develop?

Mr. POLLOCK. Congressman, I think the answer to that is it never developed because it was crowded out by the government-advantaged market of Fannie Mae and Freddie Mac. No private mar-

ket could compete with the various and very large advantages that the two GSEs had.

Mr. ROYCE. So, we ended up with a duopoly and a certain amount of moral hazard that economists argue always comes when a Government-Sponsored Enterprise is presumed to have the government behind it.

Let me ask Mr. Randazzo a question. Many have noted that the mortgage finance market has been unusually susceptible to boom and bust cycles. And let me ask you, what do you believe is the major contributor to this phenomenon?

Mr. RANDAZZO. In the most recent boom, I think, as Mr. Pollock pointed out, credit drives a bubble, and we had both the GSEs and various other policies of the Federal Government, including the CRA, that fed into that—that helped feed credit into that bubble.

And when you have a distortion of the amount of credit that's available, you drive down mortgage prices. When you drive down mortgage prices, it is easier for more people to get mortgages. That drives up the prices of homes, in general, and you create a boom.

Without the GSEs or any government price distorting aspect, you are going to have less of a boom and bust cycle. If there is any boom and bust cycle, it would be a minimum.

Mr. ROYCE. And so, what would be a couple of your suggestions for ending the tendency towards these pronounced boom and busts, anyway, that have plagued the market? Why don't you give us some of your suggestions on that front?

Mr. RANDAZZO. Well, in terms of winding down the GSEs in—over the next few years, I think that the first thing that you need to do is to begin to lower the conforming loan standards of the GSEs. This will begin to allow the private sector to step into—step in behind that, as the conforming loan standards drop, and there is more open space in the secondary market.

And then you can begin to, over time—as the secondary market is taken over by the private sector, you can, over time, wind down the GSEs' portfolios and their MBS pools.

Mr. ROYCE. And do you think, also, the Federal Government setting the interest rate at below inflation also—

Mr. RANDAZZO. Yes, and I think that's absolutely a critical part. What this committee can do to encourage the Federal Reserve to begin to increase interest rates is very important, because as long as the interest rate is set at an artificially low level, you will have a distorted supply of credit.

And, in particular, I think as long as the interest rate is as low as it is, there is no incentive for the private sector to be lending money in the mortgage markets, because they can use other means to sort of ride out this unstable period of uncertainty, without having to use mortgage—use profit from mortgages to generate profit.

Mr. ROYCE. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman. And I want to thank the Independent Community Bankers. Mr. Hopkins, you represent them. I want to thank them for the role that they did not play in the crisis.

I would like to drill down just a moment on this question of how the GSEs played a role in the crisis, because the products somehow

are being equated to the institutions. It was subprime loans wherein buyers were qualified for teaser rates, but not qualified for adjusted rates that created a problem in the subprime market.

Does everybody agree that was a problem, that buyers who qualified for teaser rates did not qualify for adjusted rates, and then these loans were passed on to someone or some other entity, the originator of the loan passed on all of the liability to some other entity, maybe GSE, but passed it on?

And so, it was the product that created a real problem, in terms of the subprime market. And I would like to debate that, but I don't have the time, Mr.—is it "Randazzo?" Am I pronouncing your name—

Mr. RANDAZZO. "Randazzo."

Mr. GREEN. "Randazzo," all right. I don't have the time to debate that with you, but I would like to debate at some point the question of the products versus the institutions, because the products were all products that were—came into being because of changes in the laws. The Alternative Mortgage Transaction Act, 1982 I believe it was, changed that—made it possible for us to have a lot of these exotics. So, it was products.

But now, let's come to something that I did want to talk to a couple of you about, and do want to talk about in the—I hate to follow the same paradigm as Mr. Watt, but the truth is he and I had the same thoughts, so I have to pursue it the same way.

Mr. Reed—not you, Mr. Judson, but Mr. Reed now—on page seven of your testimony, you indicate that the Federal Government would not back the MSICs. But it would back the secured transactions, the securities themselves. Is this correct?

Mr. REED. Yes, sir, that's correct.

Mr. GREEN. Okay. So now you have the government as a backstop. Mr. Judson, you have the government as a backstop, as well. And, Mr. Pollock, it's your opinion that is not a good idea. Is this correct?

Mr. POLLOCK. That's correct, Congressman.

Mr. GREEN. And you would simply allow the market to function without the benefit of a government backstop with any sort of entity, whether you call it GSEs or you call it MSICs. In your world, it's the same, eventually.

Mr. POLLOCK. For the prime conforming market, yes, Congressman, that's right.

Mr. GREEN. Okay. Now, let's just see how many folks agree with this. Because at some point—I don't mean to put you on the spot, sir, but we need to get some sense of where we are here.

If you are of the opinion that there should be no government backstop at all, kindly extend a hand into the air, so that—or let me just start. Mr. Reed, yes or no? No government backstop at all?

Mr. REED. No. No, sir. We believe there should be a government backstop.

Mr. GREEN. Should be. Okay, Ms. Crowley?

Ms. CROWLEY. Yes, there should be a government—

Mr. GREEN. Should be. We know where you are, Mr. Pollock. Mr. Hopkins?

Mr. HOPKINS. Yes, there should be a government backstop.

Mr. GREEN. All right. Mr. Gleason?

Mr. GLEASON. Should be.

Mr. RANDAZZO. There should not be.

Mr. GREEN. Should not be?

Mr. JUDSON. Yes.

Mr. GREEN. Yes.

Mr. JUDSON. Should.

Mr. GREEN. Okay. I—the public is always interested in knowing the source of all of these things. Do you find that most people, Mr. Reed, that you work with in the industry—in the industry—are of the opinion that there should be some sort of backstop?

Mr. REED. Thank you, Congressman. The committee that I am co-chairing represents about 18 of the top lenders in the country, and mortgage insurance companies, and others involved in the lending industry. And I think there is an almost unanimous opinion that, again, if what we are trying to achieve here is consistent access to reasonably-priced home finance, that a government guarantee is—

Mr. GREEN. Mr. Hopkins, quickly. Are you with the bankers, or do you find that most people in the industry, who have a hands-on experience, what are their thoughts?

Mr. HOPKINS. Well, I think they believe there should be some sort of a government backstop on it. We are dealing with Fannie Mae and Freddie Mac. We have done it for many, many years. And we have very low foreclosures. On 3,000 loans last year, we only had 4 foreclosures for Fannie Mae and Freddie Mac. So it can be done right. You have to use appropriate underwriting.

Mr. GREEN. Yes, sir?

Mr. REED. Congressman, just to emphasize again, what we advocate, again, is not a guarantee of the corporate entities themselves. They should be allowed to fail.

Mr. GREEN. Yes.

Mr. REED. They make bad decisions, they ought to be allowed to fail. But we do advocate some mechanism to assure MBS investors of what they are getting.

Mr. GREEN. Okay.

Mr. REED. And—

Mr. GREEN. Thank you. I will have to yield back now. Thank you very much.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman. Just two short questions. Ms. Crowley, as I struggle with the whole issue with the GSEs—and you have been around here a great deal—I am wondering if perhaps one of the problems is the mission. The two main missions would be to make a profit and to increase the supply of affordable housing. Do you see those as conflicting?

Ms. CROWLEY. Well, I would say that certainly some people see that as conflicting. Our view would be that when you are dealing with a commodity that is so necessary as housing or health care or other things that are basic human needs, that—and you're relying on the private sector to do the majority of the provision of that basic human need, and that there is a profit to be made from that, that in fact there should be some corollary social responsibility that goes along with that.

And it would be lovely if everybody who made a profit understood they had a social responsibility, but that's not always the case. And so, usually that has to be regulated by the government in some way.

Mr. CLEAVER. Thank you.

Ms. CROWLEY. Okay.

Mr. CLEAVER. Mr. Randazzo, my last question. This is more philosophical, but how difficult do you think it would be for Congress to eliminate Medicare?

Mr. RANDAZZO. To eliminate Medicare?

Mr. CLEAVER. Yes, sir.

Mr. RANDAZZO. I think it would be difficult, though probably needed.

Mr. CLEAVER. How difficult do you believe it would be to eliminate the GSEs, or some kind of a backstop?

Mr. RANDAZZO. Difficult, but it would be easier.

Mr. CLEAVER. Easier than Medicare?

Mr. RANDAZZO. Easier. I think it's absolutely doable, if—with the principle that the mortgage market is going to change. The secondary mortgage market would not look the same as it is today, with the GSEs.

Mr. CLEAVER. Yes. Of course, you could explain all the things that would happen in Medicare, as well.

Mr. RANDAZZO. Sure. But the—

Mr. CLEAVER. And—

Mr. RANDAZZO. The GSEs, it would be unpleasant in the short term. It would benefit all homeowners and taxpayers in the long term.

Mr. CLEAVER. So we call a press conference and say, "Everybody here is going to suffer for a while, but just suffer in joy because it's going to change later?"

Mr. RANDAZZO. There are short-term pains that are going to come with any significant change in government policy. And the GSEs have been well-rooted into American society and—

Mr. CLEAVER. Yes, that's the point—

Mr. RANDAZZO. —the market for a long time. But yes, there will be some short-term pains as a process of phasing out the GSEs, as we try to figure out how the private sector is going to step in behind them.

Mr. CLEAVER. All right, thank you. Thank you, Mr. Chairman.

The CHAIRMAN. If the gentleman would yield to me his remaining time, I would just like to say that while the gentleman from Missouri, for rhetorical purposes, talked about eliminating Medicare, I want to reassure all my fellow Medicare recipients, that is not something being currently contemplated—heading off some phone calls before they come.

I thank the witnesses and the members. This has been helpful in advancing this discussion. And the hearing is over.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

A P P E N D I X

April 14, 2010

OPENING STATEMENT OF CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON THE FUTURE OF HOUSING FINANCE: WHAT SHOULD THE NEW SYSTEM BE ABLE TO DO? – PART II

APRIL 14, 2010

Mr. Chairman, we meet today to continue our discussions about what functions a new housing finance system should perform. I appreciate your efforts to focus the Financial Services Committee on this complex set of issues and share your interest in these important matters.

Today's hearing is just one of many conversations with stakeholders that we will need to have before determining what legislative actions we should take to achieve the end goal of reestablishing a healthy, stable housing finance system. I approach these debates with an open mind and without any preconceived notion of what the solution ought to be. Through careful deliberation, however, I do believe that we can ultimately find the right policy approach.

In late 2008, then-Treasury Secretary Paulson placed Fannie Mae and Freddie Mac under conservatorship. Since then, the Treasury Department has committed to purchase more than $125 billion in preferred stock of the enterprises. Government agencies have also purchased in excess of $1.3 trillion in mortgage-backed securities. All of these actions have preserved the availability of housing credit during these difficult economic times.

The government, however, has further scaled back its commitments in our mortgage markets since our hearing last month on this same topic. Specifically, on March 31 the Federal Reserve ended its program to purchase mortgage-backed securities. As our markets recover from the financial crisis, we must return to the private sector those functions that properly belong with the private sector. Although we must continue to carefully monitor what happens to mortgage rates and investor demand, I am so far pleased with the results of this separation.

In thinking about where we should go, we must also consider where we have been. In good times and in bad, Fannie Mae and Freddie Mac have historically proven vital to increasing liquidity and improving the distribution of capital available for home mortgages. Together, these institutions have helped tens of millions of middle class families to share in the American Dream of owning their homes. I want the new housing finance system to continue to achieve this goal.

While I look forward to hearing the testimony of all of the participants today, I am especially eager to learn the thoughts of the Secretary of Housing and Urban Development. His thoughts will help to guide the Capital Markets Subcommittee as it continues with the explorations begun last June regarding the housing finance system. At our forthcoming hearings, I anticipate that we will explore specific questions like the need for mortgage insurance, the housing finance systems of other countries, and the structure of guarantee fees.

In sum, Mr. Chairman, these important matters are ripe for debate and represent the next big mountain that our Committee must climb. This trek is almost as difficult as reforming financial regulation. If the legislative debates on financial services regulatory reform were like scaling Mount Everest, then the deliberations of the future of housing finance are surely like ascending Mount McKinley. I am glad that we have had some practice.

Testimony of Sheila Crowley, MSW, Ph.D.
President of the National Low Income Housing Coalition
presented to the
Financial Services Committee
United States House of Representatives
April 14, 2010

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to testify today on the future of federal housing finance policy.

I am Sheila Crowley, President of the National Low Income Housing Coalition (NLIHC). NLIHC is dedicated solely to achieving socially just public policy that assures people with the lowest incomes in the United States have affordable and decent homes.

Our members include non-profit housing providers, homeless service providers, fair housing organizations, state and local housing coalitions, public housing agencies, private developers and property owners, housing researchers, local and state government agencies, faith-based organizations, residents of public and assisted housing and their organizations, and concerned citizens. We do not represent any sector of the housing industry. Rather, NLIHC works only on behalf of and with low income people who need safe, decent, and affordable homes, especially those with the most serious housing problems, including people without homes. NLIHC is funded entirely with private contributions.

We organize our work in service of three specific goals for federal housing policy:

- There will be no further loss of federally assisted affordable housing units or federal resources for affordable housing or access to housing by extremely low income people.
- The federal government will increase its investment in housing in order to produce, rehabilitate, and/or subsidize at least 3,500,000 units of housing that are affordable and accessible to the lowest income households in the next ten years.
- Housing stability in the neighborhood of one's choice, which is foundational to good health, employment, educational achievement, and child well-being for people with the lowest incomes, will be the desired outcome of federal low income housing programs.

We are interested in the topic of today's hearing primarily because the housing finance system in the United States to date has failed miserably in assuring enough housing for all Americans and we want any reform that Congress undertakes to address that serious shortcoming. We think Congress can and should structure the way housing is financed in our country to finally make good on the housing goal that Congress established in 1949: "A decent home and a suitable living environment for every American family." If Congress is able to achieve this result, it may be possible for historians to look back at the housing and economic crisis known as the "Great Recession" and say that something good emerged from the turmoil that has caused such hardship.

My testimony will discuss the most serious housing problem in the United States, principles to guide reform of the housing finance sector, and specific policy recommendations.

The most serious housing problem.

In the United States today, there are 9.2 million extremely low income (ELI) renter households (incomes of 0-30% of their area median) and only 6.1 million rental homes they can afford (paying no more than 30% of their income for their housing). For every 100 extremely low income household in the United States, there are just 37 rental homes that are affordable and available to them.[1] As a result, these households pay precariously high portions of their income for the homes, leaving little left for other necessities. Nearly three quarters (71%) of ELI renter households spent over half of their incomes for housing in 2007, and the average ELI renter spent 83% of household income on housing.[2]

The most recent *State of the Nation's Housing* report from the Joint Center on Housing Studies comes to the same conclusion. Households of all kinds with incomes in the bottom quintile all have housing cost burdens, paying more than 30% of household income for their homes. No matter what the age group, household composition, or employment status of the head of households, these households have to pay unacceptably high portions of their meager income for their homes.[3]

In the wake of the foreclosure crisis, conventional wisdom is that the nation has an excess supply of housing and higher than normal vacancy rates. While that may be the case for high cost housing, there is no evidence that the available supply of low cost rental housing has increased. Indeed, the supply of low cost rental housing continues to decline.[4]

Moreover, rents at the lower end of the market continue to rise. The National Low Income Housing Coalition's annual study of housing costs, *Out of Reach*, will be published next week. What I can report is that the 2010 national housing wage, that is, the hourly wage that a full-time worker must earn in order to afford a two-bedroom rental home, is $18.44 an hour, up from $17.84 an hour in 2009. There remains no place in the United States where a full time minimum wage worker can afford the rent on a one-bedroom rental unit.[5]

The consequences of this scarcity of housing are dire for the families who are most directly affected. High housing cost burdens mean fewer dollars to spend on other necessities and going without. High housing costs mean never saving money and having no cushion for emergencies. High housing cost burdens mean risk of eviction and frequent moves. The shortage of affordable rental homes for extremely low income households is the principle cause of homelessness in the United States.

A stable home is the platform for success in all other spheres of individual and family life. Children cannot succeed in school if they do not have a stable place to go home to when school is out. Adults cannot succeed in the workforce or in civic life if they do not have a stable

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[1] Pelletiere, D. (2009). *Preliminary assessment of American Community Survey data shows housing affordability gap worsened for lowest income households from 2007 to 2008.* Washington, DC: National Low Income Housing Coalition.
[2] Ibid.
[3] Joint Center for Housing Studies, Harvard University. (2009). *State of the Nation's Housing.* Cambridge, MA: Author.
[4] Collison,R.& Winter, B. (2010). *U.S. Rental Housing Characteristics: Supply, Vacancy, and Affordability.* HUD PD&R Working Paper 10-1.
[5] National Low Income Housing Coalition. (forthcoming). *Out of Reach.* Washington, DC: Author.

place to go home to at the end of the workday. Someone cannot recover from illness in the absence of a stable home. People with chronic disabilities are consigned to institutions or the streets if they lack access to stable homes. All the other interventions policy wonks and helping professionals devise to help low income people improve their social and economic well-being are for naught if we first do not make sure they have safe, decent, and affordable homes.

With the intense emphasis on homeownership as the preferred form of tenure in recent years, we have lost touch of with what housing really means. Housing needs to be understood much more as the place where one is sheltered and carries out family life, and much less as a financial asset and a source of wealth building.

Given this understanding of the housing crisis today, we offer the following principles to guide reform of the housing finance system in the United States.

Principles to guide reform.

1. *Federal subsidies to the housing sector should be directed to meeting the needs of those with the most serious housing problems first.*

In FY 2009, the Federal government spent $300 billion to support housing and the mortgage markets. Eighty percent subsidized home ownership, and the remaining 20% supported rental housing. The majority of the homeownership subsidy is provided through tax expenditures, while most of rental housing support is provided through the HUD budget.[6]

The tax advantages provided for homeowners are highly skewed to benefit higher income households. First, a taxpayer has to have sufficient income to benefit from filing an itemized return in order to take a tax deduction at all. Only a third of all households claimed the mortgage interest in 2009. Second, the bigger one's mortgage, the greater one's deduction will be, so people with the most expensive homes get the most generous subsidy. Of those who took the deduction, 76% of the subsidy went to households with incomes of $100,000 or more; 32% went to households with incomes of $200,000 or more. Similar skewing in favor of the financially well-off is found in the real property tax deduction.[7]

A truer picture of the Federal commitment to housing would also count the nearly $2 trillion in support for mortgage credit and other insurance through FHA, Ginnie Mae, VA and Rural Housing Services loans, the National Flood Insurance Program, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

Despite this considerable federal involvement in the housing sector, we have a persistent structural deficit of housing that the lowest income people can afford. This is a problem that the housing market has not and cannot solve. Clearly subsidies are not being directed to where they are needed the most and where they would do the most good.

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[6] Congressional Budget Office. (2009, November 3). *An overview of federal support for housing.* Washington, DC: Author.

[7] Joint Committee on Taxation. (2010, January 11). *Estimates of federal tax expenditures for fiscal years 2009-2013.* Washington, DC:Author.

2. *All segments of the housing finance sector have a duty to contribute to solving the most serious housing problems.*

Some would argue that imposition of the conflicting goals of maximizing profits and serving a public purpose contributed to the downfall of Fannie Mae and Freddie Mac. We would argue that housing, like health care, is so essential to human well-being that any profit seeking enterprise in housing must be grounded by social responsibility that is assured by government regulation.

In 1992, Congress directed Fannie Mae and Freddie Mac to take a more active role in assuring the availability of affordable housing by establishing "affordable housing goals" that the GSEs were required to meet. There is little agreement as to the effectiveness of these goals.[8] Many observers would do away with them. Certainly the affordable housing goals made little difference in addressing the affordable housing shortage for the lowest income people.

In July 2008, Congress enacted additional reforms for the GSEs and added a further affordable housing obligation, in the form of contributions to the National Housing Trust Fund and the Capital Magnet Fund.[9] The National Housing Trust Fund is specifically designed to address the shortage of rental housing for the lowest income people. Of course, these contributions were suspended before they ever started when Fannie and Freddie went in conservatorship in the fall of 2008.

We think that in whatever form Fannie and Freddie take in the future, the obligation to contribute to the National Housing Trust Fund must be renewed and expanded. Just as important, we think all federally regulated financial institutions have a similar obligation and should be required to make similar contributions.

3. *Federal policy should not favor one form of tenure over another; rather, federal policy should incentivize balance in the housing market and the full range of housing choices in every community.*

Federal policy has clearly favored homeownership over rental housing for much of the last 60-75 years, as indicated by the skewed nature of federal housing subsidies reviewed above. Not only has a disproportionate share of subsidies gone to homeownership, subsidies provided to homeowners through the tax code are an entitlement. Someone who fits all the eligibility criteria automatically receives the subsidy. Subsidies to renters through direct spending by HUD or other federal agencies are limited to the amount of annual appropriations; most people who are eligible for rental assistance do not receive any because of a lack of funding.

In the wake of the foreclosure crisis, many political and financial leaders, including HUD Secretary Shaun Donovan, are calling for a more balanced federal housing policy. Every community has members at all stages of the life cycle, at all income levels, and in all forms of family constellations. Every community needs a variety of housing options: owned and rented, single family and multifamily, assisted and supportive homes, sized for single persons and large

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[8] Federal Housing Finance Agency. (2010, February 1). *The housing goals of Fannie Mae and Freddie Mac in the context of the mortgage market: 1996-2009. Mortgage Market Note 10-2.* Washington, DC:Author.

[9] The Housing and Economic Recovery Act of 2008 also established a "duty to serve" for the GSEs, explicitly to serve three underserved markets: manufactured housing, affordable housing preservation, and rural areas.

families. Forms of housing that expand housing choice such as two-to-four unit multifamily homes and manufactured housing should be encouraged.

Assuring that all members of a given community have homes they can afford in the neighborhood of their choosing will require strict enforcement of fair housing laws, including fair lending, and full implementation of the duty to affirmatively fair housing as a condition of receiving direct and indirect federal subsidies.

4. *Federal policy should reward housing forms that are of reasonable size and are earth friendly, that is, policy should reward moderation, not excess.*

One of the manifestations of the housing bubble was the growth in the square footage of individual homes. The demand for bigger homes with more expensive amenities was in part fueled by the federal housing subsidies through the tax code. Currently, interest on a mortgage up to $1 million is deductible. A simple reduction in the size of mortgage that would be eligible for favorable tax treatment would help right size houses and reduce the energy that each house consumed. Tax credits and favorable mortgage terms for homeowners and owners of multifamily properties that encourage energy efficiency should be continued and expanded.

5. *Federal policy should make sure the housing finance system has enough liquidity to assure a robust single-family and multifamily housing market at affordable interest rates.*

A strong secondary mortgage market is essential to the long-term health of the U.S housing sector. Consider how much worse our economy would be if we had not had Fannie and Freddie over the past 18 months. Federal backing in some form or fashion will be required to sustain such a secondary mortgage market.

6. *Federal policy should maximize the capacity of mission driven, public or non-profit housing providers to achieve tangible results in solving the nation's housing woes.*

Public and non-profit housing organizations that are not motivated by profit are more likely to engage in housing development and operation that will serve low income people over the long term.

Specific recommendations.

1. Immediately provide initial capital of $1.065 billion to implement the National Housing Trust Fund, passed by Congress in 2008.

2. Fund the National Housing Trust Fund at the level required to take the program to scale needed to solve problems. The National Housing Trust Fund campaign recommends at least $15 billion a year for ten years.

This funding level can easily be accomplished by structuring revenue-generating requirements on all financial institutions including, but not limited to, the next generation of Fannie and Freddie like entities. These could include:

a. Fees on Federal Support to Financial Institutions. The federal government provides private financial institutions with low cost funds through a variety of sources. The most important of these are lenders' ability to borrow from the Federal Reserve and the Federal Home Loan Banks and to acquire low cost deposits based on federal deposit insurance. A 5 basis point annual fee on outstanding low-cost funding balances could raise several billion dollars per year for the NHTF.

b. Securitization Fees. Congress could levy a fee on the securitization of mortgages by any capital markets participant.

Funding for the National Housing Trust Fund can also be generated through the tax code. We propose a Capital Gains Tax Surcharge. Homeowners benefit from their ability to avoid taxation on the capital gains that would be realized on the sale of their homes. A capital gains tax surcharge could be structured as percentage of the capital gains that the seller realized at the time of sale. A 10% surcharge would generate $3 billion a year.

3. Reform the mortgage interest deduction. CBO estimates that if the upper limit on mortgages eligible for tax subsidies were lowered from $1 million to $400,000, it would have produced $4.2 billion in revenue in 2008 and $88.1 billion over 10 years. Such a change in 2008 would have raised taxes for just 1.2 million people, those with the largest mortgages, representing only 1% of all households in the United States.

   Alternatively, CBO estimates that if the current mortgage interest tax deduction were replaced with a 15% tax credit on mortgages up to $400,000 for primary residences, revenue of $21.7 billion would have been generated in 2008 alone, with $418.5 billion between 2008 and 2017.[10] Such an approach would benefit lower income home owners who do not itemize their taxes and thus get no housing subsidy, while creating a disincentive to overinvest in housing.

4. Enact a federal rent credit to provide unassisted low income renters with a housing subsidy similar to that which homeowners receive. Twenty-eight states currently provide state tax credits for renters. Most are restricted to seniors or other subsets of the population, and most are limited to people at or below a prescribed income level.[11] A renter tax credit could be structured in any number of ways, with the primary purposes of creating greater equity between homeowners and renters and to reduce housing cost burdens.

   Thank you for the opportunity to offer this testimony today.

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[10] Congressional Budget Office. (2008). Budget Options. Washington, DC: Author.

[11] Pellietiere,D. et al. (2008). *Housing assistance for low income households: States do not fill the gap.* Washington, DC: National Low Income Housing Coalition .

Testimony of Shaun Donovan
Secretary of U.S. Department of Housing and Urban Development
Hearing before the U.S. House Committee on Financial Services
"Housing Finance- What Should the New System Be Able to Do? Part II-
Government and Stakeholder Perspectives"
April 14, 2010

Mr. Chairman, Ranking Member Bachus, thank you for inviting me to talk about Fannie Mae and Freddie Mac, together often referred to as the GSEs, and the Administration's efforts to reform our housing finance system.

I would like to begin my testimony by briefly reviewing how we arrived at a point of crisis in our housing markets, and the role that the GSEs played in that history. I will then talk about the federal response to the crisis, with emphasis on the comprehensive approach the Administration has taken and the role that the GSEs have played in conservatorship. And finally, I will discuss the principles and process that will guide us as we work to reform the housing finance system so that it can contribute to a more stable housing market.

Background: How We Got Here

As Secretary Geithner reviewed during his testimony before this Committee last month, there were many contributing factors that led to the housing crisis of the past few years. I will not revisit those factors in detail, but suffice it to say that I concur that there is plenty of blame to go around.

Low interest rates, global savings rates, greater investor appetite for housing and a mix of other factors combined to drive home prices to historic highs. But there were issues throughout the housing financing structure that made these increases in home prices unsustainable. Lightly regulated lenders and brokers with no "skin in the game" delivered increasingly risky loan products to the market. In the securitization market, instruments became increasingly complex, leading to widespread misunderstanding and mispricing of risk. And the regulatory environment was not sufficiently strong or broad to curb excesses in the market or clarify risk exposures for borrowers, investors, and the taxpayer.

Poor risk assessment and management existed in institutions at all points along the housing finance chain. Companies and managers assumed that risk could be virtually eliminated – relying on tools that were ill-equipped to assess the risk exposure embodied by Alt-A and non-prime loan products. And consumers drove demand for these products,

seeking quick returns, bigger homes or cash for other uses by entering into loans they could only afford if house prices kept rising indefinitely so that the loans could be paid off through sale proceeds or refinancing.

Seeing their market share decline as a result of this change of demand, the GSEs made the decision to widen their focus from safer prime loans and begin chasing the non-prime market, loosening long-standing underwriting and risk management standards along the way. This would be a fateful decision that not only proved disastrous for the companies themselves – but ultimately also for the American taxpayer.

With this broad shift towards riskier products and looser lending standards, we all know what happened next: an unsustainable market began to unravel. Foreclosures swept across the country, and housing prices went into a sharp decline, with prices falling nationally for the first time since the Great Depression. Homeowner equity declined by nearly 50 percent from its 2006 peak to $6.6 trillion. This translated into an average loss of over $80,000 for the American homeowner, with much of those losses concentrated in particularly hard hit areas of the country.

Faced with the collapse of the GSEs, the FHFA, with the support of the previous Administration, made the decision to place Fannie Mae and Freddie Mac into conservatorship in September of 2008.

A Comprehensive Response

Upon taking office last year, the current Administration took swift and comprehensive action to stabilize housing nationwide. Key elements of the response include:

- $220 billion in purchases of Fannie Mae ,Freddie Mac and Ginnie Mae mortgage-backed securities by Treasury;
- $1 trillion in purchases of Fannie and Freddie mortgage-backed securities and debt securities by the Federal Reserve through a program that has recently ended;
- The Treasury's changes to the senior preferred stock purchase agreements with Fannie Mae and Freddie Mac, which has allowed the GSEs to continue to support the availability of mortgage credit;
- The emergence of the FHA and Ginnie Mae as a major vehicle for continuing the extension of mortgage credit, with FHA insuring approximately 30 percent of all home purchase loans today, and Ginnie Mae guaranteeing more than $620 billion since the beginning of fiscal year 2009 to fund FHA and other government-insured loans;

- Support for temporarily expanding the limits for loans guaranteed by Fannie Mae, Freddie Mac, and the FHA from previous limits up to $625,500 per loan to $729,750 to provide needed support to keep markets functioning during this crisis;
- Maintaining the traditional and important role of FHA in helping homeowners refinance into more sustainable 30 year, fixed-rate FHA-insured loans, many of them at historically-low rates;
- The First Time Homebuyer Credit, which brought numerous new buyers into the market, and helped reverse the fall in housing markets, before it expired in November, 2009, and the subsequent Homebuyer Tax Credit, which applies to sales contracts signed by April 30, 2010.
- The Home Affordable Modification Program, or HAMP, which has resulted in nearly 1.3 million trial modifications being extended for mortgages at risk;
- Recent changes to FHA and HAMP that will motivate lenders to write down the principal of underwater borrowers, resulting in more sustainable mortgages and lower default rates;
- Aggressive loss mitigation efforts through several programs, including FHA's loss mitigation program and HAMP;
- Increased support for housing counseling services;
- Launched a $23.5 billion Housing Finance Agencies Initiative which is helping more than 90 state and local housing finance agencies (HFAs) across 49 states provide sustainable homeownership and rental resources for American families;
- An additional $2 billion in competitive funding through the Recovery Act for the Neighborhood Stabilization Program, to help communities mitigate the effects of concentrated foreclosures;
- $2.25 billion for the Tax Credit Assistance Program and awards of $5.4 billion in Housing Tax Credit Exchange Program funds through the Recovery to jumpstart housing construction and development stalled by the collapse of the Low-Income Housing Tax Credit; and
- The HFAs Hardest Hit Fund program, which will allocate over $2 billion of funds from TARP to help ten state housing finance agencies develop innovative ways to address their communities' housing issues.

Since the GSEs have been in conservatorship, dozens of major lenders have either failed or greatly reduced their mortgage lending, and as a result we have witnessed a severe contraction of the private secondary market. The GSEs—along with FHA and Ginnie Mae—stepped in to fill the vacuum, playing an indispensible role at a time of inadequate private capital. Indeed, few would disagree that, had they not played this increased role, the secondary market may well have shut down completely, which would have sharply

constrained the availability of new mortgages and households' ability to take advantage of the opportunity to buy a home or refinance at historically low rates. Any such shut down of the secondary market and lack of financing, in turn, would have reduced demand sharply, leading to a deeper fall in housing prices than we experienced.

A Fragile Recovery

The Administration's comprehensive approach has helped to restore the stability of the housing market, easing the very painful fall in home prices and playing a critical role in our broader economic recovery.

According to the Federal Reserve Board, stabilizing home prices and lower financing costs nationwide have supported the recovery of homeowner wealth -- homeowner equity started to grow again in the second quarter of 2009 and, to date, has increased by over a $1 trillion, or $13,000 on average for the nation's nearly 78 million homeowners.

Over 4 million borrowers have refinanced their homes in the past 15 months, saving an average of $1,800 per year on housing costs – pumping an additional $7 billion annually into local economies and businesses, generating additional revenues for our nation's cities, suburbs, and rural communities.

And just last month, our economy started creating jobs again – 162,000. At the end of 2009, quarterly economic growth increased at the fastest pace in six years.

For all this progress, however, it is important to recognize that the housing recovery remains quite fragile. And while the current status of Fannie Mae and Freddie Mac in conservatorship is a temporary one, they are playing a critical role in these still-uncertain times. That is why, as we think through the next steps in reforming our housing finance system, we must proceed very carefully to avoid undermining the stability that has been achieved.

Principles of Housing Finance Reform

As we work to reform our housing finance system, it is essential to keep in mind our broader housing policy goals. While not all of these goals are addressed directly through housing finance, some certainly are, and we should not compromise any of our core policy goals in the decisions we make in structuring our housing finance system. These broader goals include promoting sustainable homeownership and sustainable communities; expanding affordable rental options and reducing rental housing discrimination; preventing avoidable foreclosures and mitigating the impact of foreclosures on communities; and decreasing homelessness and de-concentrating poverty.

There are of course many others, but together our housing policy goals form the broader framework within which any comprehensive reform of our housing finance system must be carried out.

With that in mind, the Administration believes that a stable and well-functioning housing finance market should achieve the following objectives:

- *Widely available mortgage credit.* Mortgage credit should be available and distributed on an efficient basis to a wide range of borrowers, including those with low and moderate incomes, to support the purchase of homes they can afford. This credit should be available even when markets may be under stress, at rates that are not excessively volatile.

- *Housing affordability.* A well-functioning housing market should provide affordable housing options, both ownership and rental, for low- and moderate-income households. The government has a role in promoting the development and occupancy of affordable single- and multi-family residences for these families.

- *Consumer protection.* Consumers should have access to mortgage products that are easily understood, such as the 30-year fixed rate mortgage and conventional variable rate mortgages with straightforward terms and pricing. Effective consumer financial protection should keep unfair, abusive or deceptive practices out of the marketplace and help to ensure that consumers have the information they need about the costs, terms, and conditions of their mortgages.

- *Financial stability.* The housing finance system should distribute the credit and interest rate risk that results from mortgage lending in an efficient and transparent manner that minimizes risk to the broader financial and economic system and does not generate excess volatility. The mortgage finance system should not contribute to systemic risk or overly increase interconnectedness from the failure of any one institution.

Our nation's housing finance system could be redesigned in a variety of ways to meet these objectives. However, the Administration believes that any system that achieves these goals should be characterized by:

- *Alignment of incentives.* A well functioning mortgage finance system should align incentives for all actors – issuers, originators, brokers, ratings agencies and insurers – so that mortgages are originated and securitized with the goal of long-term viability rather than short term gains.

- *Avoidance of privatized gains funded by public losses.* If there is government support provided, such as a guarantee, it should earn an appropriate return for taxpayers and ensure that private sector gains and profits do not come at the expense of public losses. Moreover, if government support is provided, the role and risks assumed must be clear and transparent to all market participants and the American people.

- *Strong regulation.* A strong regulatory regime should (i) ensure capital adequacy throughout the mortgage finance chain, (ii) enforce strict underwriting standards and (iii) protect borrowers from unfair, abusive or deceptive practices. Regulators should have the ability and incentive to identify and proactively respond to problems that may develop in the mortgage finance system.

- *Standardization.* Standardization of mortgage products improves transparency and efficiency and should provide a sound basis in a reformed system for securitization that increases liquidity, helps to reduce rates for borrowers and promotes financial stability. The market should also have room for innovations to develop new products which can bring benefits for both lenders and borrowers.

- *Support for affordable single- and multifamily-housing.* Government support for multifamily housing is important and should continue in a future housing finance system to ensure that consumers have access to affordable rental options. The housing finance system must also support affordable and sustainable ownership options.

- *Diversified investor base and sources of funding.* Through securitization and other forms of intermediation, a well functioning mortgage finance system should be able to draw efficiently upon a wide variety of sources of capital and investment both to lower costs and to diversify risk.

- *Accurate and transparent pricing.* If government guarantees are provided, they should be priced appropriately to reflect risks across the instruments guaranteed. If there is cross-subsidization in the housing finance system, care must be exercised to insure that it is transparent and fully consistent with the appropriate pricing of the guarantee and at a minimal cost to the American taxpayer.

- *Secondary market liquidity.* Today, the US housing finance market is one of the most liquid markets in the world, and benefits from certain innovations like the "to be announced" (or TBA) market. This liquidity has provided a variety of benefits to both borrowers and lenders, including lower borrowing costs, the ability to "lock in" a mortgage rate prior to completing the purchase of a home, flexibility in refinancing, the ability to pre-pay a mortgage at the borrowers'

- *Clear mandates.* Institutions that have government support, charters or mandates should have clear goals and objectives. Affordable housing mandates and specific policy directives should be pursued directly and avoid commingling in general mandates, which are susceptible to distortion.

***Special Focus:* Equal Access, Responsible Ownership, and Sustainable Rental**

Among the broad set of issues that housing finance reform touches, all of which are of vital importance, I would like to speak in a bit more depth on a few subjects. The first is the importance of maintaining equal access to housing credit. The second is facilitating a responsible, sustainable form of homeownership that involves safe, easily understood financing products that work for most Americans. And the third is ensuring that reform supports a sustainable and stable market for rental housing, which is directly related to and influenced by the single-family ownership market.

Maintaining Equal Access to Credit

In recent decades we have witnessed an important democratization of credit. This provided many of those families that had previously been shut out and unable to make investments in home ownership with an opportunity to access this option for the first time. And we subsequently witnessed a dramatic growth in ownership among underserved groups. Though the current crisis reminds us that great care is needed to promote homeownership that is sustainable over the long-term, ensuring that home ownership opportunities are available to members of these communities should remain a priority.

Responsible home ownership can be a critical foundation upon which American families build wealth and stability. In the early 1990s, housing represented the largest single asset for 53 percent of households, according to the Survey of Consumer Finances. And even after the boom in 401(k) retirement plans and broader engagement of families in the stock market, the fraction of households for which the home was the major asset remained basically unchanged. In the run-up to the recent crisis, many homeowners made decisions that contributed to the crisis, taking on more debt on their homes as a way to boost their spending power, and many others who had behaved responsibly saw their equity fall as the value of their homes dropped in the crisis. Yet, even after the recent declines in home prices, home equity continues to be a central asset for American families.

So a reformed housing finance system should ensure broad access to mortgage credit and capital markets. At HUD, the FHA has long played this role for minorities and others who have historically not been able to access mortgage capital through mainstream financial channels. For example, in 2008, 50% of all home loans made to African American families were FHA loans and 45% of all loans made to Hispanic families were FHA loans.

For Fannie Mae and Freddie Mac, the affordable housing goals expanded the reach of lower-priced mortgage credit to many families. Some have argued that these goals were a principal cause of Fannie and Freddie's collapse and subsequent losses. But this argument is simply not supported by the facts.

Early this year, we released a detailed report to Congress on the Root Causes of the housing crisis. As shown in the report, one of the primary factors driving GSE losses was the desire to recapture market share and increase profits. The housing boom saw a rapid rise in non-prime and alt-A originations and securitization outside of the GSEs. To regain market share, and increase revenue, Fannie and Freddie made poor strategic decisions to take on greatly increased risk, notably in alt-A mortgages. Management made clear that increasing revenue was the motivation for purchasing non-prime and other alternative mortgage products that subsequently produced significant losses (Root Causes, p. 42).

We should thus be careful not to learn the wrong lesson from this experience and sacrifice an important feature of the current system: wide access to mortgage credit for responsible borrowers. The affordable housing mandates under the current system spurred innovations that have promoted responsible homeownership among lower-income families. We must be careful to ensure that the incentive structures in a reformed housing finance system do not retard the development of such innovations.

Promoting Responsible Homeownership

At the same time, we also must make sure that our commitment to access does not drive some to take imprudent risks. As I noted, consumer behavior was a contributing factor to the housing crisis, and we have seen the devastation that such risk-taking has inflicted upon families and communities across the country. Many borrowers simply used their home like "ATM machines" – without sufficiently considering the risk involved.

We must ensure that our efforts to maintain access are coupled with incentives that minimize the likelihood that a family gets a mortgage that they cannot afford -- a system

in which families take out home mortgages that are affordable in the long-term. Promoting this kind of sustainable and responsible homeownership is an important goal for this Administration.

Of course, there are many components that will be required to accomplish this. First, we need market practices that support responsible homeownership. Second, a strong regulatory system that discourages excessive risk-taking, enhances market discipline, and eliminates predatory activities is critical. And third, improved and streamlined disclosures that make clear the commitments that homebuyers are making as well as the obligations of brokers, realtors and lenders, will increase transparency and reduce the possibility of abuse.

Fannie Mae and Freddie Mac provide an instructive lesson in how responsible homeownership can be impacted by our housing finance structures. For many years, they played a pivotal role in promoting responsible ownership through the standardization of underwriting requirements and mortgage products.

Looking forward, we will want to ensure that these kinds of standardized products are widely available, and that homebuyers are fully aware of the risks associated with products that fall outside of such standard product offerings. Ultimately, we need a housing finance system that will help us once again see housing not simply as a tool for investment, but as the platform for stability that it has been throughout our history.

This will mean that, for some, ownership will not be the right answer. As you have noted on numerous occasions yourself, Mr. Chairman, while we continue to promote affordable homeownership, for many Americans renting will continue to be the only or preferred option.

Creating a System that Promotes Stability and Real Choice for Renters

The next-generation housing finance system must also facilitate a healthy rental market as part of a comprehensive, balanced national housing policy that supports responsible homeownership and affordable rental housing alike. This means not only ensuring that those considering renting have a choice, but that they have a real choice, meaning affordable housing that is close to schools, work, and amenities. A well-functioning rental market will be particularly important in the immediate future, as rental markets will absorb a larger-than-usual number of families who owned homes during the bubble but will be renting in the near future.

Throughout the past decade, evidence suggests that rental markets have contributed to considerable stress for families. For example, Census data show that 8.7 million renter households paid more than half of their income on housing in 2008, an increase of 400,000 households in just one year.

Moreover, we have witnessed severe disruptions in the Low-Income Housing Tax Credit program, which in the past decade was responsible for about half of all new multifamily developments, and has been the federal government's principal program supporting construction or rehabilitation of affordable rental units. This is directly related to the problems facing the GSEs, which were a substantial purchaser of these tax credits.

Through the Recovery Act, the Tax Credit Assistance and Tax Credit Exchange programs have temporarily eased some stress in the tax credit markets and provided some additional support to affordable housing production. But while much attention has been placed on the distress in single-family ownership housing, and rightfully so, it is important to recognize the effect this crisis has had on renters, many of whom were already struggling.

We thus cannot consider reforms to the ownership market without also factoring in the effects on rental markets. Those families with the fewest assets and resources—namely, those that rely on the rental market or are tenuously attached to ownership—would potentially be exposed to greater volatility and turmoil absent a stable rental market infrastructure. We therefore must be careful to promote policies that provide countercyclical support for rental markets as we have for single-family ownership markets.

In recent years, Fannie Mae and Freddie Mac have emerged as major providers of financing for the ownership and production of multifamily housing. Moving forward, we must make sure that this role is not overlooked, and that the government continues to provide adequate support for the production and preservation of affordable rental housing. In short, government support for multifamily housing is important and should continue to ensure that consumers have access to affordable rental options.

Relationship to the FHA and Ginnie Mae

Any discussion of reforming our housing finance system must take account of the role of FHA and Ginnie Mae in relation to the GSEs. Each provides enhancements to basic loan products that are defined by strict and clear underwriting standards. Each serves the single-family ownership and multi-family rental markets. Each has mission elements that represent important components of their current activities. And there is clear evidence

that actions by the GSEs, FHA and Ginnie Mae influence the other in real ways. As such, housing finance reform must carefully consider both the roles of the FHA and Ginnie Mae and the impact of any changes on them.

This is of course true also for institutions beyond the FHA and Ginnie Mae. The Federal Home Loan Banks, community development financial institutions, community banks and other private institutions play important roles in housing finance. Any significant changes to our housing finance system must explicitly recognize the interconnections and overlaps in the current market structure as well as recognize the overall role that the government plays in supporting the housing market. And of course, if government support is associated with the activities of private entities in a reformed housing finance system, we believe that such support must be carefully designed and appropriately priced.

Transition to New System

All of these issues point to the need for fundamental but careful reform. But transition from where we are today to where we need to be itself presents several important challenges. There is a large stock of investments on the balance sheets of the GSEs, and financial markets are depending on the ability of the GSEs, in their current form, to make good on their obligations. The GSEs and the federal government, through the FHA and Ginnie Mae, are playing a larger role in the housing finance market today than they have since the Great Depression. Conditions must be created so that private capital will return in a substantial manner to the housing market.

In conjunction with the Treasury's commitment to supporting the GSEs while in conservatorship, it should be clear that the government is committed to ensuring that the GSEs have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any of their debt obligations. Given the nascent state of our recovery, the Administration will take care not to pursue policies or reforms in a way that would threaten to disrupt the function or liquidity of these securities or the ability of the GSEs to honor their obligations. We recognize the central importance the mortgage finance market plays in the broader capital markets and we will ensure that this market is not allowed to be disrupted. Maintaining the current securitization operational flow, TBA liquidity, secondary MBS market liquidity, and the ability of the GSEs to issue corporate debt securities during the transition will remain key priorities for the Administration.

All of that said, government's role in the housing finance system and level of direct involvement must change, and the Administration is committed to encouraging private capital to return to the housing finance market. The substantial direct support for the housing markets that has been put in place will be allowed to fade as the market recovers and fully stabilizes – and we have taken initial steps to prepare for this.

A good example of these steps is the recent action taken by the FHA, where we are requiring a higher FICO score for those borrowers putting down less that 10%, stepping up enforcement on bad actors in the market, and increasing premiums to improve the financial health of the MMI fund. Together these steps will put the FHA on more sound footing heading into the future.

In addition, through regulatory reform and other supervisory actions, the Administration is committed to clarifying the framework for new securitizations to restart these important markets. These steps should create the room necessary for private markets to re-emerge.

Finally, during this period of transition the GSEs must be able to effectively continue to support a stable housing market. There are important human resources, infrastructure and capabilities at the GSEs that have great value. Through the transition we will seek to maintain this extensive infrastructure, knowledge, personnel, and systems. Designing an effective transition plan that leverages these resources and minimizes market disruption will be a critical component of reform.

We have confidence that this approach will result in a next-generation housing finance system that achieves our broad principles, strengthens our country and endures for decades to come.

Questions for Public Comment

In his testimony before this committee last month, Secretary Geithner announced that we would be releasing a series of questions to solicit the public's thoughts on these subjects by April 15th. In keeping with that commitment, HUD and the Treasury have today released a copy of these questions, and they will be submitted tomorrow to the Federal Register to be published for formal public comment.

These questions will help us consider what functions we want our housing finance system should serve, the structure or structures that they should take, how housing finance fits within our broader housing policy goals, and the best steps to get from where we are today to a stronger housing finance system.

The public's input will be invaluable as we think through these difficult and complex issues. So we will take that input in two forms. First, we will ask the public to submit written responses to the questions. The Federal Register notice will contain guidance on where the public should submit their responses and the form that the responses should take. Second, the Administration intends to hold a series of public forums across the country over the summer and fall of this year.

Together these opportunities for input will give a broad range of constituents the opportunity to deepen our understanding of the issues and help inform our response as we move forward over the coming year.

This is both in keeping with this Administration's commitment to openness and transparency, and the careful, deliberative way that we have approached our housing recovery to date.

And so, Mr. Chairman and Ranking Member Bachus, I hope you can see that the Administration is committed to building a next-generation system of housing finance that meets the diverse housing needs our country requires, while building on the nascent housing recovery we have established to date, protecting the taxpayer and, above all, ensuring we prevent a crisis of this magnitude from ever happening again.

Given the challenges we still face, we must take a responsible approach to housing finance reform in which transition is not marked by hasty changes that could threaten another breakdown in the market, but by care and deliberation as we work with Congress to develop proposals to support the institutional structure for the next-generation of housing finance.

In the months to come, I look forward to working with you, Mr. Chairman, Ranking Member Bachus, and the members of this committee to make this charge a reality. Thank you.

Testimony on Housing Finance

Submitted to the

House Committee on Financial Services

by Thomas Gleason, Executive Director, MassHousing,

on behalf of the National Council of State Housing Agencies

April 14, 2010

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for the opportunity to testify today on the future of our country's housing finance system and particularly, its Government-Sponsored Enterprises (GSEs). I am Tom Gleason, executive director of MassHousing, the Housing Finance Agency (HFA) of the state of Massachusetts. I am testifying on behalf of the National Council of State Housing Agencies (NCSHA), which represents the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. Though they vary widely in their characteristics, including their relationship to state government, HFAs have in common our public-purpose mission to provide affordable housing to the people of our states who need it.

NCSHA calls on Congress and the Administration to seize the opportunity of GSE reform to establish a powerful commitment to affordable housing within any future housing GSEs. We further appeal to you to direct future GSEs to prioritize the use of the proven HFA delivery system to fulfill this commitment in a safe and sound manner.

Before I elaborate on these points, I want to express our appreciation to Congress and the Administration for making it possible for HFAs to put housing to work for people and the economy. By providing us housing recovery resources and by removing barriers the financial crisis created to the deployment of our existing resources, you opened the door for HFAs to finance hundreds of thousands of affordable, sustainable homes for America's working families, while generating jobs and tax revenue for the economy.

Mr. Chairman, we especially want to thank you for recognizing that we could not afford to have the Low Income Housing Tax Credit (Housing Credit) and tax-exempt Housing Bond programs sidelined with affordable housing need so great and the housing market so fragile. We are grateful for the extraordinary efforts you made to reinvigorate and expand these programs with the Tax Credit Assistance Program (TCAP), the Tax Credit Exchange Program, new Housing Bond authority, and the Administration's HFA Bond Purchase Initiative.

We appreciate and join you in the efforts you are now making to continue and enlarge the Exchange Program to include 4 percent and disaster Credits, to extend the availability of the new Housing Bond authority, and to permit the continuation of the Administration's HFA Initiative should that prove necessary to keep affordable mortgage money flowing through HFAs. These steps are critical to fueling first-time home buyer lending, which will in turn ignite the trade-up market, and to spurring affordable rental home production.

GSE Reform and the HFA Opportunity

NCSHA believes a strong secondary market is an essential component of our country's housing finance system that must be preserved and strengthened to ensure the widespread availability of and ready access to mortgage capital. We further contend that federal government support of the secondary market is necessary to ensure the constant and stable flow of capital to all housing markets at all times, including periods of economic downturn.

We feel strongly, however, that federal support must carry with it an affirmative and commensurate duty on the part of the secondary market—regardless of the number of entities of which it is comprised or their structure—to finance affordable and sustainable homes and to reach underserved people, markets, and needs, including low- and moderate-income people, low-income communities and rural areas, and populations with special needs. These public-purpose obligations should be mandated and enforceable under federal law and regulation and not simply goals to which the entities aspire, without consequence for their failure to achieve them.

The relationship of any future housing GSEs with the federal government, the benefits derived from that relationship, and the public-purpose responsibilities those benefits compel must be clearly defined and understood. GSEs must be held accountable for achieving their public purposes and further federal support must be conditioned upon their success in doing so.

We understand that some say future GSEs should not make affordable housing investments, because that is what caused Fannie Mae's and Freddie Mac's financial demise. We disagree. Buying affordable loans did not get Fannie Mae and Freddie Mac into financial trouble. Buying bad loans did.

While it is true that both Fannie Mae and Freddie Mac made investments in subprime, Alt-A, and other nontraditional mortgages that contributed significantly to their financial woes, they also made sound affordable housing investments in partnership with HFAs that have performed exceedingly well. It is also true that the Federal Home Loan Bank (FHLB) system is experiencing financial stress, but FHLB partnerships with HFAs have not contributed to it.

In fact, recognizing the reliability of HFA lending, Fannie Mae in recent years entered into several exclusive arrangements with us, offering HFA customers preferred mortgage pricing and terms. Fannie Mae and Freddie Mac also purchased HFA mortgages because of their high quality, and several FHLBs extended HFAs liquidity, lines of credit, and advances on the strength of our loan portfolios.

HFAs have proven over many decades that affordable housing lending done right is good lending. We do it right through a time-tested combination of low-cost financing; flexible, but prudent, underwriting; diligent loan documentation and income verification; down payment and closing cost assistance; homeownership counseling; proactive servicing; and aggressive asset management.

Congress and the Administration recognized this when you entrusted to HFAs billions in housing recovery resources, on top of the substantial resources you already commit to us annually to create affordable housing opportunity in this country. You understood that we have consistently achieved, in both strong and weak economies, successful and sustainable housing outcomes by combining public purpose and accountability with sophisticated lending practices. You knew we had not and would not engage in subprime or other risky lending.

NCSHA urges you to again turn to the time-tested and consistently high-performing HFA delivery system to extend the reach of any future GSEs and to help them achieve their affordable housing mandates. We urge you to direct these entities to prioritize their relationships with HFAs, to work closely with HFAs in designing their affordable housing programs and products, and to rely upon HFAs to carry out those activities within reasonable, yet flexible, parameters that allow us to respond to varied needs across the country. We ask you to instruct these entities to partner with HFAs in meaningful and innovative ways that complement, augment, and expand our activities, rather than compete or work at cross-purposes with them.

NCSHA feels strongly that effective fulfillment of their public-purpose mandates will require future GSEs to wholly integrate within their business cultures and across their operations a dedication to affordable housing and underserved market financing. These activities should be pursued by these entities broadly and consistently, not as side or niche businesses.

Though GSE capitalization of the Housing Trust Fund is essential, that alone should not fulfill the GSEs' public-purpose responsibilities. They must fully devote themselves to bringing about affordable and sustainable housing outcomes, especially in areas where market forces fail.

Future GSEs should make low-cost capital available to support a broad range of affordable housing financing needs, including affordable homeownership lending; rental housing development; predevelopment, site acquisition, and construction lending; subordinate lending; and small and mixed-property financing. They should provide support in a variety of ways, including through the purchase and securitization of mortgages, lines of credit, loan guarantees, and Housing Bond and Credit purchases, all with reasonable rates and terms.

It is critical that GSEs be given broad authority and flexibility, within prudent standards of safety and soundness, to practice innovation in carrying out a wide array of affordable housing and underserved market strategies, which may include subsidizing lending for these purposes. GSEs must be able to respond quickly and nimbly to changing housing markets and conditions and to take measured risks.

Finally, NCSHA recommends that HFAs play a key role in GSE governance. We suggest HFAs be at the regulatory table, along with other representatives of the affordable housing community, not only to help ensure that the GSEs meet their affordable housing mandates, but also to inform those efforts and evaluate their success.

Thank you for soliciting NCSHA's views on future GSEs and the safe and sound affordable housing outcomes they could accomplish in partnership with HFAs. We are eager to assist the Committee as you move forward with this important work.

Testimony of

Jack E. Hopkins
President and CEO, CorTrust Bank, N.A.
Sioux Falls, South Dakota

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"Housing Finance – What Should the New System Be Able to Do?"

April 14, 2010
Washington, D.C.

Introduction

Chairman Frank, Ranking Member Bachus, thank you for this opportunity to present the views of our nation's community bankers on the future of housing finance. My name is Jack Hopkins and I am President and CEO of CorTrust Bank in Sioux Falls, South Dakota. CorTrust is a national bank with more than $600 million in assets. CorTrust Bank is a Seller/Servicer for both Fannie Mae and Freddie Mac, and currently services more than 3,500 loans with balances exceeding $400 million. I am proud to testify today on behalf of the Independent Community Bankers of America[1] and its nearly 5,000 community bank members nationwide.

Community Banks Rely on GSEs

ICBA has been a strong supporter of Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks), and community banks across the nation have benefited greatly by the liquidity they provide and by the robust secondary mortgage market they have created which over the years has enabled community banks to offer mortgage products to their customers and invest in mortgage-backed securities.

In 2008 and 2009, CorTrust Bank originated more than $150 million and $250 million in secondary mortgage loans respectively. We have also used FHLBank advances extensively over the last few years to fund fixed-rate commercial and agricultural loans, as well as provide liquidity for the bank. We currently have $34 million outstanding to support our lending. We have also purchased the GSE bonds over the years to support our investment portfolio and liquidity requirements, as well as to fulfill pledging requirements for municipal deposits.

These GSEs have made it possible to combine wholesale funding and community bank service at the local level.

Though very different in key respects, all three housing GSEs provide community banks with irreplaceable access to money markets. This access allows our members to offer the same home mortgage products to our customers that the largest firms offer to theirs. Without the GSEs, community banks would be unable to offer their customers long-term fixed rate mortgages. In addition, the FHLBanks provide members advances for liquidity, asset/liability management, and to fund long term loans to small

[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and more than $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

businesses and other customers. It is critically important that the GSEs remain reliable sources of funding and liquidity and continue to support a residential mortgage secondary market for our nation's community banks.

ICBA commends this committee for taking on the difficult and complicated task of rebuilding America's housing finance system and resolving the conservatorship status of Fannie Mae and Freddie Mac.

While there has been a great deal of discussion about what caused the financial crisis and the roles the GSEs may have played in it, today I would like to focus on the future of housing finance in this country.

Future of the GSEs

Since the government placed Fannie Mae and Freddie Mac under conservatorship in late 2008, the Treasury Department has committed to purchase more than $125 billion in preferred stock of the GSEs, and government agencies bought more than $1.3 trillion in mortgage-backed securities. In December, 2009, the administration lifted its $400 billion cap on assistance to the two GSEs saying it would cover unlimited losses through 2012. While these actions clearly helped maintain the flow of housing credit and prevented the complete collapse of our nation's housing markets, it is equally clear that this is not a long-term solution.

GSE Preferred Shareholders Must Be Made Whole

An unfortunate by-product of the government's take-over of Fannie and Freddie is that the value of GSE preferred shares plummeted, injuring more than a thousand community banks that purchased these shares with the encouragement of their regulators. Banks are generally prohibited from investing in the stock of other corporations, making AAA-rated GSE preferred shares an attractive option, and one that Treasury and the regulators promoted.

The actions of then-Treasury Secretary Paulson, primarily to protect the interests of the Chinese government (his own admission in Paulson's book On the Brink), resulted in an "ambush" of preferred shareholders by placing the preferred shares in a second position and eliminating all dividend payments. Despite earlier warnings by ICBA, Paulson's actions sent the entire market for financial preferred shares into a freefall, making it even more difficult for community banks to raise needed capital when additional capital was desperately needed.

Notably, nearly $36 billion in Fannie and Freddie preferred stock was outstanding prior to Fannie and Freddie being placed into conservatorship. An estimated $15 to $20 billion of that was held by the banking sector and almost one-third of banks reported holdings including many community banks. In my opinion, this action has directly

resulted in the failure of many banks by wiping out any excess capital that may have been available prior to normal losses experienced in a recession, such as we are now experiencing. These actions continue to have detrimental consequences on many community banks today by driving down capital levels and reducing the amount of available credit.

As this committee deliberates over the future of housing finance, ICBA urges you to ensure that this injustice is corrected by restoring the dividend payments on Fannie and Freddie preferred shares and paying injured holders the amount of suspended dividends from September 7, 2008, on an estimated $20 billion in GSE preferred holdings. As options are being considered to lift Fannie and Freddie out of conservatorship, ICBA urges that it be done in a way that will restore a reasonable value to the preferred shares. Helping restore the $15 to $20 billion in community bank capital value crushed by the unwarranted Treasury actions can foster $150 to $200 billion in new lending as banks leverage this capital.

ICBA would like to thank Chairman Frank and other members of the committee for their efforts on behalf of community banks to correct this injustice.

Range of Proposals

A number of proposals have surfaced recently to reform the GSEs, ranging from abolishing Fannie and Freddie and allowing the private securitization market to take over, to restoring Fannie and Freddie to their former selves. Other ideas include creating a covered bond market that would allow banks to issue mortgage-backed debt to finance mortgage loans, or allow each of the twelve Federal Home Loan Banks to securitize loans. The Mortgage Bankers Association favors a plan that would allow banks to charter their own GSE units with the government providing a guarantee for the securities.

Corporate Structure, Governance and Mission

As Congress considers these proposals, you will be faced with critical questions relating to corporate structure, governance, and mission. These are crucial issues that will require careful study as the solutions will have long-term effects.

What should the corporate structure of the secondary market be? Of the structures currently under debate, the cooperative structure or that of a public utility appears to be the most suitable for the needs of community banks. The cooperative structure has served the Federal Home Loan Banks well as its users also provide capitalization that is at risk. If the secondary market is capitalized by private, non-user capital, the private utility structure may be appropriate to set pricing and control undue risk taking.

What should be the ownership structure of the secondary market? Should the users be the owners such as in the FHLBank and Farm Credit systems? Should they provide all of the capital or should there be outside shareholders?

What should the governance structure be? Should users elect directors (some users, some outside independent directors)? Should there be presidentially appointed directors?

What should the mission be? The primary mission of Fannie Mae and Freddie Mac is to provide stability to the secondary market for residential mortgages, access to mortgage credit throughout the nation, to increase the liquidity of mortgage investments and to improve the distribution of investment capital for residential mortgage financing. Should this be changed? Are there other functions the secondary market entities could take on to help community banks and their customers?

Key Principles

ICBA is in the process of studying these proposals and considering these questions. What is clear is that community banks need a secondary market for residential mortgages. Without a reliable secondary market for residential mortgage loans, many community banks would be unable to offer this service to their customers. As the Administration and Congress consider how to resolve the conservatorship of Fannie Mae and Freddie Mac, and re-build America's housing finance system, ICBA has developed the following key principles that we believe must be included in the future structure of the secondary market for residential mortgages.

- *The secondary market for residential mortgages must be impartial.* The secondary market must provide equitable access and pricing to all lenders regardless of size or volume. Lenders large and small need secondary market access and consumers benefit by their activity in the mortgage market.

- *The secondary market must be financially strong and reliable.* Recent legislation established a world class regulator for Fannie Mae and Freddie Mac; strong regulatory oversight must be maintained to ensure that the secondary market operates within its mission and in a safe and sound manner.

- *The secondary market entities must have a limited mission focused on supporting residential and multifamily housing in all communities in the U.S.* Resources should be focused on supporting housing finance. Fannie Mae and Freddie Mac created uniformity to the market through the underwriting and processing systems they developed. The secondary market entities should continue their technical innovations that can be shared with their users to the ultimate benefit on consumers

- *The secondary market entities need to have the operational flexibility to hold some mortgages in portfolio when market conditions dictate, along with their securitization authorities.* Recent market events demonstrate the important role Fannie Mae and Freddie Mac have played in providing liquidity and market stability when other sectors of the market cease to function. Portfolio levels can be controlled through regulations and regulatory oversight.

- *The conflicting requirements of a public mission with private ownership must be eliminated.* Fannie Mae and Freddie Mac had housing goals for the purchase of mortgages from underserved people and in underserved areas. Meeting the demands of maximizing shareholder wealth created an environment where the two GSEs took on inordinate amounts of risk. This conflict must be eliminated going forward.

- *Congress should consider requiring the secondary market entities to dedicate a portion of their earnings to support housing programs in a form such as the Federal Home Loan Bank Affordable Housing Programs in return for the benefits of GSE status and in the place of the current housing goals.* The Federal Home Loan Bank Affordable Housing Program has been a very successful vehicle to help support affordable housing in a very structured, regulated manner. Dedicating a percentage of income to such a program would provide a return benefit to the public for the benefits of GSE status.

- *The accumulation of retained earnings must be an important component of the secondary market structure to provide some level of initial protection of user or private capital.* Many community banks were encouraged by regulators to purchase preferred stock in Fannie Mae and Freddie Mac and lost essentially all of their investment. Retained earnings will help to attract needed equity capitalization going forward.

- *Congress must ensure that a secondary market with government ties continues to exist.* Whether the Fannie Mae and Freddie Mac charters are retained or a new secondary market is created, it must have some government tie going forward to ensure continued steady and favorable access to the capital markets.

- *More than one secondary market entity should exist in the future.* The existence of more than one secondary market entity fosters competition, providing better access for community banks and lowers mortgage rates and closing costs for consumers.

- *The function of Fannie Mae and Freddie Mac should not be incorporated into the FHLB system.* There has been a suggestion that Fannie Mae and Freddie Mac be split up and incorporated into the Federal Home Loan Bank system. While the

Federal Home Loan Banks have had a limited secondary market function, the focus of their business must remain that of providing liquidity to their members to support housing, economic development, small farm, small agribusiness and small business lending.

Importance of the FHLBanks

The Federal Home Loan Banks must remain a strong, stable, reliable source of funding for community banks. As the financial crisis has moved through the financial system, many of the FHLBanks have suffered financial stress too, as mark-to-market accounting forced them to write down the value of securities, and debt issuance spreads widened increasing the cost of funds to members. Yet, throughout the financial crisis, the FHLBanks continued to provide advances to their members without disruptions, while other segments of the capital markets ceased to function. Daily, community banks depend on their FHLBanks for liquidity, asset/liability management and to enable them to match fund longer term loans. We must ensure a healthy, stable, vibrant FHLBank system that is a reliable source of funding, liquidity and other products to serve the needs of all its member/owners and provide lendable funds for the local communities they serve.

The FHLBanks have been repaying their REFCORP obligations more quickly than expected due to strong earnings. This rapid payoff has caught the attention of some who look at the FHLBanks as a potential source of funds for other purposes. There are already suggestions that the FHLBanks should continue to make the payments once the obligations are completely paid for. Once the FHLBanks complete their REFCORP payments, the earnings that would otherwise go to them should be kept in the FHLBank system to build retained earnings and protect the system's financial condition. Once the system has built sufficient safeguards to protect it against future financial challenges, funds may be used within the system for programs that help members serve their communities. The FHLBanks, their members and the consumers and businesses they serve across the country should not be penalized because the FHLBanks paid off their debts early.

ICBA continues to study the role the FHLBanks should play in facilitating a secondary market for residential mortgages. In a 2009 report, the Congressional Research Service suggested that Fannie Mae's and Freddie Mac's mortgage portfolios and other assets be divided among the FHLBanks. ICBA does not believe this is there right solution to the resolution of the two housing GSEs. Further, we would have significant concerns about any proposal to incorporate the function of Fannie Mae and Freddie Mac into the FHLBank system. While community banks have benefitted from the existing FHLBank secondary market programs, the primary business of the FHLBanks must remain advances.

Conclusion

Community banks rely on Fannie Mae and Freddie Mac to provide a reliable secondary market for residential mortgage loans they offer to their customers. Community banks rely on the Federal Home Bank System to provide liquidity, asset/liability management and long-term funding. Access to these GSEs is vital to the ability of community banks to provide financing options for housing, small businesses and agriculture.

Whatever solution Congress ultimately chooses to resolve Fannie and Freddie's conservatorship issues and restructure the future of housing finance, it must provide equitable access and pricing to all lenders regardless of size or volume.

Thank you for this opportunity to present the views of our nation's community bankers.

Testimony of

Rick Judson

On Behalf Of the
National Association of Home Builders

Before the
United States House of Representatives
House Financial Services Committee

Hearing on

Housing Finance – What Should the New System Be Able to Do?:
Part II – Government and Stakeholder Perspectives

April 14, 2010

Introduction

On behalf of the 175,000 members of the National Association of Home Builders (NAHB), I thank you for the opportunity to submit this statement on the issue of the future of the housing finance system. My name is Rick Judson, and I am a Charlotte, North Carolina-based home builder and the 2010 NAHB Third Vice Chairman of the Board.

Fannie Mae, Freddie Mac and the Federal Home Loan Banks have been, and remain, critical components of the U.S. housing finance system. Collectively, these organizations are called housing government-sponsored enterprises or GSEs. They were created by Congress to support mortgage market liquidity and help address affordable housing needs.

The GSEs have operated with implicit government backing that allows them to raise funds at favorable rates, which ultimately benefits mortgage borrowers. The housing GSE system functioned well for decades, but the past few years have seen unprecedented turmoil. Freddie Mac and then Fannie Mae were found to have serious accounting irregularities before both companies suffered financial problems that required them to be placed under government conservatorship and receive direct federal support. The Federal Home Loan Banks have experienced much less difficulty and continue to operate outside of direct government control.

The regulatory system for the GSEs also underwent a complete overhaul during this period, with all GSEs now under the oversight of a single regulator, the Federal Housing Finance Agency or FHFA. However, FHFA's regulatory reach has been constrained due to Fannie Mae's and Freddie Mac's conservatorship status and the significant role that Fannie and Freddie have been assigned in supporting mortgage markets and mitigating mortgage foreclosures.

One thing that is clear is that the status quo cannot be maintained. Policy discussions are underway on what should become of Fannie Mae and Freddie Mac following the current, still-indefinite conservatorship period, and what, if anything, should change in the structure and operation of the Federal Home Loan Banks. A key consideration is how to get from the current structure to a future arrangement without undermining ongoing financial rescue efforts and disrupting the operation of the housing finance system.

Flaws in the Current Housing Finance System

The causes of the severe problems that have plagued the housing finance system and broader financial markets have been extensively discussed. NAHB members have identified a number of system flaws that should be considered in overhauling the present framework:

- Underwriting standards and decisions based on expectations of rising collateral value rather than documented borrower credit and repayment capacity.
- Inappropriate focus on fee income rather than mortgage quality.
- Too little concern with credit (as opposed to interest rate) risk.
- Excessive risk-layering in mortgage lending.
- Inadequate regulation of mortgage originators.
- Consumer attitude that a house is a commodity.
- Financing standards and decisions that permitted excessive speculative buying by investors seeking short-term profits.
- Flawed evaluation/appraisal process which increased price volatility.
- Departure of Fannie Mae and Freddie Mac from their core, and previously successful, business model of mortgage securitization to engage in investing in securities backed by Alt-A, subprime and other non-traditional mortgages.
- Limited accountability and liability for mortgage originators and securities issuers.
- Lack of transparency for investors in mortgage-backed securities.
- Rating agency conflicts of interest and lack of oversight.

While not all of these problems can be addressed directly in overhauling the housing GSEs, they are issues that should receive careful examination as GSE restructuring is undertaken in conjunction with other housing finance and financial system reforms.

NAHB Position

NAHB has had a strong and longstanding interest in the maintenance of an efficient secondary mortgage market and the role of the GSEs in facilitating the flow of capital to housing. Last year, NAHB developed principles for reconstituting and improving the housing finance system that included provisions dealing with the secondary mortgage market and the future of the housing GSEs. NAHB recently developed some specific proposals related to the portion of the secondary market involving Fannie Mae and Freddie Mac and is in the process of refining policy recommendations dealing with the Federal Home Loan Bank System. These recommendations are summarized under the following major policy considerations.

Degree and Structure of Government Support

NAHB believes that it is crucial for the federal government to continue to provide a backstop for the housing finance system to ensure a reliable and adequate flow of affordable housing credit. The need for such support is underscored by the current state of the system, where Fannie Mae, Freddie Mac, the Federal Home Loan Banks, the Federal Housing Administration and Ginnie Mae are the only conduits for residential mortgage credit. NAHB feels the federal backstop must be a permanent fixture in order to ensure a consistent supply of mortgage liquidity as well as to allow rapid and effective responses to market dislocations and crises. With regard to the future of Fannie Mae and Freddie Mac, however, NAHB recommends major changes in terms of structure and operations.

NAHB believes the secondary market should encourage a number of private entities to compete in a manner that facilitates innovation and efficiency. While government support is needed to ensure that mortgage credit is available and affordable in all areas of the country under all economic circumstances, for the conforming conventional portion of the mortgage market, that support should not be provided directly to private companies. Rather, the federal government should provide an explicit guarantee of the timely payment of principal and interest on securities backed by conforming conventional mortgages, in the same manner that Ginnie Mae now provides guarantees for investors in securities representing interests in government-backed mortgages.

The operation of the new secondary market for conforming conventional mortgages is illustrated in the diagram attached to this statement.

Operation of the Conforming Conventional Mortgage Market

Private companies, called conforming mortgage conduits (CMCs), would be chartered to purchase conforming conventional mortgages that are originated by approved mortgage lending institutions such as banks, savings and loan associations, mortgage banking companies, and credit unions. CMCs would issue securities backed by those mortgages, which would carry a federal government guarantee of the timely payment of principal and interest for the securities investors.

CMCs would guarantee the timely payment on the mortgages that are pooled in the government-guaranteed securities. However, CMCs, and the mortgages backing their securities, would not have implicit or explicit support from the federal government. CMCs would be required to be well-capitalized and to maintain reserves at levels appropriate for their risk exposure. CMCs would also pay fees in exchange for their securities receiving a federal guarantee. Those fees would capitalize an insurance fund, similar to that maintained by the Federal Deposit Insurance Corporation for insured depository institutions, which, along with CMC reserves and private mortgage insurance coverage, would cover loss exposure on the mortgages in the CMC securities. The federal government, therefore, would only be called on to support the conforming conventional mortgage market under catastrophic situations, when the

capital and insurance of the securities issuers and the resources of the CMC mortgage insurance fund have been depleted.

Conforming Conventional Mortgages

Mortgages eligible for inclusion in securities receiving an explicit federal guarantee should be those with tested and well-understood features and well-known risk characteristics, including fixed-rate mortgages, standard adjustable rate mortgages and select multifamily mortgage loans. These mortgages would satisfy the following criteria:

- There should be continued availability of financing for long-term (at least 30-year) fixed-rate mortgages.
- Mortgage maturities should also be available for longer than 30 years.
- There should not be overly rigid adherence to loan-to-value limits that results in inappropriate rejections of creditworthy borrowers.
- Mortgage originators, lenders and investors should have appropriate accountability and liability for the instruments in which they are involved.
- Underwriting standards and decisions should be based on documented borrower credit and repayment capacity rather than expectations of rising collateral value.
- Underwriting decisions should be based on mortgage quality and not driven by fee income.

The characteristics of a conforming conventional mortgage would be established in broad terms by Congress, with CMCs developing specific mortgage programs under the oversight of their regulator. The maximum amount of a conforming conventional mortgage would continue to be determined by statute. The current limit is 125 percent of the median area home price, not to exceed $729,750 but with no area having a limit below $417,000.

Regulatory Oversight

There should be separate regulatory oversight for the primary and secondary mortgage markets. CMCs should operate under the diligent oversight of a regulator charged with ensuring the CMCs are conducting their business in a safe and sound manner, have adequate capital reserves, and are meeting housing mission requirements established by Congress.

Mission Focus

The primary mission of CMCs should be to support mortgage market liquidity in a safe and sound manner. These entities should focus on a core business of securitizing

mortgages. However, their activities should be directed at a broad range of housing market needs, to enable all Americans at all income levels to achieve decent, safe and affordable housing.

Capital and Portfolio Requirements

CMCs should have capital requirements that ensure their safety and soundness. These requirements should include minimum as well as risk-based capital thresholds.

CMCs should be permitted to hold a portfolio of loans sufficient to facilitate transactions as well as loans, including housing production loans, which do not have a secondary market outlet.

The Federal Home Loan Bank System

NAHB is in the process of updating its policy regarding the future of the Federal Home Loan Bank (FHLBank) System but continues to support a number of basic principles with regard to the FHLBanks. NAHB views the FHLBank System as an essential component of the U.S. housing finance framework that has served as a key source of liquidity for institutions providing loans to home buyers and home builders as well as credit for community and economic development. The fact that each of the twelve FHLBanks is owned cooperatively by its financial institution members, and that increases in member borrowing from a FHLBank require members to purchase additional FHLBank stock, ensures there is adequate capital reserves in the FHLBank System through all stages of economic cycles. NAHB notes that the FHLBank System, while benefiting from an implicit federal government guarantee, is self-supporting, through funding raised by issuance of securities backed collectively by all twelve FHLBanks, and has never required infusions of taxpayer funds.

During the recent period of mortgage and financial market turmoil, the FHLBanks played a vital role in sustaining mortgage liquidity for depository institutions. The FHLBanks increased their loans to member institutions by a third between year-end 2006 and year-end 2008, a period where financial markets worldwide were at the brink of collapse. The FHLBanks also contribute 10 percent of their net income for an affordable housing program that is an important source of support for affordable housing production for homeowners and renters.

The FHLBanks are significantly different from Fannie Mae and Freddie Mac in structure and operations and these differences should be acknowledged and respected during the consideration of the future structure of the housing finance system. NAHB urges policymakers to undertake any changes to the housing finance system in a manner that will not diminish the favorable cost of funds for the FHLBanks or impair the role of the FHLBanks in supplying liquidity to institutions providing mortgage and housing production credit, support for community and economic development, and resources to address affordable housing needs. In addition, NAHB believes that the future regulation of the mission and safety and soundness of the FHLBank System should reflect the

uniqueness of the System's mission, cooperative operating structure, charter type and other characteristics.

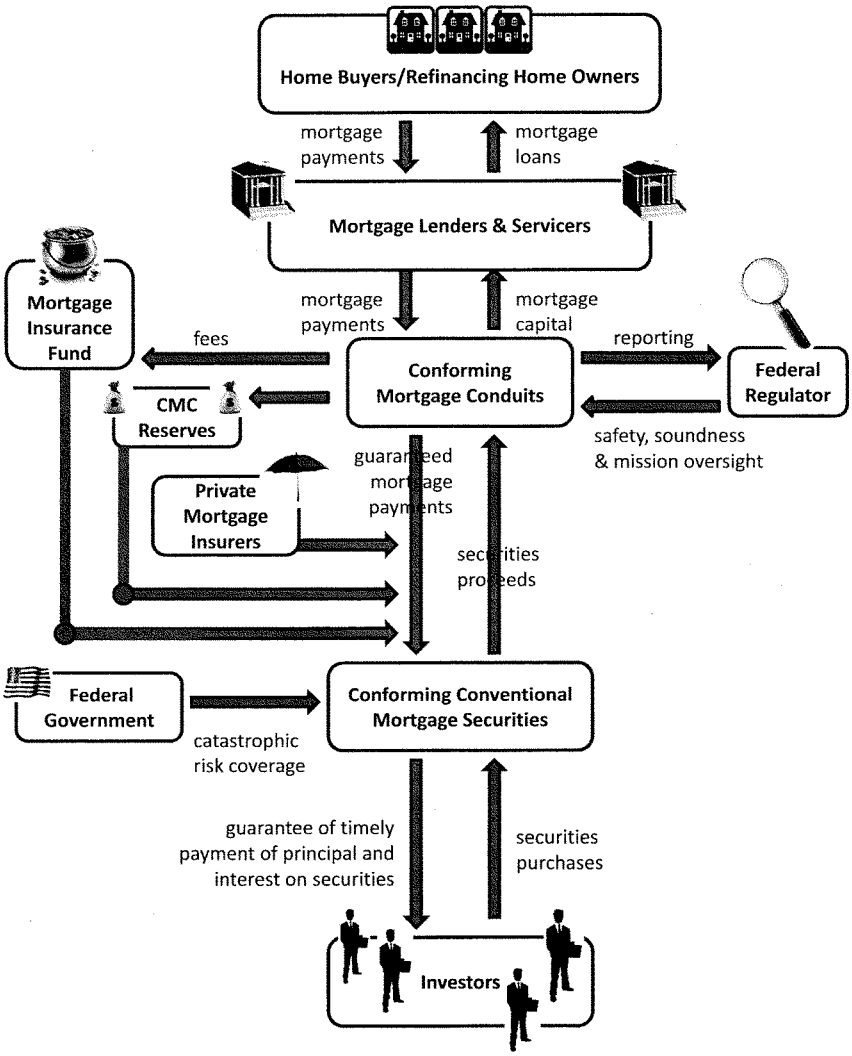
Transition Considerations

Fannie Mae and Freddie Mac are operating under conservatorship and experiencing severe financial pressures, and the private component of the conventional secondary mortgage market is not functioning at all. In addition, the housing and economic recovery is still sputtering and is vulnerable to relapse, while surging mortgage defaults and foreclosures continue to absorb a major portion of the resources of the current finance system as well as the attention of policy makers. Under these circumstances, finding a means of moving to a new secondary market framework may be as great, or greater, a challenge as developing the new conforming conventional secondary market structure. NAHB urges Congress to carefully consider and address the short-term, unintended consequences that could occur during the transition to a new housing finance system. Any changes should be undertaken with extreme care and with sufficient time to ensure that U.S. home buyers and renters are not placed in harm's way and that the mortgage funding and delivery system operates efficiently and effectively as the old system is abandoned and a new system is put in place.

Conclusion

Thank you for the opportunity to participate in this important and timely hearing. NAHB looks forward to working with all stakeholders to develop an effective as well as safe and sound means to provide a reliable flow of housing credit under all economic and financial market conditions.

Conforming Conventional Mortgage Secondary Market



Testimony of

Alex J. Pollock
Resident Fellow
American Enterprise Institute

To the Committee on Financial Services
U.S. House of Representatives

Hearing on Housing Finance—What Should the New System Be Able to Do?

April 14, 2010

Seven Steps Toward Sound Mortgage Finance

Mr. Chairman, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to be here today. I am Alex Pollock, a resident fellow at the American Enterprise Institute, and these are my personal views. Before joining AEI, I was the President and CEO of the Federal Home Loan Bank of Chicago from 1991 to 2004, and I am a Past-President of the International Union for Housing Finance. I have both professionally lived through and studied important transitions in mortgage finance, including of course, the one we are now in the midst of.

This morning I would like to propose for your consideration seven steps toward sound U.S. mortgage finance in the future:

-Create a private secondary market for prime, conforming mortgage loans

-Transition to no GSEs

-Facilitate credit risk retention by originators

-Develop countercyclical strategies

-If there should be surviving GSEs, do not use government-insured banks to promote their finances

-Develop clear, straightforward key information for borrowers

-Reintroduce savings as an explicit goal of mortgage finance.

1. Create a private secondary market for prime, conforming mortgage loans

The future mortgage finance system should have a robust private secondary market for the largest segment of the business: prime, conforming mortgage loans. In this market, private investors should put private capital at risk, and prosper or lose as the case may be. This is the most obvious case where the risks are manageable and no taxpayer subsidies or taxpayer risk exposures are required or desirable.

There may decades ago have been a case for GSEs (Fannie Mae and Freddie Mac) to guarantee the credit risk of prime mortgage loans in order to overcome the geographical barriers to mortgage funding, which were created by government regulation. There was lately a case for using GSEs to get through the financial crisis which they themselves did so much to exacerbate. But as we move into the future mortgage finance system, the prime mortgage market should stand on its own. Covered bonds, as well as securitizations, might well be part of this evolution.

A private secondary market for prime mortgages should have been a natural market development. Why did it never develop? The answer is obvious: no private entity could compete with the government-granted advantages of the GSEs. There could be no private prime conforming mortgage loan market while they used those advantages both to make private competition impossible, and to extract duopoly profits ("economic rents") from the private parties.

That element of the old housing finance system should not survive.

2. Transition to no GSEs

The old GSE duopoly could be taken out of the prime market by limiting GSEs' activity by regulation—but a better and more direct solution is to structure a transition to a world of no GSEs. I would like to commend Congressman Hensarling's bill, the "GSE Bailout Elimination and Taxpayer Protection Act" (HR 4889), for suggesting how this might be done, and how an orderly transition might actually be put in gear.

Housing finance inflation was at the center of the financial crisis, and the GSEs were at the center of housing finance inflation. No mortgage system reform can be meaningful which fails to address Fannie Mae and Freddie Mac, as I think everyone now agrees.

In my view, this is the core issue: You can be a private company, with market discipline; or you can be part of the government, with government discipline. But you can't be both. Trying to be both, in other words, a GSE, means you avoid both disciplines. Fannie and Freddie, or parts of Fannie and Freddie, should become one or the other.

A large part of them should become a private company competing, sink or swim, in the secondary prime conforming market, with zero special advantages. The part of Fannie and Freddie which makes non-market loans and provides housing subsidies should be merged into the structures of the Department of Housing and Urban Development, subject to the normal government disciplines of the budget and appropriations.

The desired transition is somewhat easier at the moment because Fannie and Freddie are not now GSEs. They are government housing banks, owned for the most part and controlled entirely by the government.

Therefore in my opinion, it is quite clear that, as recommended by the Congressional Budget Office, they should be on the federal budget. Fair and transparent accounting seems to demand that they not get off-balance sheet accounting treatment, which comes in for so much criticism in other areas. In this context, I would also like to commend Congressman Garrett's bill, the "Accurate Accounting of Fannie Mae and Freddie Mac Act" (HR 4653).

3. Facilitate credit risk retention by originators

The retention of credit risk or "skin in the game" in mortgage finance is a lesson drawn by a great many observers from the mistakes of the bubble. In my view, there is indeed a fundamentally important idea here (which I did a lot of work on starting in 1994). What should be more natural to ask of someone creating and then wishing to sell you credit risk than, "How much are you keeping?"

I propose that the retention of credit risk by mortgage originators should be facilitated, but not required, by public policy. One size is very unlikely to fit all, and the painful risks of "originate to sell" models are unlikely to be forgotten for several years. During that time, we should bend our efforts to make sales with originator credit retention, in various forms as the market develops, a real and robust alternative. I believe many investors will prefer such loans and they may well command premium prices. We should focus on removing the regulatory and accounting obstacles to this healthy development.

I believe the essential locus of credit risk retention is the originator of the loan—the place at which the credit decision is made and controlled. Naturally, some originators will provide enhancements which are more credible than others. What we want is the market always asking about this factor.

4. Develop countercyclical strategies

Financial cycles, particularly in real estate, are inevitable. But they could be moderated by developing countercyclical elements to the mortgage finance system. This is one of the most important things we could do.

Two promising ideas of this kind are countercyclical loan-to-value ratios (LTVs) and bigger (countercyclical) loan loss reserves in good times.

Bubbles involve an unstable positive feedback loop between asset prices and credit availability. For a possibly extended period of time, as in the 21st century housing bubble, higher asset prices (of houses, in this case) call forth more aggressive lending with higher LTVs, and more aggressive lending allows buying which drives the price of the asset higher. This cannot last forever, of course, but it can last a number of years.

As asset prices inflate higher and higher in a boom, the risk of loans seems to be decreasing, when in fact it is increasing. As assets prices go further and further above their trend line, the risk of their subsequent fall is becoming greater and greater. The logical and necessary thing to do is to reduce the amount being lent against the current market price of the asset.

But what generally happens in fact is the exact opposite: with increasing optimism, LTVs rise instead of being reduced. "Innovative" low down payment and no down payment mortgages, for example, are promoted and made, and are politically popular. This helps inflate the credit bubble further, ensuring that the inevitable bust will be worse.

In short, we need to create a mortgage finance system in which LTVs fall and down payments increase as asset prices inflate—then we would have countercyclical LTVs.

Congressman Foster, in a very interesting discussion, has pointed out that the desired countercyclical LTV behavior is like a feedback controller in engineering theory—it is like a governor on an engine. He has proposed some simple mathematical ways that inflating asset prices might define lower LTV requirements. This part of the problem is key, but it is easier than to get the idea actually implemented in time for the next boom. It is clear that something along these lines would be extremely beneficial.

Turning to loan loss reserves, as now mandated, they are procyclical. Successful private risk bearing requires the opposite of our current accounting: specifically, much bigger loan loss reserves should be created in the good times. This is required, because it is in the optimism of the good times that you are making the bad loans that will later haunt you.

With bigger, more old-fashioned loss reserves, we can do better in the next cycle.

5. <u>If there should be surviving GSEs, do not use government-insured banks to promote their finances</u>

If we do not succeed in transitioning to no GSEs, and Fannie and Freddie survive in some GSE form, an essential reform to prevent financing them from being promoted through the regulations and capital rules of the banking system. Banks have been encouraged through government policy to invest in GSE preferred stock, unsecured debt and MBS.

This channels government-insured deposits into GSE balance sheets. It is double-dipping on the government guarantee and a doubling down on the financial system's concentration in real estate risk.

I suggest that in a continuing GSE world, banks should have to hold 100% equity against equity investments in GSEs, and that exactly the same concentration limits on unsecured credit to one entity be applied to GSEs as to any other debt issuer.

6. Develop clear, straightforward key information for borrowers

I have spoken this Committee too many times on the need for a one-page key mortgage information form for a repetition to be welcome. I continue to think that making sure borrowers have clear, simple and straightforward information about the commitments they are making will enable informed decision-making, greater personal responsibility by all parties, and a better mortgage finance system.

7. Reintroduce savings as an explicit goal of mortgage finance

Savings and loan associations were once central providers of mortgage finance. But the original leaders of the "movement," as it then was—for they considered themselves a movement for personal and social improvement—were very clear about the order of things: first the savings, then the loan.

Our subsequent political development seems to have forgotten about the "savings," and put all the emphasis on the "loan." Even savings in the form of building up equity in the house by retiring the mortgage loan has turned into ways of extracting the equity instead.

A successful mortgage finance system of the future will find ways to rediscover and reemphasize thrift and savings. This sounds old-fashioned, and of course, like all the other eternal verities of financial prudence, it is.

Thank you again for the chance to share these views.

Testimony of Anthony Randazzo
Director of Economic Research
Reason Foundation

Before the Committee on Financial Services

U.S. House of Representatives

April 14, 2010

Chairman Frank, Ranking Member Bachus, and distinguished members of the committee, thank you for the invitation to testify today on the important matter of reforming our nation's framework for housing financing. My name is Anthony Randazzo, director of economic research at Reason Foundation, a non-profit think tank that researches the consequences of government policy, works to advance liberty, and develops ways the free market can be leveraged to improve the quality of life for all Americans.

The financial crisis has exacerbated the urgent need to reform Fannie Mae and Freddie Mac. These government-sponsored enterprises (GSEs) were important players in creating the housing bubble and bust that helped cause the recession and such great hardship for so many Americans. The GSE support of the housing market, backed by low interest rates from an implicit government guarantee, rapidly expanded the homeownership rate, which contributed to the spike in home values. Those prices turned out to be artificial and unsustainable

A fundamental overhaul of Fannie Mae and Freddie Mac is necessary before a real, sustainable recovery can take hold in the housing sector. Delaying reforms until there is a surge in housing prices or a new wave of housing starts allows the problems that caused the housing crisis to continue. And if Fannie Mae and Freddie Mac continue to distort mortgage prices and hinder a true long-term recovery in housing, we are laying the foundation for yet another housing bust.

The Current State of the Housing Market

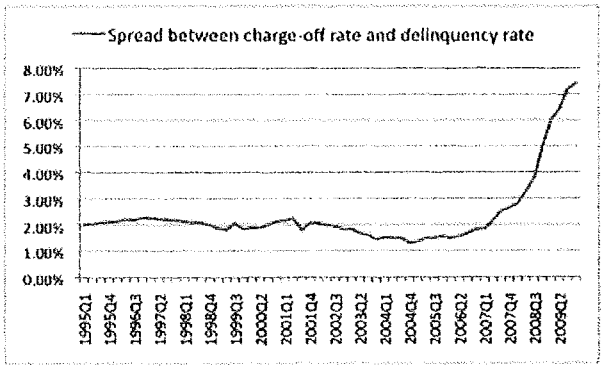
Negative Equity & Delinquencies: The growth in mortgage delinquencies is putting downward pressure on housing values, exacerbating mortgage losses in the financial sector, and contributing to the constriction in credit markets today. The massive amount of negative equity in the housing market today has pushed over 11 million homeowners into insolvency, putting a strain on the balance sheets of both banks and families. Currently, 25 to 30 percent of mortgages in America are underwater, meaning homeowners owe more on their mortgages than their homes are worth. The growing number of homes underwater has contributed to the spike in mortgage delinquencies. Over 14 percent of home mortgages were delinquent at the end of 2009. If delinquencies continue to rise at their current rate, there could be more than $300 billion in delinquent mortgages—up from around $250 billion today—by the summer.

The Shadow Inventory: With the growing delinquency rate has come more and more foreclosures. According to the Federal Reserve, 5.6 percent of mortgages are 90-days or more past due, the beginning stage of foreclosure. However, as bad as the foreclosure problem has been in some areas, it could be much worse. Banks have actually been slow to move many houses into foreclosure. Traditionally the bank charge-off rate of failed residential mortgages tracks relatively evenly with

residential delinquencies. Yet, beginning in 2006 with the bursting of the housing bubble, the charge-off rate began to separate from delinquencies (see Figure 1).

Since 2005, the spread between the charge-off rate and delinquency rate has spiked over 500 percent. Banks are waiting to make these write-offs to avoid taking losses, or hoping that economic conditions will change and allow homeowners to get caught up with severely past due mortgages.

Figure 1: Spread between the charge-off and delinquency rates of residential mortgages



Source: Federal Reserve System

The foreclosures are also being put off due to moratoriums and other reasons. This group of mortgages—homes that are not being paid for, but are also not being foreclosed on—is contributing to a growing "shadow inventory" of homes. If these homes were on the market instead of being held in delinquency limbo, they would be adding downward pressure on prices by adding to the supply. Simply put, housing prices are higher than they otherwise would be right now because these homes are being kept off the market.

Federal Programs Promoting a Housing Recovery: Since 2007, there have been a number of programs to help promote a housing recovery. Current initiatives include the First-Time Homebuyer Tax Credit, the Making Home Affordable programs for modifying and refinancing mortgages, the mortgage-backed securities purchase program from the Federal Reserve, and the unlimited financial backing given to the GSEs. Unfortunately, these initiatives have not been successful at jump-starting a sustainable recovery in the housing sector.

In fact, the bailout of Fannie Mae and Freddie Mac has distorted the supply of money available for homes by providing more liquidity to housing than is really available in the private market. As a result prices are being kept artificially high.

The First-Time Homebuyer Tax Credit is not increasing the rate of homeownership, but is distorting housing prices. The temporary bump in residential investment in

2009 from homebuyers taking advantage of the tax credit was subsequently wiped out by a sharp fall in housing sales after the first deadline passed. The tax credit took future demand for housing and moved it to 2009, keeping prices from falling to their natural bottom, a step that is needed to ensure the long-term stability of the housing market.

The Making Home Affordable programs have good intentions, but they are aiding a select few while perpetuating a cycle of propping up prices, pretending they are stable, and then trying to clean up after the façade falls apart. Over 75 percent of trial modifications failed in 2009. And it is estimated that about 70 percent of approved modifications will eventually fail as well. This is just delaying, rather than solving, the problem of foreclosure. Financial institutions should certainly work with homeowners to adjust mortgages and keep families in their homes. But by delaying the foreclosure process with taxpayer money, the government is just increasing the shadow inventory and creating problems for housing prices in the future.

And finally, while the mortgage-backed securities purchase program operated by the Federal Reserve (like similar activities by the Treasury Department) has helped maintain mortgage prices for the past few months, this has come at a cost of artificially propping up prices. Not allowing housing to find its true bottom means that a recovery will be built on a false foundation, and we will likely suffer another cycle of boom and bust in housing.

Fannie Mae & Freddie Mac: The GSEs are virtually the sole source of liquidity in the mortgage market today. While this situation has propped up housing prices, it is mainly distorting mortgage interest rates by using a public subsidy to maintain low interest rates in the secondary mortgage market. Without the GSEs, mortgage prices would rise to market-based rates and housing prices would drop further.

However, as counterintuitive as it may seem, that would actually be *good* news. It would set the stage for an organic recovery—that is, a naturally evolving and sustainable recovery—as private lenders would once again become more willing to invest in a market comprised of assets with undistorted values. As a bonus, American taxpayers would no longer be subsidizing mortgages that will never be repaid while shouldering risks that belong on private entities.

Fannie Mae and Freddie Mac cannot be immediately eliminated because virtually the entire mortgage market is dependent on them as a wastebasket for toxic mortgage debt. But a strategy for dissolving Fannie Mae and Freddie Mac over the next few years can and should be created now. There are three main components to the process of phasing out Fannie Mae and Freddie Mac:

1. The first component involves divesting the mortgage portfolio and liabilities of the GSEs, winding down the purchasing and securitization operations, and liquefying all remaining assets. Ideally, this would be done over a four-to-five year process.

2. The second component is the GSEs's mortgage-backed security pools, a separate entity on the federal flow of funds balance sheet. These mortgage-backed securities pools represent all mortgages from the GSE portfolios that have been securitized and shifted off GSE balance sheets. These assets would need to be divested or shifted into a bad bank holding entity—preferably one serviced by a private sector asset manager—as Fannie Mae and Freddie Mac are phased out.

3. The third component is the GSEs affordable housing mission. Many of these activities should be re-evaluated now that it is clear they have done more harm than good. But in any case, programs intended to fulfill this mission could be shifted over time to the Federal Housing Administration, consolidating all such activities into one federal agency.

The Value of Reform Now Instead of Waiting

GSE reform is urgently needed. A plan should be put into motion this year, instead of waiting until 2011 or beyond. The sooner a plan that clearly outlines how Fannie Mae and Freddie Mac will be phased out is in place, the sooner the housing market can stabilize. The longer a plan is delayed, the harder it will be to shift towards a real recovery. When the rules of the new system are clear, the private sector will move into the shoes currently occupied by Fannie Mae and Freddie Mac. There are three primary reasons why waiting to reform the GSEs is a major problem and acting now would be of great benefit to the economy:

1. **Waiting increases risks to taxpayers.** The longer the GSEs are allowed to operate in their current role, as political rather than business entities, the greater the financial losses will be for taxpayers. The Treasury Department has already committed American taxpayers to covering all of Fannie Mae and Freddie Mac's financial losses. This financial risk should be borne by the private sector. Given the nation's exploding debt, it is imprudent to simply wait and let more losses build up. Acting now means helping taxpayers avoid the sustained losses from maintaining the GSE model backed by government guarantees.

2. **Waiting allows the recovery to be built on a faux-foundation while continuing the housing boom and bust cycle.** When it comes to finding a solution for the nation's housing ills, the focus should be on encouraging and fostering a *sustainable* recovery. Waiting to reform the GSEs would let an unsustainable *faux*-recovery build up in the system that will eventually come apart at the seams. Growing delinquency and home vacancy rates, the expanding shadow inventory, and negative equity troubles indicate an excess of supply that is only going to expand in the coming months. This means that at current prices, the quantity of homes available for sale is greater than the quantity demanded at current prices. Eventually that

shadow inventory will hit the market and expose the housing "recovery" as a façade.

Many people overpaid for their homes, especially if they bought in 2005 and 2006. This is a common feature of any bubble. Removing the government support of mortgage prices and allowing prices to adjust to their natural levels is a requirement for recovery. This will mean short-term pain, as the negative equity issue gets worse and foreclosures increase. But the long-term value is that the housing market will finally reach its organic level of prices, and future growth will be stable, avoiding another "boom-and-bust" cycle.

3. **Waiting perpetuates the feeling of uncertainty in the financial markets that has largely frozen capital.** The uncertainty that gripped the market in 2008 was the chief reason credit markets froze up, paralyzing the financial system. While inter-bank lending has returned, banks are largely holding onto their capital as a reserve against the potential of future problems. Waiting to reform the GSEs would keep lenders in perpetual limbo on what the future market for housing finance will look like. It is likely that capital that could be used for the mortgage markets, increasing lending availability, and pushing down mortgage prices (and thus increasing housing values) will remain frozen until the market knows what the new rules of the game are. Putting a plan in place to reform the GSEs would provide the private sector a roadmap for how and when it could replace Fannie Mae and Freddie Mac's role in the market. There remain other uncertainties in the market surrounding financial services regulation reform in general, but putting the GSEs on a defined phase out plan would be a very positive step in alleviating some of those concerns.

Principles of Reform

There are two overarching problems plaguing the housing industry today: uncertainty about the future and crippling price distortions that threaten to prevent a sustainable housing recovery. Any principles for reform must be focused on addressing these two issues.

- **We should reform now.**

The current policy of the Treasury Department, as Secretary Geithner testified before this Committee, is to wait until housing markets are more stable before reforming the GSEs. However, any such stability will be artificial and susceptible to sudden declines either from another bubble bursting or from the emergence of a large supply of the shadow inventory into the market.

A prudent first step would be to reduce conforming loan limits to restrict GSE operations in the "jumbo" markets. Conforming loan standards could also be

reduced further to median home value levels on a state-by-state basis, or even to the affordable housing rates that municipalities develop (often a mortgage payment costing no more than 30 percent of a family's income). Another prudent step would be to immediately limit the time frame that GSEs are allowed to keep raw mortgages and securitized mortgages in their portfolios. These steps would not impact the GSEs affordable housing mission. Rather, if they were put in place over the next one to two years they would both protect taxpayers by reducing GSE lending activities while also phasing out the GSEs for the private sector to step in.

While the housing market is weak is precisely the time to act to reform the GSEs and promote innovation. With a long-term view of the market, it is imperative to fix the problems in housing today, dealing with short-term pains now instead of artificially covering them up and dragging them out over time.

- **We should create a future framework for mortgage financing that does not continue the "pro-cyclical" policies that support a boom-and-bust economy and distort prices.**

It is important for the housing market going forward to have a stable baseline for growth by knowing that price distortions have been removed and housing prices were allowed to reach their true bottom. In order for the mortgage and housing markets to be stable and for lenders to act more responsibly, perverse incentives must be removed from the system. The government programs created to artificially prop up housing prices during the recession should be closed and the mortgage-backed securities purchased by the Fed divested.

The First-time Homebuyer Tax Credit, currently set to expire in April 2010, should not be extended, nor re-engaged in the future. The initiatives under the Making Home Affordable Program—including HARP, HAMP, and 2MP—should be wound down quickly. Mortgages that have been refinanced or modified would remain so, and would remain managed under the agreed upon terms unless the homeowner again fell into default. All homes currently in a trial stage through one of the programs would be allowed to complete the procedures if passing all necessary tests. Congress should also encourage the Fed to begin divesting their MBS holdings as a part of a comprehensive exit strategy sooner rather than later.

Continuing these programs that avoid letting the market clear out the toxic debt delays the arrival of the bottom and prevents the natural recovery that would occur, which is likely to prompt another bust cycle based on artificially supported housing prices.

- **We should provide a framework for the private sector to step into the current role the GSEs have taken on in the market.**

A prudent process for gradually dissolving Fannie Mae and Freddie Mac will create opportunities for the private sector to step into the hole that will be left in the mortgage market. There is nothing the GSEs do for mortgage financing that would not be offered by the private sector, aside from implementing government policies

that manipulate the housing market. The government should do all it can to create conditions that allow mortgage-financing innovation to thrive in the private sector.

One example would be the use of covered bonds, which are debt instruments collateralized by mortgages, where (unlike other MBSs) issuers are required to pay regardless of whether the collateral performs as expected. Covered bonds are widely used with great success in Europe and could potentially play a big role in creating a thriving housing market in the U.S. if the clear and sensible regulatory framework were to exist.

Another example would be restarting the securitization market. Some fear securitization, as it is seen as a catalyst for spreading around toxic debt. However, it was not securitization that was the problem, rather, it was the toxic mortgages in the first place. In the current market, and moving forward, investors have a greater incentive to analyze what assets are in their mortgage-backed security or collateralized debt obligation. Furthermore, as mortgages become harder to simply originate-and-distribute, the quality of mortgages will be higher. Securitization can return to its original purpose of increasing liquidity by only packaging healthy mortgages for informed investors. There should be new oversight rules for the securitization market that ensure transparency in what assets are packaged. Credit rating agencies laws should be altered in order to eliminate the perverse incentive in which the firm issuing the securities can shop for ratings by offering better prices to the credit rating agencies. And issuers of these types of securities could be required to maintain some stake in the performance of the investment vehicle if they themselves originated the loans packaged.

It is important to reiterate that Congress cannot engineer the exact means for how the private sector will engage the mortgage and secondary mortgage markets. Policymakers can implement some of the ideas out there right now, such as frameworks for covered bonds and securitization, but there may be other ways of providing liquidity and financing that haven't been used widely before, and that do not require government control or taxpayers bearing costs and risks. Congress should design rules and regulations to encourage private capital as the sole source of mortgage financing, avoid market-distorting policies, ensure transparency, and keep taxpayers from shouldering risk.

Conclusion

The past few decades have seen the housing sector distorted by government programs and policies. The result has been a "perpetuate and pretend" boom-and-bust cycle that must be abandoned. The limited demand for homes right now, even with programs aimed at stimulating the market, suggests that housing values are still inflated. The unfortunate reality is that housing prices likely need to fall even lower to reach their true bottom. In order for this to happen, the government must eliminate programs that are distorting the market. This will also help reduce the

great uncertainty in the marketplace, which is necessary for the private sector to once again play the central role in helping Americans fulfill the dream of home ownership, in a sustainable manner.

Yes, if prices fall more, this will make the solvency problem worse in the near-term. Lenders will continue to struggle under the weight of their mortgage-related assets, in turn leading them to continue holding onto reserves in order to make the necessary write-offs, thus keeping credit tight for the country. However, delaying this problem will not make it go away. There are workable solutions to the housing sector mess, and they should be welcomed with a long-term perspective and acceptance of responsibility. When housing prices were rising through the early part of the decade until mid-2006, homeowners, lenders, politicians, and regulators were more than willing to accept the mythical gains in the housing market. Unfortunately those prices were artificial.

The policy response by the government to the drastic decline in prices has prevented, in the short term, homeowners and lenders from accepting the consequences of their bad investments. We have to recognize that, since home values were so overinflated, the new equilibrium will probably not push prices back up to those levels for some time.

The housing market must be permitted to find its natural bottom because that is the only real way to begin to fix it after years of distortion. Once the market is reformed—with the private sector providing both mortgage origination services and secondary market services—and with the private sector bearing full responsibility for private decisions, there will be less risk taken in the system than before. And perhaps most important, taxpayers will no longer have to fear a housing price bust from the façade of distorted prices crashing down. The reformed market won't look the same as today, and prices cannot be guaranteed, but the most important benefit will be a more stable foundation for growth, putting America on a path to a sustainable housing market.

Thank you for the opportunity to testify on this important subject. I look forward to answering any questions that you may have.

Testimony of
Anthony T. Reed
Vice President for Capital Markets
SunTrust Mortgage, Inc.

on behalf of
the Housing Policy Council
of the
Financial Services Roundtable

Before the House Financial Services Committee
Of the
United States House of Representatives
On

Housing Finance – What Should the New System Be Able to Do: Part II
Government and Stakeholder Perspectives

April 14, 2010

Mr. Chairman and Members of the Committee, my name is Anthony T. Reed, and I am the Executive Vice President for Capital Markets with SunTrust Mortgage, Inc. I am appearing today on behalf of the Housing Policy Council ("HPC") of The Financial Services Roundtable. The Housing Policy Council represents 26 of the leading national mortgage finance companies. HPC members originate, service and insure mortgages. We estimate that HPC member companies originate approximately 75 percent of all mortgages originated in the U.S. and service some two-thirds of those mortgages.

Introduction

Thank you for the opportunity to testify on the future of the housing finance system. The recent crisis in our financial system revealed several problems with the existing system. Lenders and securitizers relaxed underwriting standards and risk management practices. Gaps in regulation permitted bad practices to multiply. Inherent flaws in the structure and operation of Fannie Mae and Freddie Mac (the "GSEs") contributed to the collapse of these firms.

The members of the Housing Policy Council have taken a number of actions to address these problems.

First, to help homeowners, HPC was instrumental in the formation of HOPE NOW, a voluntary private sector alliance formed to prevent foreclosures through outreach to at-risk homeowners, counseling and loan workouts. Since 2007, this private sector initiative has resulted in more than 6.7 million workout solutions, including almost 2.7 million loan modifications. Servicers completed 95,000 proprietary modifications and 53,000 permanent HAMP modifications in February 2010. Details on this initiative appear in Appendix A.

Second, our members have taken steps to improve underwriting standards, and HPC has supported actions taken by federal regulators to strengthen underwriting standards. We have also endorsed the establishment of some form of risk retention requirement for loan originators and

securitizers for certain types of securitized loans. Recent changes to accounting standards suggest, however, that this issue requires some further analysis to avoid unintended constraints on mortgage finance. This issue is discussed in Appendix B.

Finally, over the past year, we have developed a proposal to revitalize the secondary mortgage market for conventional mortgage loans, which I would like to describe to the Committee in some detail.

Reform of the Secondary Mortgage Market

Fannie Mae and Freddie Mac (the GSEs) were established by Congress to facilitate and support a consistent secondary market in conventional mortgage loans. This secondary mortgage market has become an essential feature of our system of housing finance. It has produced a steady supply of mortgage finance for homebuyers by allowing lenders to convert mortgage loans into highly liquid mortgage backed securities (MBS) for purchase by investors. It permits lenders to take individual loans off their balance sheets thereby freeing capital to make new loans. The secondary mortgage market also has permitted the development of mortgage instruments with special benefits for U.S. home buyers, such as the 30-year fixed rate mortgage.

For many years, and even throughout the financial crisis, the GSEs performed their secondary market functions efficiently and effectively. The crisis, however, revealed several fundamental flaws in the mandate and operational structures of the GSEs. First, ambiguity over the relationship between the GSEs and the Federal Government caused investors to conclude that the government stood behind Fannie Mae and Freddie Mac as companies, despite the absence of any legal responsibility to do so. Second, there were inherent conflicts between the interests of private shareholders and the public mission of the GSEs. Finally, a lack of adequate supervision and regulation created the opportunity for the GSEs to employ excessive leverage and to grow their portfolios in excess of what was necessary to achieve their original objectives.

In order to ensure the continued vitality of the secondary market, these flaws in the structure and mandate of the GSEs must be addressed. This also presents Congress with an opportunity to make significant improvements in the operation of the secondary market that will benefit homeowners and the economy.

We believe that reform of the secondary market should be based upon three policy goals. First, reform should continue to ensure a steady flow of reasonably priced housing finance for borrowers, and should not disrupt the economic recovery. Second, reform should minimize risk to taxpayers. In other words, it should be clear that the Federal Government does not stand behind the companies that succeed the GSEs. Third, reform should include some mechanism to ensure a flow of funding to contribute to affordable housing.

The Housing Policy Council has developed a proposal based upon these goals. Our proposal seeks to achieve these goals through reliance on private capital, a clear delineation of the roles of the private sector and the Federal Government in the securitization process, and the transfer of a stream of funding to affordable housing. We also recommend strong federal regulation and oversight of this system.

Additional opportunities to improve the housing finance system can be found by separating the main functions performed by the GSEs. Traditionally, the GSEs have performed four basic functions: (1) they convert pools of mortgage loans into mortgage backed securities (i.e., a securitization function) and they administer the flow of payments from lenders/servicers to MBS investors; (2) they guarantee the payment of principal and interest on mortgage backed securities in return for a fee paid by lenders (i.e., a credit enhancement function); (3) by purchasing and holding mortgages and mortgage backed securities in their portfolios, they help to ensure a steady flow of funding for mortgages (i.e., a liquidity function); and (4) through the statutorily mandated housing goals, they help to ensure mortgage financing for all categories of borrowers (i.e., an affordable housing function).

Separating and isolating these functions helps address the problems inherent in the current structure of the GSEs and facilitate additional improvements in the operation of the secondary market. It permits each function to have the appropriate management, regulation, ownership, and incentives.

To perform the credit enhancement function, we propose the creation of federally chartered but privately-owned Mortgage Securities Insurance Companies (MSICs).

To perform the securitization function, we propose the establishment of a single Mortgage Backed Security (MBS) Issuance Facility that would create and administer MBS guaranteed by the MSICs.

In exchange for their federal charter, we recommend that MSICs should be required to contribute a stream of revenue that would be distributed to state and local housing finance agencies by formula to support competitively evaluated affordable housing programs.

As for the liquidity function currently performed by the GSEs, the recent financial crisis has demonstrated that the Federal Government is fully capable of performing this function in times of market stress. Moreover, it is now apparent that the portfolios of the GSEs were not used solely to provide liquidity for housing finance, but became a source of investment income for the GSEs and the desire to preserve this income contributed to their problems. Therefore, any successors to the GSE should not be required or permitted to maintain large portfolios.

Appendix C illustrates this proposal, and describes the roles and responsibilities of the different parties in the secondary market process.

A Private Sector Solution to Minimize Taxpayer Exposure

Under our proposal, the credit enhancement function of the GSEs would be performed by privately capitalized entities, MSICs that would be chartered and supervised by the Federal Housing Finance Agency (FHFA). These MSICs themselves would not have a Congressional charter and they would not be explicitly or implicitly backed by the Federal Government.

Attracting sufficient private capital to these entities is essential to the implementation of our proposal. As a result, we have not recommended or endorsed a particular organization structure for the MSICs. Instead, we believe the investors should be able to determine the most appropriate structure for a MSIC. The structure would be reviewed by the regulator (FHFA) as part of the charter process. Nonetheless, we recognize that the structure most likely to generate needed start-up capital could be a cooperative structure in which lenders that wish to securitize mortgages would be required to contribute capital to the MSIC. Appendix D summarizes the advantages and disadvantages of different organizational structures.

Similarly, we do not call for a specific limit on the number of MSICs. We believe that at least 4 would be preferable to serve the market, but probably not more than 8 would be needed or competitive. The greater the number of MSICs, the better insulated the housing finance market would be from the failure of any one company. On the other hand, too many MSICs with different underwriting systems and procedures could be overly burdensome to lenders, particularly smaller lenders. A useful real world model is the private mortgage insurance industry, which provides a credit enhancement function similar to the function performed by MSICs. There are now 8 firms in that space.

MSICs would be regulated and supervised by an independent federal agency, presumably the FHFA, with additional authority. To help ensure the safe and sound operation of MSICs, we propose several specific types of regulation.

- Strong capital and liquidity requirements – In hindsight it is clear that the GSEs were permitted to operate with insufficient capital and liquidity. We believe that FHFA should impose, by regulation, strong capital and liquidity requirements on MSICs.
- Underwriting Standards for Mortgages in MBS – We propose that FHFA set standards on the type of mortgages that could be included in the MBS insured by a MSIC. These standards should provide that the mortgages in a MSIC-insured MBS are prudentially underwritten. In other words, we envision the MSICs as the guarantors for MBS backed by conventional

mortgages. MSICs could not insure MBS composed of mortgages that do not meet the standards set by FHFA.

- Loan Limits – FHFA would set, by regulation, limits on the size of mortgages that could be included in MBS insured by a MSIC.

Unlike the GSEs, MSICs should not be permitted to establish and hold portfolios purely for investment purposes. Small portfolios should be permitted to facilitate the development of new products and certain types of loans for which there are limited markets such as multifamily mortgages. MSICs also could use their portfolios to warehouse whole loans from smaller banks prior to securitization.

Ensuring a Steady Flow of Mortgage Finance at Reasonable Rates

While MSICs would not be backed by the Federal Government, our proposal does call for the Federal Government to provide an "explicit" backup-guarantee directly on MBS that are insured by the MSICs. To be clear, this catastrophic guarantee would not apply to the MSICs themselves; it would apply only to the MBS that they guarantee.

This explicit guarantee for MBS is needed to give the broadest possible range of MBS investors confidence in these securities and to help ensure a steady flow of mortgage finance at a reasonable cost to borrowers. Without such a guarantee, investors in MBS (especially pension funds, insurance companies, banks and foreign governments that have fiduciary obligations) will seek other investments, and as they do so, the level of funds available for housing finance will be reduced and the cost of mortgage loans will increase. Moreover, as the recent crisis showed, in times of market stress even well-capitalized firms can find that funding becomes prohibitively expensive or even inaccessible, and this can prevent them from continuing to provide new credit when borrowers need it.

We would limit the government's guarantee to a form of catastrophic "reinsurance." In other words, the government's guarantee should cover interest and principal payments on MBS **only** after all private capital backing an MBS is exhausted. A MSIC would pay a fee for the government guarantee on

the MBS and the fees paid by all MSICs would be placed in a reserve that would provide an additional buffer between private capital and the federal guarantee.

The private capital standing before the government's guarantee would be:

- The down payment on a mortgage made by the homebuyer;
- Any private mortgage insurance on the mortgage loan (if the LTV is greater than 80 percent);
- The shareholders equity in the MSIC; and
- The reserve established by fees paid by MSICs in return for the government's guarantee.

These layers of private capital should insulate the Federal Government from paying claims on its guarantee.

The explicit guarantee is intended to be budget neutral. The fees paid by MSICs for the guarantee would be deposited into a reserve, and, assuming the fees are priced properly, the reserve would cover any payments made by the government under the terms of the guarantee. FHA and Ginnie Mae are models for the budgetary treatment of this fee structure. Under existing federal credit procedures, the cost of federal credit activity in a budget year is the net present value of all expected future cash flows from guarantees and direct loans disbursed in that year. For loan guarantees, cash inflows consist primarily of fees charged to insured borrowers, and cash outlays consist mostly of payments to lenders to cover the cost of loan defaults. In the case of both FHA and Ginnie Mae, the fees paid for the federal guarantee normally cover claims on the guarantees and other operational expenses.

We recognize that catastrophes do happen, and some day the Federal Government may have to make good on the guarantee. Should this occur, we would support some form of assessment upon the industry to recoup any costs incurred by the government.

Ensuring Funding for Affordable Housing

We propose that, in exchange for their federal charter, MSICs be required to transfer a specified percentage of revenue to affordable housing programs, much like the Federal Home Loan Banks do

today. We do not support the extension of the existing numerical GSE housing goals. Those goals created conflicting incentives for the GSEs. In contrast, the FHLB Affordable Housing Program (AHP) has been a successful model for supporting affordable housing. The funds for affordable housing could be distributed under an application and grant program similar to the FHLB program, or could be transferred to HUD for subsequent distribution by formula to state and local housing finance authorities.

Centralized Securitization and a Single MBS

Our proposal also calls for the creation of a single MBS Issuance Facility to perform the securitization function currently performed by the GSEs. This entity would accept pools of loans from originators and exchange those loans for MBS. It would then process payments on those MBS from the lenders/servicers to the investors. It also would place and administer the federal catastrophic guarantee on the MBS. In other words, it would perform similar functions to those performed by Ginnie Mae today for FHA.

This Issuance Facility also will permit the creation of a single MBS. Today, there are some differences in the terms and repayment characteristics of the MBS marketed by the two GSEs which from time to time result in differences in market liquidity. We propose that all MSICs be required to adhere to a standard form of MBS that has the same repayment terms and other conditions. A common – or single MBS – would promote better understanding of the MBS by investors, and it would enhance the liquidity of the market. This would help ensure home buyers consistent access to reasonably priced home finance.

A single MBS does not mean that all MBS would be composed of the same type of mortgages, only that the basic legal structure, terms and conditions governing repayment and other administrative features of the MBS would be the same. MBS backed by MSICs could be composed of loans from a single lender or multiple lenders, allowing lending institutions of all sizes access to this liquidity. Above all, these MBS should not in any way interfere with the "To Be Announced" (TBA) securities market

which the lending industry relies on to reduce risks in the origination process and reduce borrowing costs.

Whether this Facility is part of the Federal Government or owned by the private sector may depend upon how its operations might be reflected on the federal budget.

Transitional Issues

The transition from the current GSE structure to this new structure must be conducted with care to ensure the continuity of mortgage finance. Moreover, the existing operations of Fannie Mae and Freddie Mac should serve as the foundation for this new structure. The GSEs have personnel and systems that should be retained in the transition from the current system to the new system. As a first step, the securitization functions of the two GSEs could be transferred to the MBS Issuance Facility. Subsequently, the GSEs could become MSICs after a solution is found for their existing portfolios.

Conclusion

Thank you for the opportunity to testify on the future of mortgage finance. We believe our proposal accomplishes four main goals: (1) ensures a stable secondary market to provide liquidity for mortgage loans to Americans; (2) addresses key weaknesses of the current model; (3) minimizes the risk to taxpayers; and (4) ensures a flow of funding to contribute to affordable housing. The members of the Housing Policy Council are committed to the issues I have discussed today, and welcome the opportunity to work with the Committee as it develops its own proposals and reforms.

Appendix A
Foreclosure Prevention

Since 2004, foreclosure prevention has been a top priority for the Housing Policy Council. In 2005, HPC partnered with the Homeownership Preservation Foundation and NeighborWorks America to reach and assist homeowners struggling with their mortgages. In 2007, HPC was instrumental in forming a voluntary private sector alliance of mortgage lenders and servicers, mortgage insurers, investors, and not-for-profit housing counselors to help homeowners avoid foreclosure. This private sector effort pre-dated – and has supplemented and complemented – the administration's Home Affordable Modification Program or HAMP.

HOPE NOW reaches at-risk borrowers through a variety of channels. In 2009, HOPE NOW sponsored 31 homeownership workshops across the country, at which over 31,000 homeowners obtained free counseling and were able to work with their loan servicers. In 2010, there have been 10 homeownership events that reached over 10,600 homeowners and an additional 16 are schedule for the rest of 2010. Since November 2007, HOPE NOW has sent nearly 5.7 million letters to delinquent borrowers with information on how to contact their lender or a credit counselor. HOPE NOW also operates a web-based portal that allows HUD-approved housing counseling agencies to work with at-risk homeowners to submit completed HAMP applications to servicers in a secure manner. HOPE NOW also supports the Homeownership Preservation Foundation's Homeowners' HOPE™ Hotline, 888-995-HOPE, which connects borrowers to one of 450 counselors from one of ten non-profit, HUD-approved counseling agencies. Since its establishment, the Hotline has received over 3.8 million calls and counselors have assisted over 840,000 homeowners in need. Finally, HOPE NOW continues to partner with NeighborWorks America and other HUD-approved counselors to provide in-person counseling to borrowers in need.

These outreach efforts have helped thousands of homeowners. In February of this year, for example, over 95,000 homeowners received proprietary loan modifications which are in addition to the

50,000 permanent HAMP modifications completed by servicers. In other words, in February, 145,000 homeowners received loan modifications that enabled them to avoid foreclosure and stay in their homes. Approximately 78 percent of the proprietary loan modifications completed in February included a reduction of principal and interest. These loan modifications resulted in lower monthly payments for at-risk borrowers- the kind of sustainable loan mods that are necessary to help whether the housing crisis..

With almost 4 million loans currently in default, the work of HOPE NOW is far from over. Yet, since 2007, this private sector initiative has resulted in more than 6.7 million workout solutions, including almost 2.7 million loan modifications. Mortgage servicers and housing counselors have worked extremely hard through aggressive borrower outreach. The member companies of HOPE NOW remain determined to keep as many families as possible in their homes. Table 1 summarizes the total workout solutions generated through HOPE NOW since its inception in 2007.

Table 1

HOPE NOW
Total Solutions
Industry Extrapolations (July 2007 - February 2010)

WORKOUT PLANS (Non-HAMP)[1]

	Q3-Q4 2007	2008	2009	Dec-09	Jan-10	Feb-10	**Total**
Total Workout Plans	912,671	2,258,603	3,140,177	236,263	237,532	226,926	**6,775,908**
Prime	380,858	941,247	1,871,136	151,338	149,137	146,523	3,488,901
Subprime	531,813	1,317,356	1,269,041	84,926	88,395	80,403	3,287,007
Owner-Occupied				216,937	221,871	176,762	615,571
Non-Owner Occupied				18,986	15,604	14,046	48,637
Repayment Plans Initiated[2]	706,431	1,297,248	1,964,822	131,841	138,033	131,339	**4,237,872**
Prime	314,510	674,270	1,374,414	98,224	104,058	101,331	2,568,582
Subprime	391,921	622,978	590,407	33,617	33,975	30,008	1,669,290
Owner-Occupied				122,367	129,413	88,238	340,018
Non-Owner Occupied				8,724	8,589	7,034	24,348
Modifications Completed[3]	206,240	961,355	1,175,355	104,423	99,499	95,586	**2,538,036**
Prime	66,348	266,978	496,722	53,114	45,079	45,192	920,319
Subprime	139,892	694,377	678,634	51,309	54,420	50,394	1,617,717
Owner-Occupied				94,571	92,458	88,524	275,553
Non-Owner Occupied				10,263	7,015	7,011	24,289

[1]Based on "MBA Delinquency Survey" for Q4-2009. MBA 85% of the market. MBA estimates that its survey covers approximately 85% of the total industry. HOPE NOW data estimates for January and February 2010 may increase or decrease slightly when the MBA releases its Delinquency Survey data for Q1-2010.
[2]Definition of this field was revised in December 2009. HOPE NOW also began collecting Occupancy data at this time.
[3]Modifications Completed was revised in December 2009 to include Current Modifications and specifically exclude HAMP.

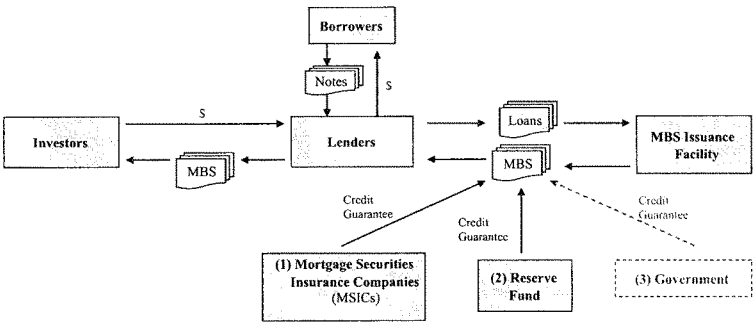
Appendix B
Strengthening Loan Origination Standards

To encourage greater accountability on the part of loan originators and securitizers, HPC supports strengthening underwriting standards and also supports the idea of credit risk retention for certain types of securitized loans. However, the recent adoption of new accounting standards for securitizations (FAS 166 and 167) has created substantial doubt on the efficacy of a broad, across-the-board risk retention requirement. As a result of these new accounting standards, we now believe that the better approach to addressing underwriting and risk management practices is to establish strong uniform underwriting standards for all originators.

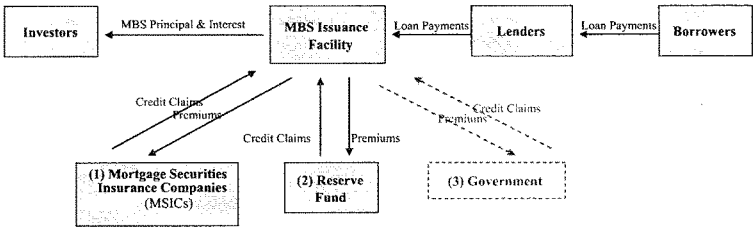
Under FAS 166 and 167, originators must retain the entire credit risk of the securitization vehicle on their balance sheet if they retain a "material" risk of loss on loans transferred. Unfortunately, there is no bright line test for what constitutes the retention of a "material" risk. It seems clear, however, that if servicing rights are retained, *any* percentage interest retained will cause the entire risk to be placed on the balance sheet of the originator. This, in turn, would require lenders to consolidate on its balance sheet all loans securitized through this structure and to also possibly hold additional capital. While it is difficult to calculate the magnitude of this capital requirement, it could be so large that it could result in a dramatic reduction in the amount of mortgage credit available to borrowers. Sound underwriting standards applicable to all lenders could achieve the same result as a percent risk retention requirement, without risking a substantial contraction in mortgage finance.

Appendix C
Proposed Secondary Mortgage Market Model

I. Flow of Mortgage Finance



II. Flow of On-Going Payments



III. Roles and Responsibilities of Parties

Borrowers

- Obtain funds from lenders
- Make loan payments to their lender/servicer

Lenders

- Exchange qualified mortgage loans for mortgage backed securities (MBS) with the MBS Issuance Facility
- Sell MBS to investors
- Service loans (i.e., collect payments from borrowers) or sell servicing rights to others

MBS Issuance Facility

- Convert qualified mortgage loans into MBS
- Administer flow of payments between parties (master service)

MSICs

- Pay for all credit losses on MBS after mortgage insurance
- Receive premiums from lenders for insuring MBS
- Pay a premium to the government for backstop guarantee of MBS

Government

- Receive fees from MSICs in exchange for backstop guarantee of MBS
- Pay for credit losses in the event of MSIC bankruptcy

Appendix D
Alternative Organizational Structures

Organization	Ownership Structure	Advantages	Disadvantages
Fannie and Freddie	Private sector shareholders, but the President appointed 5 of the 18 directors and the entities were exempted from state income tax and certain federal securities laws	• Attracted sufficient private sector capital for operations • Was conducive to innovation and efficient operations	• Implicit federal guarantee of entities distorted market • Conflict arose between interests of private investors and public mission
Co-op	Owned by lenders	• Lenders have a vested interest in managing properly • Conducive to innovation and efficient operations • Individual lenders can control their capital commitment if ownership is linked to volume of loans sold to the co-op • Freddie once operated in co-op form	• Requires good collaboration among lenders • Could exacerbate consolidation of industry and benefit larger lenders over small lenders • Limiting ownership to lenders would limit potential pool of capital needed to operate co-op
Utility	Private sector shareholders subject to regulated limits on returns, and entity potentially subject to greater limits on activities	• Reduces incentives for risk-taking • Promotes standardization of mortgage products • Transparency	• Could limit potential pool of capital needed to operate company • Reduces incentives to innovate and improve process • The ability to achieve "stable" returns is questionable • If only one or two entities, they could be viewed as "too big to fail"
Corporation	Private sector shareholders	• Promotes innovation and efficient operations • If multiple entities, they would reduce systemic risk • Activities directed by customer needs	• Too many entities could complicate process/systems, especially for smaller lenders • Search for higher returns intensified
Government	Government agency or authority	• Easy transition from current system • Eliminates challenge of private capital raising • Promotes standardization of mortgage products	• Reduces incentive to control costs • Innovation and efficiency reduced • Potential impact on federal budget • Creates a new bureaucracy

HOUSING POLICY COUNCIL
THE FINANCIAL SERVICES ROUNDTABLE

MOVING BEYOND FANNIE MAE AND FREDDIE MAC:
A PROPOSAL FOR NEW PRIVATELY CAPITALIZED ENTITIES THAT FACILIATE A SECONDARY MARKET FOR CONVENTIONAL MORTGAGES

Our Goal: Maintain consistent affordable access to 30-year fixed rate mortgages and other prudent mortgage loans in a way that minimizes taxpayer exposure.

Minimize Risk to Taxpayers

- Eliminate hybrid GSE structure and remove the implicit federal support for the GSEs.
- Create a new form of privately-capitalized, federally-chartered entities to credit enhance MBS (we call these entities Mortgage Backed Securities Insurance Companies or MSICs).
- Limit the type of mortgages that could be included in the MBS to conventional, prudently underwritten mortgages.
- FHFA would issue federal charter and regulate MSICs.
- MSICs could take various organizational forms (e.g., co-op, utility, traditional corp.).
- Limit portfolio to product incubation and multi-family loans, not for arbitrage purposes.

Maintain Liquidity for Mortgage Credit through an Explicit Federal "Back-Up" Guarantee on MBS and a Single MBS

- Provide for an explicit federal guarantee of payment of principal and interest on MBS issued by MSICs, only upon failure of MSICs.
- MSICs would pay a risk-based premium for guarantee to ensure that guarantee is budget neutral.
- Federal guarantee would be catastrophic "back-up" coverage. Several layers of private capital would stand before the federal guarantee:
  - downpayment on mortgage
  - private mortgage insurance
  - capital of MSICS
  - shareholders of MSICs
  - reserve established by fees paid by MSICs for federal guarantee.
- Create a single facility to service MBS for all MSICs.
- Create a single MBS.

MSICs Should Support Affordable Housing

- Affordable housing could be promoted in various ways such as: transfer a portion of MSICs revenue stream to state and local housing finance agencies, FHLB-like grant program, and/or a MSIC dedicated to affordable housing rather than specific housing goals.
- MSICs should not be subject to specific affordable housing goals.

Strong Supervision and Regulation:

- Provide for strong, independent regulator of MSICs, with clear authority to unwind failed MSICs.

Statement for the Record
Relating to the Hearing on the

Future of Housing Finance

Before the
Committee on Financial Services
of the
U. S. House of Representatives
April 14, 2010

Submitted by:
Manufactured Housing Institute

The Manufactured Housing Institute (MHI), a trade association representing all segments of the factory-built housing industry including manufacturers, lenders, community owners and retailers, appreciates the opportunity to submit this Statement for the hearing record regarding the March 2, 2010 hearing before the House Financial Services Committee on housing finance. We respectfully request that this Statement be included as part of the official hearing record.

Background

Manufactured housing comprises an important share of this nation's affordable housing stock and supply. At an average price of roughly $65,000, the typical new manufactured home is affordable by almost any definition. MHI has worked tirelessly to ensure access to financing for those who wish to purchase or refinance a new or existing manufactured home, yet conditions in this lending space have become dire. Despite a recent track record of excellent loan performance, there exists minimal liquidity for manufactured home lenders, especially since the onset of the credit crunch. Construction of new manufactured homes was 49,683 for 2009, a precipitous drop from 370,000 homes constructed in 1998.

Manufactured home loans for consumers can be grouped into two primary categories – real property mortgages and personal property loans. Real property mortgages are available to borrowers who wish to finance their manufactured home and land together, while a personal property loan is used if the borrower is financing the home only. In the latter case, the land is typically leased (e.g. manufactured housing community) or the home is sited on land (such as a family farm) that is owned by a family member. Lending conditions in each of these sub-groups have been severely weakened and would benefit greatly from increased activity from the private asset-backed securities (ABS) market; Fannie Mae and Freddie Mac (collectively, the GSEs); as well as fully operational FHA title I and title II programs with full Ginnie Mae participation.

The availability of capital to support any lending market is driven by investors' appetite for such loans. Multiple factors – including underwriting weaknesses in the mid to late 1990's and the resulting poor loan performance – ultimately resulted in a significant contraction of liquidity to the manufactured housing lending market for the past several years.

MHI and its members have been working for several years with Fannie Mae, Freddie Mac, the Federal Home Loan Banks, FHA, and Ginnie Mae to make the point that manufactured housing lenders operate within a disciplined lending environment with a track record of acceptable loan performance. As part of this effort, in 2002, MHI adopted the Lender Best Practices Program™, a set of best practices for business systems, procedures and standards aimed at helping industry lenders to improve portfolio performance.

Manufactured housing is one of the few sources of quality; affordable housing that does not receive government support to access the capital markets. In many states,

manufactured homes make up the largest percent of non subsidized affordable housing. To complement and promote the industry's efforts, MHI needs national policy-makers as active supporters and vocal advocates.

Asset-Backed Securities Market

In the early part of this decade, the ABS market was a critical source of capital for manufactured housing lenders. This was a very important funding mechanism which no longer exists today. With the downturn in the manufactured housing marketplace, only two companies continued to use the ABS market until the collapse of the financial markets in 2007-2008 which wiped out the ABS market. One company was put out of business because of the collapse of the ABS market, while the other was forced to go into a mortgage loan production only business model

Notwithstanding improved loan performance, the ABS market for manufactured housing loans still remains dormant

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac have historically been very small players in manufactured housing financing. Despite improved loan performance and efforts such as MHI's Lender Best Practices Program™, the GSEs policies continue to base loan purchase decisions upon underwriting standards created several years ago. As a result, the companies' automated underwriting systems reject a disproportionate number of the manufactured home mortgages submitted, even though mortgages for manufactured homes make up a very small portion of the GSEs current books of business.

More recently, during the tumultuous 2008-2009 credit crisis, the GSEs have not provided any support for manufactured housing lending. While the GSEs purchase a very small amount of conforming real property manufactured housing loans, they offer no funding for personal property loans on an ongoing or "flow" basis. In fact, less that 1% of their business is manufactured housing even though historically manufactured housing provides 8% to 15% of the new housing stock for this country. I am not sure

In the Housing and Economic Recovery Act of 2008 (HERA), Congress mandated that the GSEs have a "duty to serve" (DTS) the manufactured housing marketplace. Both Congress and MHI believe it is vitally important that the GSEs play a major role in ensuring the availability of affordable financing for low-to-middle income borrowers through adherence to the DTS. Because manufactured housing is so prevalent in rural markets across the country, greater involvement in manufactured housing would not only help the GSEs fulfill their affordable housing mission, it would also assist them in meeting their DTS for rural markets which is also identified in HERA as an underserved market.

HERA was signed into law in July 2008 and requires that the DTS provision be effective on January 1, 2010. Although the Federal Home Finance Agency (FHFA) has issued an Advance Notice of Proposed Rulemaking, to date it has still not published a proposed rule seeking public comments regarding the DTS provision. The lack of priority by the FHFA regarding the DTS provision for manufactured housing is very troublesome, especially as the industry's condition continues to deteriorate.

MHI strongly believes that the DTS requirements to be developed by the FHFA must include a mandate that the GSEs develop loan programs that provide for the purchase of new and pre-owned personal property loans on an ongoing or a "flow" basis. A manufactured home financed with a personal property loan is among the most affordable forms of homeownership as no land is involved in the loan transaction. Today, the industry estimates that personal property loans account for two-thirds of manufactured housing lending. There are approximately 8 million manufactured homes today, about 80% of which were funded through personal property loans. Enhanced liquidity for new homes will help the existing home market as well.

At this time, the secondary market for personal property loans is essentially nonexistent. As mentioned earlier, the GSEs do not currently purchase personal property loans although the charters of both Fannie Mae and Freddie Mac have always allowed for these purchases. MHI believes that the development of a GSE program to purchase these loans on an ongoing or "flow" basis will provide much needed liquidity to manufactured housing lenders, will lower borrowing costs, and will ensure the continued availability of this important form of affordable housing.

As the Administration and Congress focus upon the creation of a successor secondary market entity or entities to the GSEs, MHI believes Congress must ensure that the successor entity retains a nexus to the federal government to help ensure its commitment to affordable housing. More specifically, MHI urges Congress to require that the statutory DTS mandate for manufactured housing migrates to the successor entity.

In fact, the statutory DTS needs to be strengthened in one important area. The current DTS provision provides that FHFA's Director "may consider loans secured by both real and personal property" in determining whether the GSEs are meeting their annual DTS mandate. MHI strongly believes that this language must be amended to state that the Director "shall consider loans secured by both real and personal property". This language change will help ensure that the GSEs are doing everything they should be doing in purchasing personal property loans which secure the most affordable homes available today and in the future.

Another area where the GSEs can assist the industry relates to private mortgage insurance. Private mortgage insurance companies today routinely deny coverage for manufactured housing loans, or in the limited number of cases, coverage may be available on an 85% loan to value (LTV) loan where the costs of private mortgage insurance are higher than for site built housing. The requirement to have private mortgage insurance on any loan greater than 80% LTV places a reliance on a private insurance

product that is generally unavailable and has had a tremendously negative impact on the GSEs financing of the industry's product.

MHI believes that the FHFA must approve some form of self insurance mechanism for the GSEs, similar to the FHA insurance program, which eliminates the dependence on a private insurance industry that for all practical purposes is on "life support" and in no position to provide sufficient loan level loss protection. The manufactured housing industry's lenders have for many years "self insured" against credit loss and can provide valuable assistance in developing the levels of reserves needed to cover losses. This mechanism can also allow FHFA and the GSEs to address non-conforming loans in rural areas where appraisals and comparables are not readily available. We believe that a graduated insurance premium, depending on the LTV and the credit evaluation, is a model the industry can embrace.

FHA Title I Program

The FHA Title I program for personal property loans was virtually nonexistent in the early and middle part of this decade. The program contained serious flaws for lenders and Ginnie Mae had imposed a moratorium on new lender approval nearly 20 years ago because of the inherent risks to lenders and to Ginnie Mae. As part of the HERA statute, the FHA Title I program was updated and changed from a "pooled insurance" program to a loan-by-loan program. HERA also raised the program's loan limits, established annual indexing of the loan limits, and provided for an increased up front insurance premium.

While the above mentioned changes are for the better, MHI believes that an automated underwriting engine similar to FHA Title II's Total Scorecard is vital to the program's success. The automated underwriting engine will help to shorten the learning curve for lenders currently outside the factory built market and will also increase secondary market confidence through consistent underwriting standards. MHI believes that these changes will eventually increase Ginnie Mae's involvement and give more lenders access to the Title I program, thus serving more borrowers while improving the program's financial soundness.

Unfortunately, as of the date of this hearing, FHA has not yet issued the final rulemaking relating to the title I program. Publication of a final rule by FHA is important because Ginnie Mae cannot perform its crucial functions until it sees what the final program will look like. These Ginnie Mae functions include: lifting the moratorium on new title I issuers; accepting applications from new title I issuers; and promulgating pooling guidelines for the new title I program.

MHI specifically requests that Congress urge the FHA to issue the final title I rule as soon as possible. Further, MHI requests that Congress urge Ginnie Mae to perform the functions described above without delay. A fully functioning Ginnie Mae that is active in the manufactured housing space would greatly enhance the number of lenders offering

FHA Title I financing because they would have a way of replenishing their capital and originating more loans.

FHA Title II Program

This FHA title II program insures lenders against loss on real property mortgage loans, including manufactured housing. The FHA program has recently become a significant player in the overall market in capturing over 30% of all mortgages. Because of the easy availability of conforming mortgage money and private mortgage insurance, the Title II program in the early and mid 2000's was not utilized a great deal. However, because of the lack of private mortgage insurance and the extreme tightening of standards in the traditional mortgage market, the FHA Title II program has become a valuable tool for the manufactured housing industry.

While the FHA Title II program represents an important tool for the industry, significant constraints exist today. Most of the Title II loans are originated by community banks and specialty mortgage companies who then sell those loans to larger correspondent lenders. Those lenders then securitize the loans through Ginnie Mae or sell them to other investors. There are no significant lenders such as Wells Fargo, GMAC, and Bank of America that are agreeable to buying Title II manufactured loans through a correspondent network.

Further, there are a very limited number of lenders willing to aggregate or purchase loans for pooling into Ginnie Mae securities. This drastically reduces the availability of FHA Title II lending for manufactured housing. The lenders active in Title II are selling loans on a loan by loan or flow basis to Fannie Mae or Freddie Mac. The GSEs consider Title II loans a portfolio product and therefore issue much higher pricing than the rest of the FHA Title II market which uses Ginnie Mae securities. This increase of pricing creates undue hardship on the borrowers who need affordable financing the most. In addition, the act of the GSEs purchasing a portfolio product is at odds with their current directive of reducing its asset base. MHI believes that Ginnie Mae needs to fast track manufactured housing adept lenders who will then provide valuable capital to the market.
Because of the niche lending nature of the factory built housing industry, scalability is often difficult across a wide geographical spectrum. If the GSEs would allow pilot programs to be developed by approved seller servicers who are manufactured housing adept, it would allow capital to flow into areas that require regional expertise while maintaining lender accountability.

STATEMENT BY

NATIONAL ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES

NATIONAL ASSOCIATION OF COUNTIES

NATIONAL ASSOCIATION FOR COUNTY COMMUNITY AND ECONOMIC DEVELOPMENT

U.S. CONFERENCE OF MAYORS

NATIONAL COMMUNITY DEVELOPMENT ASSOCIATION

TO THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

HEARINGS ON

HOUSING FINANCE : WHAT SHOULD THE NEW SYSTEM BE ABLE TO DO?: GOVERNMENY AND STAKEHOLDER PERSPECTIVES

APRIL 2010

The National Association of Local Housing Finance Agencies (NALHFA), National Association of Counties (NACo), National Association for County Community and Economic Development (NACCED), U.S. Conference of Mayors (USCM) and National Community Development Association (NCDA), representing the Nation's local elected officials and affordable housing and community development practitioners appreciate the opportunity to present this joint statement to the Committee on Financial Services at its second hearing on Housing Finance: What Should the New System be Able to Do?: Government and Stakeholder Perspectives."

The Nation's cities and counties have engaged in effective partnerships with the Government-Sponsored Enterprises (GSEs), Fannie Mae, Freddie Mac, and the Federal Home Loan Banks for many years. These partnership activities have run the gamut from the GSEs purchasing tax-exempt single-family and multifamily housing bonds and investing in Low-Income Housing Tax Credits to individualized investments in specific neighborhoods and projects to affordable housing training. In many instances, but for the GSEs involvement, markets might not have been created nor projects come to fruition. Thus, the future of the housing finance system and the role that the GSEs will play in that system is of keen interest to local elected officials and practitioners.

Purchase of Tax-Exempt Bonds

Beginning in 1987, Fannie Mae (and later, Freddie Mac) initiated a program to purchase tax-exempt Mortgage Revenue Bonds (MRBs) and multifamily bonds issued by local and state governments or their housing finance agencies (HFAs). The proceeds from the sale of these bonds were used to finance below market-rate mortgages for income-restricted, first-time home buyers or to assist in the construction and rehabilitation of privately-owned rental housing, a portion of whose units were set-aside for income-restricted households. The use of these bond proceeds for ownership and rental housing created significant opportunities to expand the number of first-time homebuyers and for adequately housing lower-income renters.

According to the then Office of Federal Housing Enterprise Oversight (now Federal Housing Finance Agency) in 2004, Fannie and Freddie purchased $8.1 billion of the $22.7 billion in tax-exempt single-family and multifamily housing bonds, or 36% of the market in such bonds. Without their involvement in the market then issuers of such bonds would have paid an additional 15-25 basis points on their bonds according to the industry paper, *The Bond Buyer*. In 2006, citing the lack of taxable income with which to offset its tax liability, Fannie Mae announced that it would no longer purchase tax-exempt bonds. Freddie Mac followed suit in 2007 for the same reason. The withdrawal of Fannie Mae and Freddie Mac from the market helped contribute to the collapse of the tax-exempt housing bond market in late 2007 and early 2008.

In the Housing and Urban Recovery Act of 2008 (HERA) Congress provided local and state housing finance agencies with $11 billion in additional tax-exempt housing bond volume cap to assist first-time homebuyers, help borrowers with subprime mortgages threatened with foreclosure, and produce affordable rental housing. HERA also provided an exemption for the interest on housing bonds from the Alternative Minimum Tax. Unfortunately, these actions were

not sufficient to stimulate a market for these bonds due to such factors as historically low conventional mortgage interest rates. It was not until late October 2009 that the Treasury Department created a market for tax-exempt single- and multifamily bonds where none existed. This was done through a program whereby it would buy single-family and multifamily housing bonds issued by local and state HFAs that were securitized by the GSEs. A number of the organizations who are signatories to this statement worked very hard for over a year to convince Treasury and the GSE's conservator, the Federal Housing Finance Agency, to authorize such a program. A total of $15.1 billion was authorized for the purchase of housing bonds, securitized in Mortgage Backed Securities (MBSs) by the GSEs. We argued successfully that, while the GSEs could not benefit from the tax exemption, such a program was in keeping with the GSE's housing mission and that the program would ultimately be without cost to the federal government. The program is now being implemented and is expected to serve in excess of 100,000 homeowners and renters.

Authority under HERA for Treasury to purchase the securities and the bonds they support expired on December 31, 2009. Because the private capital market for tax-exempt housing bonds is not expected to return for some time, the organizations that are signatories to this statement are preparing to ask Congress to reinstate the HERA authority for Treasury to purchase tax-exempt housing bonds. The GSEs also have the ability to and have provided credit enhancement for housing bonds. These are precisely the type of activities that the GSEs should be engaged and any reform legislation should provide for their continuance and expansion.

Purchase of Low-Income Housing Tax Credits

Like their purchases of tax-exempt housing bonds, the GSEs were substantial players in the Low-Income Housing Tax Credit market, with estimates that they constituted over 35% of that market. However, they exited that market more than two years ago helping to cause a sharp drop in the value of these housing credits. In the American Recovery and Reinvestment Act of 2009 (ARRA) Congress recognized the upheaval that this was causing in the rental housing area and authorized a program where housing credit agencies could exchange 100% of their carry-over credits prior to 2009 and 40% of their 2009 tax credit allocation for $.85 on the dollar. This was aimed at restoring financial feasibility to many tax-credit supported rental housing projects allowing them to go forward. The House-passed version of H.R. 4849, the "Small Business and Infrastructure Jobs Act of 2010" continues the cash for credits exchange program for the 9% tax credit in 2010 and also extends it to the 4% credit (the credit that is automatic with tax-exempt multifamily housing bonds). Efforts are underway to insure that the Senate version of the jobs legislation contains extensions of the exchange provisions for both the 9% and 4% credits.

Once they return to profitability the GSEs should be strongly encouraged to continue equity investments in Low-Income Housing Tax Credits.

Targeted Investments in Neighborhoods and Projects

In years past Fannie Mae and Freddie Mac have made targeted investments in neighborhoods and projects throughout the Nation. These customized investments were made in partnership with

local governments and non-profit and for-profit developers to expand homeownership and rental housing. Their efforts targeted underserved communities and households in an effort to expand affordable housing opportunities.

Examples of these equity investments by Fannie Mae through its American Communities Fund (ACF) and subsequent investment vehicles include such projects as Lakeshore Point, an 87-unit mixed income for-sale project in an area of Chicago that had experienced "white flight" and years of abandonment In the words of the CEO of Shorebank Development Corporation Cindy Holler, "Conventional investors would not undertake the type of risk involved in a venture like Lakeshore Point. AFC and Shorebank Development Corporation are doing it because we have a mission to improve the community."

An equity investment of more than $1 million by ACF provided a gateway to neighborhood revitalization in north Philadelphia near Sixth Street and Germantown Avenue. A partnership with the City of Philadelphia and other public and non-profit organizations resulted in the acquisition, site development, and construction of Borinqueen Gateway Plaza, a $4.2 million 46,000 square foot shopping center boosting job creation and economic development in a nearby federal enterprise zone and the area around neighboring Temple University.

Renovation of a commercial building, Venus Gardens, into affordable housing in a distressed New Orleans neighborhood was the result of a local partnership that included the purchase by ACF of historic tax credits to help revitalize a building that was abandoned in the 1980s as the area's retail corridor declined. Then-Mayor Marc Morial said at the project's ribbon-cutting ceremony that, "This new apartment complex not only will provide affordable housing to local residents, it also will attract new businesses and act as a catalyst for other economic initiatives in the neighborhood."

Once they are profitable again, both GSEs should be encouraged to undertake these types of investments.

Freddie Mac works with low- and moderate-income homeowners through its Home Affordable Refinance Program and its Home Affordable Modification Program. The HOME Affordable Refinance Program helps existing credit worthy homeowners refinance into an affordable mortgage, while the Home Affordable Modification Program provides loan modifications for homeowners delinquent in their mortgage payments. Moreover, Freddie Mac recently awarded $400,000 in grants to five non-profit organizations to help them continue housing counseling to homeowners facing foreclosure, a perfect role for the GSEs.

Federal Home Loan Banks - ***Affordable Housing Program***

The FHLBanks have contributed significantly to the Nation's most underserved communities through the Affordable Housing Program and the Community Lending Program.

The FHLBank's Affordable Housing Program (AHP) provides grants and subsidized loans to support affordable rental housing and homeownership opportunities. Each FHLBank sets aside 10% of its net income to fund affordable housing for very low-, low- and moderate-income households. Since the AHP's inception in 1990, FHLBanks have contributed over $3 billion in grants for 623,000 affordable housing units across the country.

The Federal Home Loan Bank of Boston provided $340,000 in AHP funds to assist a non-profit purchase and rehabilitate a foreclosed rental property in Fall River, MA. The project will provide 17 units of permanent housing to the area's homeless. In Newton, MA, a $50,000 grant from the AHP will be used to assist in purchasing and rehabilitating supportive housing for two families headed by low-income, homeless veterans. Boston Veterans Affairs Health Care for the Homeless will provided managed health care, counseling, and job placement assistance.

The Federal Home Loan Bank of Pittsburgh's Affordable Housing Program provided a $1.25 million grant to the City of Reading, PA's community revitalization efforts to aid in the renovation of 275 units of affordable housing. A key focus of the initiative is the creation of housing for single parents who are transitioning from welfare to work.

Furthermore, the FHLBanks's Community Lending Program provides below-interest rate loans to member banks for community and economic development lending for a broad range of activities such as renovation of manufacturing facilities, purchase of business equipment in qualified income areas, and equity bridge financing for the low income housing tax credit.

These are all key activities that need to be encouraged and supported by the GSEs in a reformed system.

Housing Finance System Reform

We would like to associate our organizations with the recommendations of others who have testified before the Committee regarding the principles that should guide the Congress as it fashions a regulatory reform regime for the housing financed system. The housing finance system should provide

1. Liquidity to help insure the smooth flow of capital to the market by serving as the secondary mortgage market purchasing long-term, fixed rate mortgages that can be refinanced and prepaid.
2. Stability to insure the continued flow of capital to the market, particularly in times of economic distress such as the Nation has endured over the past two years, as well as after 9/11.
3. Affordability to support both single-family *and multifamily* housing that is affordable to a broad range of households.
4. Standardization of mortgage products offered to improve efficiency and transparency.
5. Clear mission to insure that those institutions that receive government support have a clear public mission and avoidance of private gain and public losses.

6. Strong regulation to ensure capital adequacy, that borrowers are protected from abusive practices, and have mortgages that are both suitable to their circumstances and properly underwritten.
7. Transition to ensure that any changes to the current system are carefully thought out and new structures, if any, are in place before existing ones are replaced.

Thank you for your favorable consideration of our views.

FOR IMMEDIATE RELEASE: April 14, 2010

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OBAMA ADMINISTRATION SEEKS PUBLIC INPUT ON REFORM OF THE HOUSING FINANCE SYSTEM

WASHINGTON - The Obama Administration today released questions for public comment on the future of the housing finance system, including Fannie Mae and Freddie Mac, and the overall role of the federal government in housing policy. The questions have been designed to generate input from a wide variety of constituents, including market participants, industry groups, academic experts, and consumer and community organizations. The questions will also be published in a Federal Register notice requesting public comments, and information on the process for submitting comments will be included in that notice.

"A well-functioning housing finance system is critical to the long term stability of the housing market," said Treasury Secretary Tim Geithner. "Hearing from a wide variety of perspectives as we embark on this process is an important part of establishing a more stable and sound housing finance system for the American people."

"This open process will help shape the future of our housing finance system," said U.S. Housing and Urban Development (HUD) Secretary Shaun Donovan "The Obama administration is committed to engaging the public as we consider proposals for reforming the housing finance system in the context of our broader housing policy goals, and the best steps to get from where we are today to a stronger housing finance system."

The Obama Administration will seek input in two ways. First, the public will have the opportunity to submit written responses to the questions published in the Federal Register online at www.regulations.gov. Second, the Administration intends to hold a series of public forums across the country on housing finance reform. Together these opportunities for input will give the public the chance to deepen the federal government's understanding of the issues and to shape the policy response going forward.

This effort is both in keeping with this Administration's commitment to openness and transparency and the President's Open Government Initiative. This initiative represents a major change in the way federal agencies interact with the public by making agency operations and data more transparent and creating new ways for citizens to have an active voice in their government.

Questions for Public Solicitation of Input:

1. How should federal housing finance objectives be prioritized in the context of the broader objectives of housing policy?
   - *Commentary could address: policy for sustainable homeownership; rental policy; balancing rental and ownership; how to account for regional differences; and affordability goals.*
2. What role should the federal government play in supporting a stable, well-functioning housing finance system and what risks, if any, should the federal government bear in meeting its housing finance objectives?
   - *Commentary could address: level of government involvement and type of support provided; role of government agencies; role of private vs. public capital; role of any explicit government guarantees; role of direct subsidies and other fiscal support and mechanisms to convey such support; monitoring and management of risks including how to balance the retention and distribution of risk; incentives to encourage appropriate alignment of risk bearing in the private sector; mechanisms for dealing with episodes of market stress; and how to promote market discipline.*
3. Should the government approach differ across different segments of the market, and if so, how?
   - *Commentary could address: differentiation of approach based on mortgage size or other characteristics; rationale for integration or separation of functions related to the single-family and multi-family market; whether there should be an emphasis on supporting the production of subsidized multifamily housing; differentiation in mechanism to convey subsidies, if any.*
4. How should the current organization of the housing finance system be improved?
   - *Commentary could address: what aspects should be preserved, changed, eliminated or added; regulatory considerations; optimal general organizational design and market structure; capital market functions; sources of funding; mortgage origination, distribution and servicing; the role of the existing government-sponsored enterprises; and the challenges of transitioning from the current system to a desired future system.*
5. How should the housing finance system support sound market practices?
   - *Commentary could address underwriting standards; how best to balance risk and access; and extent to which housing finance systems that reference certain standards and mortgage products contribute to this objective.*
6. What is the best way for the housing finance system to help ensure consumers are protected from unfair, abusive or deceptive practices?
   - *Commentary could address: level of consumer protections and limitation; supervising agencies; specific restrictions; and role of consumer education*
7. Do housing finance systems in other countries offer insights that can help inform US reform choices?

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