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NEW IDEAS FOR REFINANCING AND RESTRUCTURING MORTGAGE LOANS

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

OF THE

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

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXAMINING NEW IDEAS FOR REFINANCING AND RESTRUCTURING MORTGAGE LOANS

SEPTEMBER 14, 2011

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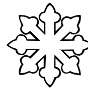

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WEDNESDAY, SEPTEMBER 14, 2011

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

The Subcommittee met at 2:02 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Robert Menendez, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN ROBERT MENENDEZ

Chairman MENENDEZ. This hearing of the Senate Banking Committee's Subcommittee on Housing, Transportation, and Community Development will come to order. I was trying to give a little time to my colleagues who are going to be on our first panel to get here. I am sure they are on their way. So I will start off with our opening statements, and then hopefully by then they will have arrived, and we will recognize them. We have got a very robust agenda here. We want to hear from all of the expertise that we have assembled and try to move it along.

This hearing of the Subcommittee on Housing, Transportation, and Community Development will focus on both the state of the housing market as well as new ideas for refinancing and restructuring mortgage loans. This is a very important hearing not only for me but I think for those of us who are concerned because the housing market is often what anchors the broader economy. We need to fix the housing market to get the broader economy moving again to create jobs as well as meet the challenges of present homeowners as well as keeping the aspirations alive of future homeowners.

On a regular basis, I hear from New Jersey homeowners who have trouble with their home loans, whether it is being denied the opportunity to refinance at today's lower interest rates because they are underwater or banks are not willing to do a principal reduction from them when they have hit hard times.

It is hard to be optimistic about economic growth if the housing market remains in its present status. For most families in America, their home is their single largest asset and their source of appreciated wealth.

So the hearing today is divided into three panels. The first panel consists of my two distinguished Senate colleagues to discuss their bill, which I am proud to cosponsor, the Helping Responsible

Homeowners Act, S. 170, which will help homeowners who are underwater to refinance more easily. The second panel will discuss the state of the housing market and specifically the state of home sales, home prices, consumer demand, short sales and foreclosures, rents and rental availability, and whether these problems continue to be nationwide in scope or are they becoming more regionalized. And the third panel will discuss ideas to refinance or restructure existing home loans, including shared appreciation, mortgage modifications, refinancing existing loans to take advantage of historically low interest rates and the barriers to doing so, and allowing the FHA short refinance program to be used on the GSE inventory.

It is my hope through this hearing and a subsequent one that we will follow up on next week that we can develop a housing policy and promote initiative that gets our housing market moving again.

With no other Member that I see wishing to make an opening statement, let me call upon my two distinguished colleagues for their statements, Senator Boxer of California and Senator Isakson of Georgia. I am happy to welcome them. They both have strong records in housing policy, and they will talk about a bill they have introduced to jump-start the housing market and help millions of homeowners refinance their mortgages. And with that, Senator Boxer.

STATEMENT OF BARBARA BOXER, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator BOXER. Thank you so much, Mr. Chairman. I am very proud to be here with Senator Isakson, and he has a long profession, a long time in his profession, which was before he came here he was in the real estate business. So I am very proud that he is on this bill.

And just to say this before I read any of my statement. Our bill is based on a very simple premise. If you have paid your mortgage all along through all these difficult times, and it is at a high interest rate, but you never missed a payment, as the value of your home went down and down and down, you find yourself underwater, Mr. Chairman, and you are still stuck at that 7-percent, 6-percent rate, you should be rewarded with a program like this. And what we say is you should have a chance, if you want, to refinance at the current levels. This is such a win-win.

Number one, Fannie and Freddie, because these would all be home mortgages that are backed by Fannie and Freddie, Fannie and Freddie actually make money on this, as we looked at the CBO analysis, about $100 million, because it would stop many people from defaulting right away.

Second, if you are the homeowner, you are going to have thousands of dollars in your pocket because you refinanced. And I remember the years when Bill Clinton was President, and one of the reasons there was such a prosperity there is the tremendous number of refinancings. It is the best way to get money into our economy quickly.

So essentially this is what our bill does. It says if you have a loan that is backed by Fannie and Freddie, and if you have a high interest rate and you would like to take advantage of these lower rates, then you should have a chance to do that, not be disqualified

because you are underwater, and have those ridiculous fees that they have in place now waived so you can take advantage of these rates. We call it the Helping Responsible Homeowners Act. We are heartened that the President mentioned something like this in his address to the Congress. We are heartened that you are on our bill. We are thrilled with that. Our bill has been endorsed by Mark Zandi, who I know is going to testify later, the chief economist at Moody's Analytics; by William Gross, managing director and co-CIO of PIMCO; and then Thomas Lawler, housing economist. It has been endorsed by the National Association of Realtors, the National Consumer Law Center, the National Association of Mortgage Brokers, and many others. So it is a win-win for Fannie and Freddie.

Now, they can do this without our legislation, and Senator Isakson and I are saying today, please, if they are listening somewhere or out there somewhere, please do this. This will save you money. You know, this will save Fannie and Freddie $100 million. This will help, by the way, CBO says, up to 2 million homeowners. But when they made that estimate, that is when interest rates were higher, and we believe you are looking at perhaps 3 to 4 million homeowners, 5 million are actually—close to 5 million are eligible for this.

So that is our story and we are sticking to it, and we are strong on this. The FHFA we hope will follow through on some of the nice statements they have been making recently. But this is going to help our economy. It is going to keep people in their homes. And for once, Mr. Chairman, I beg you, let us get out in front of this crisis. We are, you know, a dime late and a dollar short. We have been following this along. Let us get in front of these folks. These are the good folks who have never missed a payment. Let us help them stay in their homes, and I think you help America when you do it.

I thank you very much.

Chairman MENENDEZ. Thank you, Senator Boxer.

Senator Isakson.

STATEMENT OF JOHNNY ISAKSON, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator ISAKSON. Well, thank you very much, Mr. Chairman, and I would ask unanimous consent that my prepared statement be submitted for the record.

Chairman MENENDEZ. Without objection, it shall be.

Senator Isakson, thank you very much for calling this very appropriate hearing on the housing industry, and I am particularly pleased to join with Senator Boxer of California in this particular piece of legislation which addresses a new phenomenon that has taken place in the most protracted housing recession America has seen since the Great Depression, and that is called "strategic foreclosure."

There are 10,900,000 American homeowners who are underwater right now today, as estimated. That is 10,900,000 people who are making payments on mortgages that the payoff is more than the house is worth. A new phenomenon is something called "strategic foreclosure" where homeowners who are underwater are looking at

the future of real estate, looking at the future of values, and they are walking away from their loans and going off and buying a foreclosed house down the street thinking they will be better off. This has made the marketplace worse, put more foreclosures in place, and continues to contribute to the downward pressure on home values.

What this bill basically says is that of that 10,900,000 people who are underwater, up to 2 million of them—and as Senator Boxer has stated, maybe more since rates have gone down—can make the strategic decision, instead of walking away from a loan that is underwater, to refinance that existing balance at the current lower rates, put more money in their pocket, and make the maintenance of that mortgage better for them in the long run when housing recovers. That is all it does. It is not a boost to the housing market from the standpoint of creating sales, but it is a depressant on more foreclosures. It does make it less likely that people will use strategic foreclosure as a mechanism to deal with their financial situation. And it should help to stabilize home values in the long run and in the short run.

I commend Senator Boxer on her leadership. She originated this thought. I have been proud to work with her, and I think it is something Fannie and Freddie ought to do. I am not interested in pride of authorship. If they will do it tomorrow by policy, we are ready for them to do it. And it does make good sense, and the CBO score is outstanding.

Let me address a second subject, if I might, Mr. Chairman, dealing with housing. Your second panel is terrific, and I am not going to be able to stay for all of it, but I want to commend to you in particular Mr. Richard Smith of Realogy and Ivy Zelman who are going to testify on this panel. They are two of the best authorities in the real estate industry that I know of. Realogy has about 25 percent of the market share of the residential housing market in the United States. It is an outstanding consortium of companies that deal with residential brokerage. Ivy Zelman, I have attended her seminars. I know people who she consults with. She is as good as anybody I have ever heard, and both of them will make a significant contribution.

Second, I appreciate your leadership on the loan limit situation which is confronting us by the end of this month. We do not need to do things that make things worse in the housing market. We need to do things that make it better.

What Senator Boxer is proposing along with me and my help to her on this is good for waiting off strategic foreclosures, but keeping loan limits and expending them after the end of this month is important to maintain the housing market that we do have. It is not the time for the Government to constrict availability of mortgage capital for people who are qualified to buy houses because of a limitation on those loan limits, and I commend you on your leadership on that and look forward to answering any questions you or Senator Merkley may have.

Chairman MENENDEZ. Well, let me thank you both for your initiative and your insights, and I hope our friends over at the agencies hear it and get it and do not wait for us to push through legislative action, but we will if we have to. And I appreciate your ob-

servations, Senator Isakson, and am proud to have you with me on the efforts of ensuring that the present loan limits are retained before the end of the year. I think it is a critical part of the element of the things we have to do in the market, so I appreciate your long-term leadership in this field and joining with me and others in trying to preserve this.

I have no questions for either one of you. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and I wanted to express my appreciation for the work you have done on this. Helping homeowners stay in their homes and decreasing the number of foreclosures is absolutely essential.

I would ask a short question in regards to the CBO score. My understanding is this would save money for the GSEs, but because the Fed holds a number of the securities that might diminish in value with the lower interest rates, there is some cost they estimated. Could either one of you kind of just clarify what the CBO was pointing to?

Senator BOXER. Yes. Just a second. I have it here.

How much will the bill cost? Fannie and Freddie actually gain, as we said before, from the changes in the bill by up to $100 million because the savings realized by a reduction in defaults and foreclosures would outweigh any lost revenue due to the elimination of the risk-based fee and the reduced portfolio income. Because of large holdings of Fannie and Freddie mortgage-backed securities, the Fed would experience reduced investment income of $2.6 billion over 10 years. So this means there is a net cost—so although this means there is a net cost to these changes, the Federal Government should not be profiting—this is my feeling—from borrowers paying higher interest rates than they should have to. The fact that the Fed holds these securities should not create perverse incentives for the Government to keep borrowers trapped in higher-cost loans. So that is the answer. That is how I feel about that.

Senator MERKLEY. That is excellent, and I appreciate the work you all have done on this.

Senator BOXER. Thank you.

Senator ISAKSON. If I can just add to that?

Chairman MENENDEZ. Yes, Senator.

Senator ISAKSON. You know, you are dealing with what we refer to in business as "inside baseball." You have got the conservatorship control of Freddie Mac and Fannie Mae, and you have got the Federal Reserve buying paper. And, yes, if you lower the rate or the yield on a mortgage, you will lower the value financially of that instrument. But if, on the other hand, you are stabilizing a loan that would otherwise have been defaulted on under any form of dynamic scoring, this is a net gain to the U.S. housing economy and the U.S. Government. There is just no question about it.

Chairman MENENDEZ. What is the interest rate on walking away on your——

Senator ISAKSON. I am sorry?

Chairman MENENDEZ. What is the interest rate on walking away on your obligation?

Senator ISAKSON. Well, that is a great question. Let me tell you what the consequences are. You probably would not be able to borrow money for 7 years at best, and Richard Smith can address that

subject, but that would be my guess. If you walk away from your mortgage and default, your credit score goes in the tank, and every interest rate you pay on credit cards and car finance, student loans, whatever else, is going to go up, not down. You are probably not going to be able to get a home mortgage for 7 years, if that soon, and the disruption it does to your financial statement and to your credibility as a homeowner goes away. So the cost is far greater to the country for somebody to default on the loan and have it foreclosed on than it ever would be a loss to help them stay in the house.

Chairman MENENDEZ. Absolutely. With that and the thanks of the Committee, thank you to both of you.

Senator BOXER. Thanks so much.

Chairman MENENDEZ. Let me ask our next panel to come up to the table, and I will introduce them as they come up and be seated.

Let me welcome my fellow New Jerseyan, Richard Smith. He is president and CEO of Realogy Corporation, a global provider of real estate and relocation service which is headquartered in Parsippany, New Jersey. Mr. Smith oversees the Realogy Franchise Group consistent of many well-known companies such as Better Homes and Gardens, Century 21, Coldwell Banker, and Sotheby's International Realty, among others. He is a member of the Business Roundtable, and the Committee looks forward to his testimony today.

Mark Calabria is the director of financial regulation at the Cato Institute and has worked there since 2009. Before that, he was a senior member of the professional staff of this Committee. In that position, he worked on issues relating to housing, mortgage finance economics, banking, and insurance for Ranking Member Shelby. He has appeared before this Committee many times, and we thank him for his present this afternoon as well.

Ivy Zelman is the CEO of Zelman & Associates and has over 19 years of experience in the housing and related industries. Zelman & Associates, which she founded in 2007, delivers research on the housing market and has been repeatedly recognized for its expertise. Prior to that, she worked at Credit Suisse Group, including 8 years as a managing director, and we are pleased to have you today to discuss the state of the housing market.

With that, Mr. Smith, welcome and we look forward to your testimony. I would ask you each to synthesize your testimony to about 5 minutes or so. We are going to include your full statements for the record, and we look forward to having a discussion with you. Mr. Smith.

STATEMENT OF RICHARD A. SMITH, CHIEF EXECUTIVE OFFICER, REALOGY CORPORATION

Mr. SMITH. Good afternoon, Chairman Menendez and distinguished Members of the Subcommittee, and thank you for those kind introductions.

As to the current state of housing, we will make the bold statement that existing home sales in our view have stabilized on a unit basis in the range of 4.9 to 5.1 million units on an annual basis. However, average price will continue to move in a range of down 4 percent to up 2 percent.

New homes should see slight improvement in year-over-year growth for new homes, and price we think is also going to move in that range, but more on the positive side from flat to up about 2 percent. We think the high-end and the first-time buyers make up the majority of the market. The middle market or the move-up buyer is noticeably absent. High-end buyers are typically paying all cash. First-time buyers are financing with FHA and less than 20 percent down.

It is important to note that 25 to 27 percent of all homeowners have little to no equity, which is a point that you made earlier in the Chairman's opening comments.

Renting is certainly in vogue. It is a very popular topic in the media these days. It will run its course, however. It is certainly most cost-effective today to own in most markets in the United States than to rent. Rents are increasing at the rate of about 5 to 7 percent annually. New York City as an example is 10 percent year over year.

What is holding back housing? High unemployment, the foreclosed inventory overhang, low consumer confidence, and failed or marginally successful Government intervention programs.

We are going to recommend some remedies. We are going to start with jobs. I would be remiss in not stating that the unemployment number that concerns us in housing is not the 9.1 or 9.2, but the U.S. Bureau of Labor Statistics standard, which is currently at 16.2. Underemployed or temporary employees do not buy homes.

Foreclosure is a major issue for us. It is depressing prices nationally. Although most foreclosures occur in ten States, predominantly in five, it is nevertheless an overhang that needs to be addressed. The continued delay in the foreclosure process is harmful to housing. The sooner the foreclosures are permitted to continue and accelerate, the sooner we will see some balance in average sales price, and thus the equity that is in the homes owned by taxpayers.

We are very much in favor of efforts to mitigate or prevent foreclosure. We are strong proponents of the short-sale process. We like in particular the debt-for-equity program that has been recommended by a number of people where both the lender and the homeowner share in the equity of the home.

We also like assumability. We think that in the current environment some measure of loans could be assumed or have an assumable loan characteristic so that at some future date a new buyer could be in a position to assume those very low interest rates that we enjoy today.

We are strongly in favor of refinance programs. We think that, again, is an effort to mitigate and prevent foreclosures. So the expansion of HARP or any program that makes it possible for homeowners to refinance at the current rate of 4, 4.5 percent we are very much in favor of.

We also are very much in favor of not permitting the current GSE loan limits to expire in October. We think that is damaging to a very fragile market. We are strongly in favor of the Chairman's and Senator Isakson's efforts to extend those for at least 2 years. This is not a time to run the risk of upsetting again a very fragile market.

The National Flood Insurance Program needs to be extended. If not, that is going to put about 500,000 homes at risk. We would encourage an extension very strongly.

And I would be remiss in not mentioning for the benefit of this Committee and for others who may be watching the very substantial concerns we have with respect to Dodd-Frank, in particular the qualified residential mortgage component of Dodd-Frank, which we think is particularly punitive to low- to moderate-income home buyers.

GSE reform is not something that we view should be entertained in this environment. The market is too fragile and too uncertain. GSE reform can certainly be handled at a later date. It is working quite well now. We know there are fundamental reasons for a focus on GSE reform. That will come. It is just not appropriate in this environment.

We very much appreciate the opportunity to speak to the issues. We know that we will have an opportunity to elaborate on these items when we go to panel discussion, and I want to thank the Chairman for his leadership on this very important issue. And, again, we are available as a resource in any manner you think is appropriate.

Thank you.

Chairman MENENDEZ. Thank you very much. You actually had time left on your 5 minutes.

Mr. SMITH. I did my very best.

Chairman MENENDEZ. You have led the way here.

Mr. Calabria.

STATEMENT OF MARK A. CALABRIA, DIRECTOR, FINANCIAL REGULATION STUDIES, CATO INSTITUTE

Mr. CALABRIA. I will try to keep within that.

I want to start by saying that there is actually a fair amount of consensus in terms of what is going on in the market, and I think the differences would be the hows, whys, and wheres. So I want to emphasize that. I am not going to talk about the things we agree upon and put most of my time on the attention that I think where some of the disagreements and some of the details are. That is not to undermine the widespread agreement, and I really do want to emphasize jobs is incredibly important, and we think we are at the point where the labor market is more so driving the housing market than the labor market, although obviously there is a feedback between the two. And I also want to emphasize the point that Mr. Smith made about the foreclosure process really does need to be fixed and needs to be sped up; otherwise, we are continuing to have a huge overhang of homes out there, and I think that is important.

So I just want to touch on a couple of facts, the first of which is that, despite the price declines we have seen, in many parts of the country housing is still very expensive relative to income. Nationally we have seen median home prices fall to about 3 times the median income, and that is about historical average. So overall it looks like housing is back to the affordability it should be, but if we look at places like San Francisco, you are still looking at median house prices being about 8 times income. So it is important to keep in mind we are looking at a lot of different markets. There

are lots of markets that are still unaffordable by any stretch of the imagination. There are also a number of markets where new home prices still remain above production costs. Over the long run, in a competitive market prices are going to fall to meet the price of production. Up until about 2003, that was actually the trend. I do think as we see in other markets that reassert itself, prices are going to continue to fall in those markets.

I think it is also worth noting the total existing home sales in 2010 were only 5 percent below their 2007 level. But if you look at new home sales, they were 60 percent below the 2007 level, and I think the primary reason for this difference is that existing home prices have fallen considerably more than new home prices. To me as an economist, this illustrates that markets actually work. If you let prices fall, volumes will clear. And I think we need to not be so concerned about any price declines. I recognize there are costs to price declines, but there are also costs to keeping prices above market-clearing levels.

It is also worth noting that for the first 6 months of this year, existing home sales were 12 percent above the last 6 months of last year, and that is on a seasonally adjusted basis. So as you have seen these minor price declines continue, you have actually seen sales start to go up, and I want to echo again something Mr. Smith said, which is I think we are near about the bottom in terms of volume of sales, and I think we will continue to slowly climb our way out. I do want to emphasize we are years away from seeing anything that looks like the activity of 2005–06. So I think it is going to be a slow climb getting there.

I think there is also a fair amount of consensus about you have got a number of units, about 2 million, in pent-up demand that I think once you get to the point where people—where confidence is back in the market, prices are back where people still feel comfortable, I think this demand will start to come back. But I think we are a ways away from it. I think borrowers still are very much concerned that if they buy today, they are going to continue to see price declines. My recommendation would be I really believe we need to get to a point where buyers believe prices can go no further. And that absolutely risks overshooting on the downside, but, again, I think the risks of overshooting on the upside outweigh the risks of overshooting on the downside.

I would also emphasize I look at housing as one of life's basic necessities, so I do not see it becoming cheaper is a bad thing. And so I think in many markets, again, the San Franciscos of the world, I would like to see house prices actually decline even further because I think that would open up opportunity for middle-class families to actually buy houses that they are priced out of buying today.

I also am very concerned about interactions between the unemployment and the mortgage policies we have. I like to use the example of if you are a carpenter in Tampa, you are unlikely to find a job as a carpenter in Tampa anytime in the next couple of years. We need to encourage you, assist you, help you move to someplace like Austin where they might be creating jobs. And so I do think we have locked people in place in a way that has hurt the labor market. There are a number of statistics in my testimony that show some of the discrepancies, and I want to emphasize to me it

is really illustrative of, for instance, San Jose is a very tight market, whereas Riverside is a very loose market. So even within the same State, you can have housing markets that are very different, and we need to target our policies in a way to keep that in mind.

Let me talk very briefly about the rental market, which is we have started to see some minor declines, but we also still have about 4 million vacant rental units although that is down about 500,000 vacant units from last year. Again, the ease or the tightness of rental markets tends to mirror the overall housing market we are in.

But let me end emphasizing I think a point sometimes we overlook when we talk about the housing market, which are those without homes. And while there are a variety of statistics that are not as good as what we have on the other side of the housing market, by any indication homelessness has increased over the last year, the last 2 years, several years, and it has increased particularly among family homelessness, and it has increased particularly in suburban areas. So I do think a rethinking of our current homelessness assistance programs to see that they assist people in these newer areas instead of the traditional focus on central cities is something that merits attention.

Chairman MENENDEZ. Thank you.

Ms. Zelman.

STATEMENT OF IVY ZELMAN, CHIEF EXECUTIVE OFFICER, ZELMAN & ASSOCIATES

Ms. ZELMAN. Good afternoon, and thank you, Mr. Chairman and Senator Merkley, for having me here today to talk about the state of the U.S. housing market.

As we enter the sixth year of the worst recession in housing since the Great Depression, many have suggested that we have become a "Renter Nation" and the American dream of home ownership is dead. I do not believe this to be the case. We believe that—or I should say I believe that our great Nation is still forming households, which is supported by population growth, and we expect that population growth and household formation will translate into nearly triple the activity from today's depressed levels.

With that said, there has clearly been a disconnect between the longer-term demographics and the near-term reality. I estimate there are currently 2.5 million "excess" vacancies that need to be absorbed before a return to "normal" building activity levels can be justified. This number has the potential to move even higher given the current pipeline of 4.1 million mortgages that are either in the foreclosure process or 90 days delinquent.

I believe the most powerful tool that Washington can provide is a rental program to dispose of these vacant REO and future foreclosures in an orderly manner. The most efficient and cost-effective way to achieve this goal is for the GSEs to ease financing terms and expand financing options to investors that would purchase properties at low LTVs and pursue a single-family rental strategy.

Over the past 5 years, single-family rental has been the fastest growing residential asset class. From 2005 to 2010, single-family rentals grew at 21 percent versus just a 4-percent increase in total housing units. In the hardest-hit markets, such as Nevada, Ari-

zona, and Florida, single-family rental grew at approximately 48 percent while apartment units were basically flat or unchanged.

Facilitating an orderly transfer of these distressed units should also have a favorable impact on pricing. Given modest improvement in the economy, record levels of affordability, and a reduction in inventory, through the first 7 months of 2011 home price deflation has diminished. In fact, prices of traditional homes, excluding foreclosures, only declined 1 percent year over year as of July, according to CoreLogic; whereas, the total decline was approximately 5 percent, suggesting double-digit deflation for distressed sales, which currently account for approximately one-third of transactions.

The second piece of the equation is demand, which remains at all-time record lows measured by sales activity. Despite favorable affordability and historic low interest rates, this has not been enough to drive more home buyers off the sideline. Nevertheless, according to the University of Michigan Consumer Sentiment Survey, 72 percent of respondents believe that now is a good time to buy a home. Furthermore, a recent survey by our firm of 1,500 renters conducted in five markets showed that 67 percent of those surveyed want to become homeowners over the next 5 years, with 82 percent of renters in the key 25–34 age group expressing their desire to buy a home.

So if people want to purchase a home and think now is a good time to do so, why aren't they doing it? The answer, I believe, is twofold. First is the weak condition of consumers' balance sheets, which are still laden with high levels of net debt and negative equity. Indicative of these challenged consumers, our renter survey showed that just a third of respondents were able to come up with the 3.5-percent downpayment necessary to purchase a median-priced home using FHA financing today.

The second issue is uncertainty, which I believe is a nationwide problem negatively impacting home sales and prices given the volatility created by prior tax credits, fear of job loss, and mixed messages sent by the Government around future housing policy.

However, regional differences are significant, with major dichotomies dependent upon levels of unemployment, distressed inventory, negative equity, delinquencies, and vacancies.

Nationally, one of the most significant problems prospective home buyers face today relates to stringent underwriting criteria, magnified by strict credit overlays being imposed by banks due to unknown risk related to putbacks or other future unexpected Government burdens. As a result, many qualified home buyers are being turned away.

Creating a business environment that would encourage banks to remove these stringent overlays that are above and beyond already tight lending criteria would be a catalyst to spur housing activity. I also believe that given the still-tenuous nature of the housing market, allowing the GSE and FHA loan limits to roll back to lower levels on October 1st is a significant mistake and should be put off until the market is on more solid footing.

Similarly, any legislation related to eliminating or reducing the mortgage interest deduction should be carefully crafted and only considered with a longer-term implementation in mind.

In closing, housing has historically been a significant driver of recessions and recoveries. Currently, residential investment represents just 2.2 percent of GDP, representing an all-time trough and well below the long-term median of 4.4 percent, suggesting that the industry has been a significant head wind on economic growth. Housing's recovery is essential to the overall success of a broad economic recovery, and without it the economy will continue to languish.

Thank you again for the opportunity to testify today.

Chairman MENENDEZ. Well, thank you all. You have covered a lot of waterfront here and we will continue to do a little bit more in our question and answer. We will start a round and then we will see how our time goes.

If I were to ask you, you have a magic wand and outside of the issue of jobs, which clearly the President was focused on, came to the Congress, laid out his vision, and I would hope all of us are focused on that as the number one job before the country, getting people to work. Obviously in an economy that 70 percent GDP is consumer demand, and without a job, there is no income, and without an income, there is not demand, so that is critical and I think we collectively can agree on that.

The next question is, so, setting that aside for the moment as something that we have a plan, there are different views how else we might do that, what specifically on the housing front, if you had one or two initiatives that could come from the governmental side to incentivize moving this marketplace forward, what would you say would be? Mr. Smith.

Mr. SMITH. Well, we would begin with the comment I made regarding the foreclosure problem. It is a major overhang. It is, in fact, impacting values across the board, not only in the 10 States that I mentioned but nationally. We need to accelerate that and get it behind us. We need to get those nonperforming assets back into the marketplace as performing assets that generate true economic value. It is inevitable that there are going to be foreclosed assets at some point. Accelerate it, get it behind us, and let the market correct.

I agree with many of the comments that the market will correct itself, but it needs a little help in this case. This overhang needs to be lifted permanently, and——

Chairman MENENDEZ. What is the size of that? Can you quantify it?

Mr. SMITH. The size of the foreclosure problem, there are, depending on who you are listening to, there are about 1.6 to 1.7 million homes. I think the latest S&P estimate is about 1.7 million homes that are at some stage of foreclosure that need to be moved through the pipeline. That is probably a low estimate. I think Ivy and others may actually be of the view that it is much higher than that, because not only those that are in foreclosure but those that are likely to be in foreclosure. You will see estimates as low as 1.3. You will see estimates as high as seven million units. The good news is that inventory is shrinking a bit.

The banks are very hesitant to proceed on the foreclosure for the Attorney General lawsuit reasons and a number of other regulatory reasons. But it is definitely a major overhang. In fact, in many of

our conversations with buyers and sellers, principally with buyers, they are generally of the view, more often than not, certainly in those 10 States, that if they just wait, that foreclosure inventory will be released, bringing pricing down even lower, creating better opportunities. So they are literally sitting on the sidelines, well prepared, perfectly capable of proceeding with the transaction, but they are waiting, and that is taking a lot of wind out of the market.

Chairman MENENDEZ. Waiting, thinking that they will get even a lower——

Mr. SMITH. A much lower price, yes. That is a common problem that we——

Chairman MENENDEZ. So your answer to my question is dealing with the overhang issue.

Mr. SMITH. I do not know how we can move beyond that. I think that fundamentally must be put behind us.

Chairman MENENDEZ. Mr. Calabria.

Mr. CALABRIA. I want to echo that, and I certainly would include that as one of my two. And maybe to flesh out the numbers a little bit, my estimate, which is from the Mortgage Bankers Association, is you have about 1.6 million loans that are at least 90 days late. Of that, my own estimate is you are looking about between 400,000 and 500,000 that are over 2 years late. So those core, you can start with a pretty good assumption that someone who has not been able to make a payment for 2 years is very, very unlikely to become current again.

So what I would say is I think you need a triage process. We need to decide who is savable, who can we keep in the home, who can we help, who can we not, and we have to be realistic about it because this is a triage and we will not be able to save everybody.

So I would say for those segment in which the owner has not paid for a very long time, we need to streamline the process. We need to get those houses back into inventory very quickly, let the prices adjust. So that would be my number one.

My number two, which might be echoed by Ivy, I think we need to find a way to get some of this excess inventory held by Freddie, Fannie, FHA, out into the private market, back into the market, either via investors—now, some of it does make sense to me as a rental. For instance, I would much rather—I go back to my carpenter in Tampa argument. I would rather help pay that guy's rent in Austin where he can find a job than to encourage him to stay in the house that he is in because he is not going to have to pay the mortgage. So we do need to change the dynamics in helping people adjust in their life.

So those are my two, but I will also emphasize it is important to keep in mind that, first, it should be do no harm. I think we do need to think through proposals and make sure that we are sending the right signal to buyers, make sure we are sending the right signal to investors, and all that does need to be kept in mind.

Chairman MENENDEZ. Ms. Zelman.

Ms. ZELMAN. Well, first, I would say that we need to instill confidence in the asset class, and the way you instill confidence is you mitigate deflation. How do you mitigate deflation? You have demand and supply back in balance. How do you get supply back in balance? You absorb it through a rental program that the Govern-

ment has the ability to implement. That rental program is appropriate given the consumers' balance sheets are too weak for consumers to purchase homes today, yet households need dwellings. Single-family dwellings today by far outpace the magnitude of population living in 50-plus unit apartment buildings and these people that have been displaced, if they were living in a single-family rental with three kids and two cars and a dog, they are moving across the street to a single-family rental. So there would be orderly disposition.

By doing so, we would mitigate new dwellings on the market. That would put pressure on prices and we would stabilize home prices, which would take the consumer who is sitting on the sidelines just because he is afraid, actually allow him to be back in the market. That is my first response.

My second response would be, today, consumers that are qualified are being turned away because we have now taken underwriting to an extreme. The stringent underwriting is important and needs to be sound, but because of a black and white underwriting process, as well as incremental credit overlays, very strong potential home buyers with downpayments exceeding 30, 40 percent are being turned away in some cases because of a situation where they are self-employed, for example. We have made it very difficult for qualified buyers who have credit scores that might be a 639, it falls below the 640, which, by the way, FHA will insure a mortgage at 580 or higher, but underwriters will not underwrite a mortgage unless it is 640 or higher. So we have taken the pendulum and swung it too far to bring in real qualified buyers.

So I think really two-fold, all of which would bring back confidence, and confidence, we think, is the biggest impediment to recovery in the housing market. But first, eliminate deflation through getting rid of the supply.

Chairman MENENDEZ. Mr. Smith, what about the rental idea?

Mr. SMITH. Well, two, with the Chairman's permission, two points. There is the thought in the marketplace that foreclosed properties are not selling. I would dispute that. We are one of the largest resellers of foreclosed properties in the United States. Sixty percent of our sales are going to individual investors. They are typically small. They are not institutional. They are family owned and operated. The balance are first-time buyers. The investors are paying cash and the first-time buyers, the 40 percent, are generally FHA financing with less than 5 percent down.

So there is a very robust market. From the list date to the actual close of the transaction is taking us 80 days. So we are turning our inventory over every 80 days. So there is a very robust market for this. We should not think that they are in a warehouse somewhere. They move rather briskly. So that is an important point.

As to the rental, we think rental programs can be effective to the extent it is not being used to create subsidized housing. Subsidized rental programs, in the cases that we are familiar with, which in one case we manage, it was a dismal failure. They were taking a home that was a GSE inventory, putting it into a market, it was a single-family marketplace, and they were making those homes available at half the local market rate. That created property value problems. It created significant problems with the local taxpayer,

the local homeowner. It just—if that is the intent, that is, I think, a poor strategy and is not going to benefit anybody long-term. If, however, the intent is to put it back in the marketplace at market rental rates, I think that is perfectly acceptable.

Chairman MENENDEZ. Let me ask one final question. I exceeded my time, but since it is only Senator Merkley and me here at this point, I will yield to him in a moment.

Twenty percent down is a constant. Is that a good idea?

Ms. ZELMAN. I think 20 percent is probably too high. I think that we have sound underwriting with 10 percent probably as a more reasonable level, along with FHA financing today, which is critical to stay at the 3.5 percent downpayment level. But I think 20 percent is too high.

Chairman MENENDEZ. I get the sense that, institutionally, there has almost been an adoption of the 20 percent, even though there has not been, in fact, any, obviously, regulations to that effect. That is concerning to me because that takes a whole universe of responsible borrowers off the marketplace. I think we definitely need to deal with that.

Ms. ZELMAN. If I may, Mr. Chairman——

Chairman MENENDEZ. Surely.

Ms. ZELMAN. ——just say that the single family renter is actually getting the unit made available to him by the purchase of the foreclosure that Richard Smith spoke of by investors. And so they are rehabbing those homes and they are putting tenants into those homes. So the process of disposition is happening, but because of rental yields for investors need to be at a certain level. Today, they are running about 6 to 8 percent. With leverage, like multifamily is provided Government funding to do construction loans and development loans at very attractive financing, but yet single-family renters have no financing available to them. Only the single-family mortgage market and the multifamily mortgage renter has Government assistance of funding.

With leverage, the Government can get a better return, because if you provide leverage to investors, there is significant demand for this type of asset class. We would get a higher bid, the Government would get a better return, and everybody wins.

Chairman MENENDEZ. Very good.

Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and I apologize. After I ask my questions, I will have to head to the floor to preside. I would be very interested in the second panel, but I will not be able to be here and so I apologize for that.

I wanted to ask a little bit about if anyone has a take on how the Boxer-Isakson bill differs from what the President is proposing. I have not seen details yet on what the President is proposing so I am not sure if you all have, and if you have, it would be helpful to give some insight.

Mr. SMITH. I, for one, have not seen the President's bill, so I——

Mr. CALABRIA. I would say I have not seen the President's bill. I am not sure that there is a detailed plan. But it would seem to me to be the difference is—I mean, the concept is the same. You are going to try to refinance underwater borrowers. There certainly are a couple important questions that would go along with that.

One, is it voluntary, and under the Isakson-Boxer bill it seems like the borrower has to come forth and request. What are the fees that are going to be waived? What is the LTV going to be? For instance, under the Isakson-Boxer bill, there is no LTV. You could arguably have a 300 percent loan-to-value ratio and you could still get refinanced.

I have a hard time thinking that FHFA on its own—I mean, my understanding is their current discussions at FHFA are to raise the 125 under HARP higher. Again, I would have a hard time seeing it removed altogether. So those, I think, are important details in how it functions, but the core concept is basically the same.

Senator MERKLEY. And Ms. Zelman.

Ms. ZELMAN. Thank you, Senator Merkley. From what I—I have not seen more specifics other than talking. The President mentioned something about a Rebuilding America, which would take foreclosure units through some type of partnership with maybe investors and refurbish foreclosure units. That is the only thing that was mentioned as far as I know in the President's Create Jobs bill.

As it relates to Senator Boxer and Senator Isakson's bill, you know, I think today the Administration is more focused on improving upon the existing HARP program, and I think the challenges of executing implementation of a mass refi are significant and could cause some major unexpected consequences. I am supportive of helping consumers, but I also realize that there could be unexpected consequences, one of which is breaking contract law by waiving appraisals, also the mortgage-backed security investors that today would get prepaid could have significant consequences on the secondary mortgage market as they would lose several hundred basis points of what they have in their portfolios. Also, and more importantly, I think right now, we do not know for certain if these people who are going to be refinanced still do not walk away, if they still have negative equity even though you have reduced their payment.

So I am not against it. I just think it would be difficult to execute successfully with unexpected consequences.

Senator MERKLEY. Thank you. And in that context, do either of you want to share what you think the strengths or weaknesses are of the Boxer-Isakson approach?

Mr. CALABRIA. Well, I think—I will first reiterate something that Senator Isakson said, which is this is not really as much about the housing market as it is about trying to create consumption because you are just refinancing people who are already in their existing home. I think there is actually some argument to be said by lowering their rate, you reduce the chance that they will buy another home in the future because they have to take that into consideration 5 years from now when they might buy a house and the rate might be 6 or 7 percent and they have a four. That is something that is going to interact their decision making.

So I would reiterate, this is not about the housing market. It is about are you creating increased consumption by lowering somebody's monthly payment so that they have money to go and spend it on other things. And so the core of this is about getting the economy going in terms of spending.

The question that I have in my mind, which essentially is an empirical question and I do not really know if there is any way you can answer it without a fairly detailed study, is a mortgage is one person's liability, it is another person's asset. So you are increasing somebody else's wealth by reducing their monthly payment. You are decreasing somebody else's wealth by reducing their bond payment.

It is not clear to me as an economist that the effect on consumption is going to be any different than zero. So I think that that is something that needs to be studied fairly significantly before we know there is actually a positive consumption impact. And again, my read of it and my read of Senator Isakson's statements is this is all about trying to create a boost to consumption, and that is where the focus should be.

I would raise one concern. I will preface, I am an economist, not a constitutional lawyer. But the resubordination of second liens within the bill strikes me as coming very close to a takings, and I certainly think that somebody—any investor out there who has got a pool of second mortgages is likely to challenge that. I can almost guarantee you that somebody will challenge that in court. But again——

Senator MERKLEY. If I understand right, this person in the second position would be in no worse shape than they are currently. So they do not suffer, if you will, a reduction of their position, and it is contingent upon access to a future privilege, if I understood the bill correctly. It cannot be a taking if they are not in a worse position——

Mr. CALABRIA. Exactly. So it would depend on how—well, it would depend on how it would be interpreted. You would argue that you would be in a better position with the refinance, but I think that is something that would definitely be dragged out in the courts. And again, we have seen this, for instance, in the Countrywide settlements and——

Senator MERKLEY. Yes. Yes. No, it gets messy quickly.

Mr. CALABRIA. Yes.

Senator MERKLEY. Mr. Smith.

Mr. SMITH. Sir, I think Senator Isakson said it well in his statement that this was not going to impact sales. It was to create stability where stability does not exist. And arguably, it is complex. It will run afoul of contract law in general, I believe. But given the circumstances, which are unique, and given the possibility of strategic default, which is a real event happening on a daily basis, this is an attempt on the part of Congress to get ahead of that, as Senator Boxer said, and to be more proactive than we have been in the past. So I applaud that effort and I fully recognize there are a lot of details that are going to have to be worked out. But I think the end goal is to create stability where it does not exist.

Senator MERKLEY. Thank you all very much.

Chairman MENENDEZ. Let me take advantage of one more set of questions before I bring over our next panel. We love having your expertise here.

So, just so I understand well, Ms. Zelman, in reference to getting an asset class that would be purchased and then rented, what is the incentive there? Is it just market incentive or is it something

the Government will do, and what is the guarantee that the person will move toward a rental along the way?

Ms. ZELMAN. Well, first, there is very strong demand for the rental product. With respect to occupancies right now, they are in the 90 percent range. So I think that the incentive to the Government is to allow for an orderly disposition to a product that is deflating the current market and do so with a rental would basically mitigate that from occurring. So their recoveries on the assets would actually stabilize and we would see the cost of holding these REO the cost of holding REO every day is annually running about 12 percent, 1 percent per month to pay for property insurance, taxes, safeguarding the property. All of those are mitigating or increasing severities daily. So we would stabilize the losses or reduce the losses on the Government balance sheet and we would put people in homes that cannot afford to buy them through investors purchasing them with provided leverage.

Chairman MENENDEZ. And finally, under the guise of do no harm that Mr. Calabria has suggested, it seems to me that if we do not act and have the mortgage loan limits at the end of this month expire, the higher loan limits, it is going to further destabilize the mortgage market. Certainly, I hope that our legislation, the Home Ownership Affordability Act of 2011, which Senator Isakson and I have introduced so that we can keep the maximum loan limit right now for the next 2 years for FHA, VA, and GSE insured home loans, will take effect. If it does not, what is the consequences of that, briefly.

Mr. SMITH. Well, you would substantially limit the availability of financing in certain markets. To a point that was made earlier by one of the panelists, there are certain markets in the United States that are high-cost markets. They are going to suffer, principally the coastal markets, I think, in an environment that is as fragile as this one.

Further limiting the availability of credit, to Ivy's point, is not a good strategy. It is certainly not going to be helpful. The unintended consequence will be a slowdown in sales and, again, the restriction of credit, and I think that is a bad outcome given the environment.

Mr. CALABRIA. As an economist, I am always reluctant to generalize from anecdote, particularly my own, but it seemed like an appropriate place to start since I am in the middle of a refinancing and I live here in the District of Columbia. And as you could imagine, prices are kind of expensive here and it is a market in which it is going to go down. And the options that are facing me are getting a loan just below that limit and a soft second at a higher rate.

Now, looking at the rates I have been offered, 4.25 for my first one and 4.5 for the soft second, that does not strike me as terribly onerous to me. I am not happy about it necessarily, but I recognize I think we need to transition at some point, sooner rather than later. I do remember in the past when many of us tried to fix Freddie and Fannie in the past and we were told the housing market was too strong then, and now we are told it is too weak. So those who say we should not ever do anything about Freddie and Fannie, maybe they could at least help me detail what are the mar-

ket qualifications in which we are able to take reform and so when I get there I can know.

But I do think that, *A,* if you look at the segment of the market that is there that we would shift, there is a tremendous amount of bank capacity to do that. So we are not talking a very large segment of the market. We are talking fairly high income. So I guess my point would be I think we need to start transitioning away from Freddie, Fannie, FHA, to the private market. I am very open to ways to do that and say which part should go first. But maybe it is the progressive deep inside of me that says rich people are the place to start.

Ms. ZELMAN. Well, Mr. Chairman——

Chairman MENENDEZ. I am tempted, but I will just go on.

[Laughter.]

Ms. ZELMAN. Mr. Chairman, in response to the—we believe, as well—I believe that conforming loan limits should not be allowed to roll back to their normal limits. Looking at FHA endorsements, the negative impact, at least for FHA, quantified for the Nation would be approximately 3 percent. The hardest-hit States would be Connecticut and the District, Washington, about 8 percent with respect to FHA.

I would say when you look at the level of sales activity, let me put it in perspective for you today. We are running at 300,000 annualized new home sales. This is an all-time record low, since records have been ever kept. We are at housing start levels today approximately 600,000. That level of housing starts compares to 1982's trough when unemployment was 10.7 percent and mortgage rates were 16 to 18 percent were over a million. We are at such a depressed level of activity. Even though existing home sales have actually been increasing, if you excluded foreclosures, distress sales, which are deflationary, we are at all time record low traditional home sales. So putting that in perspective, anything that you take away from housing today is going to be a negative in further eroding the level of sales and activity, putting further pressure on home prices.

Chairman MENENDEZ. I appreciate that. That is my concern.

With thanks to the panel, we appreciate your insights. I look forward to being able to continue to pick your brains as we move through this process and thank you very much.

Let me call up our next panel and ask them to come forward to the witness table. David Stevens is the President and CEO of the Mortgage Bankers Association in Washington, and prior to this current position, he was the Federal Housing Administration, FHA's, Commissioner, appointed by President Obama, confirmed by the U.S. Senate. Many Members of the Committee have worked constructively with Mr. Stevens and I am pleased to welcome him back to the Committee one more time.

Marcia Griffin is the President and Founder of HomeFree-USA, which is a nonprofit home ownership development, foreclosure intervention, and financial empowerment organization. Ms. Griffin was moved to found HomeFree-USA after working at a loan servicing center and witnessing firsthand the abuses that many families were subjected to. Her experience will be very informative for the Committee and I thank her for her presence today.

Mark Zandi is the Chief Economist of Moody's Analytics, where he directs research in analytics. Some of Mr. Zandi's recent research has looked at the causes of mortgage foreclosure, personal bankruptcy, as well as appropriate policy responses to bubbles in asset markets. He has been quoted widely by major media outlets and has appeared before many of the Senate's committees as well as this one. We are thankful to have his expertise with us again.

Dr. Anthony Sanders is a Professor of Finance in the School of Management at George Mason University. He has previously taught at the University of Chicago, the University of Texas, the Ohio State University, and although he is from Rumson, New Jersey, we wish he would come back and teach somewhere like Princeton or Rutgers.

[Laughter.]

Chairman MENENDEZ. His research and teaching focuses on financial institutions, capital markets, real estate, finance and investment. We welcome him to the Committee again.

And Professor Christopher Mayer is the Paul Milstein Professor of Real Estate and Codirector of the Richmond Center for Business Law and Public Policy at Columbia Business School. I would like to see your business card. There must be a lot of room on that card to get that all in. His research explores many topics in real estate, financial markets, including real estate cycles, credit markets, debt securitization, mortgages, and many other topics. He has advised many policy makers in the past and we look forward to his testimony and expertise today.

Thank you all. As I said to the previous panel, we are going to include your full statements for the record. We ask you to synthesize your statement in about 5 minutes or so so we can have a discussion.

With that, Mr. Stevens, welcome back and we look forward to your testimony.

STATEMENT OF DAVID STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION

Mr. STEVENS. Thank you, Chairman Menendez, for the opportunity to be here today and talk about ideas for refinancing and restructuring mortgage loans.

I am encouraged that the focus of today's hearing is toward the future and the role that private capital can play in driving our housing recovery. MBA and its members strongly believe that housing will be a key factor to our economic recovery.

The MBA recognizes that our ability to effect change depends on rebuilding badly shaken trust by restoring credibility, transparency, and integrity to our industry. We all know that there are many who share responsibility for the mistakes that led us to this place, including mortgage bankers and servicers. However, rather than pointing fingers today, all stakeholders need to work together to stabilize and revitalize the housing industry. MBA is grateful for the variety of relief efforts undertaken by Congress and two Administrations, including HARP, HAMP, 2MP, and the variety of other efforts that have been implemented. Clearly, the challenge is greater than these programs could support on their own.

Mortgage services have already participated by completing 4.8 million loan modifications in the last 4 years, and any successful solution must include those entities as part of the effort. Additionally, any new programs must give lenders adequate time to implement these changes.

In searching for solutions, MBA members continue to be concerned about the ongoing conflicting policy objectives emanating from all stakeholders. The regulatory and legal ambiguity is causing consumers to pay an uncertainty premium in the form of increased costs and diminished access to credit. The MBA recently convened a task force to develop new solutions to reinvigorate the housing market by bringing private capital back to absorb excess supply. We believe any program to help spur the housing recovery should be prioritized in the following order, and I elaborate on each of these in my written testimony.

First, we need to help the large number of borrowers unable to refinance at today's near record low interest rates. While policy makers have introduced programs to help some distressed borrowers, eligibility criteria excludes a significant number of borrowers who would benefit from refinancing. Some advocates have called for other types of large scale mortgage refinance programs that would include principal forgiveness by lenders and new mortgage rates below current market rates. Although such programs could have a positive impact on the housing market and the economy, the CBO and other analysts indicate that the programs could also entail significantly higher costs.

The MBA believes the preferred approach is adjusting the guidelines of existing programs. Policy makers should consider reducing the GSE's loan level price adjustments on HARP-eligible loans, which would reduce costs to borrowers that are arguably unnecessary because the GSEs already assume the credit risk of the existing loan. Other options include considering streamlining the appraisal process and closing requirements in order to reduce the time and expense of refinancing and raising HARP's LTV, loan-to-value, requirements to enable more otherwise qualified underwater borrowers to refinance into a lower mortgage rate. Finally, FHFA should expand the loans eligible for HARP refinance to loans that were originated after June 2009.

Senator Menendez and others have suggested a shared appreciation mortgage, where a lender agrees to reduce the principal balance of a troubled borrower's mortgage in exchange for the borrower sharing any future increase in the home's appreciation with the lender. We look forward to further discussions with you on this and other possible solutions to help borrowers.

Second, we should encourage local investment in the existing housing inventory. Local investors understand the local rental market and have a long-term stake in the community. Existing Government programs should be modified to support financing and availability for local investment in rental housing. Unfortunately, individual sales and local investors cannot provide the economies of scale required to recover the housing market, so the MBA also supports bulk investor sales of properties in order to alleviate the REO inventory.

In order for any large scale program to be successful, it needs to be simple, quick to administer, and attractive to investors. Safeguards need to include investor screening, buy and hold covenants, revenue sharing, rehabilitation incentives, though they should not be so restricted as to sabotage the program's success.

We also believe the GSEs should consider a mechanism to allow investors to identify and aggregate REO properties, likely enhancing multiple property sales.

Mr. Chairman, thank you again for the opportunity to testify today. I look forward to working with you and other Members of the Committee to find creative solutions to these critical issues. As we work to attract private capital back to the housing market, I urge you to pay careful attention to the relationship between housing an the overall economy, as well as to the importance of certainty for consumers, lenders, and investors. I believe it is important to remember that no part of the housing market operates in a vacuum. Instead, the housing market is a series of complex but interdependent systems, and well-intentioned changes may result in unintended consequences that could result in increased cost and diminished access to credit for consumers.

I look forward to taking your questions.

Chairman MENENDEZ. Thank you very much.

Ms. Griffin.

STATEMENT OF MARCIA GRIFFIN, PRESIDENT AND FOUNDER, HOMEFREE-USA

Ms. GRIFFIN. Thank you very much, Senator. I appreciate the opportunity to be here with you today.

At HomeFree-USA, we represent the marriage between the interest of the mortgage servicers and the investors and the borrowers. Since this mortgage crisis began in 2008, among our 21—well, we fund 66 organizations there in HomeFree-USA, but 21 of our nonprofit counseling organizations focus primarily on this foreclosure crisis.

I am here to say that despite all that is said and heard, and it is good to hear some great things from the testimonies today, that the people—many of the borrowers that we interact with, and we, as I said, have worked with over 30,000 to date, many of these borrowers cannot afford to pay a mortgage. They perhaps cannot afford to pay the mortgage that they have right now. But they can afford to pay something. These people are employed. They are trying to do the right thing. You know, they want to be good citizens.

We are here certainly on the ground working with—working between the servicers and investors and the borrowers and are here to say that this idea of the shared appreciation modification is a sound one. We encourage and certainly would be honored, you know, to work with you in any way in the bill that Senator Boxer, the Homeowners Responsibility bill, because we want you to know that homeowners do want to be responsible. These borrowers need an opportunity.

And, you know, it is really important, too, that through the work that you are doing and through the work that our Government is doing, we have to really bring back a level of fairness, and this is one of the advantages that the shared appreciation modification

provides. So you reduce the mortgage payment for the person for a period of time so that they can afford to pay that mortgage, and at the back end when they sell the mortgage or they refinance, everyone would share. The investor would share. The homeowner would share in the appreciation.

It is really key as we move forward that these homeowners understand that this is a partnership here. We are trying to work together. I can tell you that the sentiment on the level of the borrowers is simply that the lender is trying to take my home away from me, and everyone that we work with, you know, everyone cannot keep their home, but there are a lot of people who can. And this particular shared appreciation modification program not only would minimize foreclosures, it would increase property values because, obviously, people would not have to move out of their homes. It creates a sense of fairness. It gives people an incentive to stay rather than just walking away, because now there is no incentive when their house is so underwater.

People need to be brought back. We need to give more consideration to our borrowers and give them a sense that we are all working together, the Government, the mortgage industry, the investor. We are all here as a win-win for each other, and with that, I think that is the only way that we are going to be able to turn around our mortgage crisis and really improve the economic conditions of our country.

I thank you very much. You have my much longer written testimony and I am certainly open for any questions that you may have.

Chairman MENENDEZ. Thank you very much.

Mr. Zandi, I see you are technologically advanced. You have your testimony on——

Mr. ZANDI. I do, I do, but these guys have iPads. They are even a step ahead of me.

Chairman MENENDEZ. Oh, OK.

Mr. ZANDI. I have got one, but I just have not really gotten around to working through it yet.

STATEMENT OF MARK ZANDI, CHIEF ECONOMIST AND CO-FOUNDER, MOODY'S ANALYTICS

Mr. ZANDI. I want to thank you for the opportunity. My remarks are my own views, not that of the Moody's Corporation. I will make three points in my remarks. The first point is that the housing and mortgage markets remain under significant stress, and as you pointed out, this is a significant impediment to the economic recovery.

I think the housing market, broadly speaking, has hit bottom, but this is still very unusual. At this point in the economic recovery, housing would be contributing significantly to economic growth.

So, for example, if you look at the economic recovery since World War II, at 2 years into the recovery, and we are now 2 years into this one, housing would have contributed about one-fourth of GDP growth to overall economic activity, and, of course, this go-round, it has not been a contributor at all.

There are two fundamental problems. One is excess vacant inventory because of the overbuilding in the boom. We just have way too many vacant homes. By my calculation, the number of excess units is close to 1.25 million, and the current housing demand which is depressed, it will not be until 2013 before we work through that.

The other fundamental problem is, as we have been talking about, the foreclosure issue. By my calculation, there are 3.5 million first mortgage loans that are in foreclosure, or 120 days delinquent and, thus, obviously pretty close. And at the current of resolving these foreclosed properties, it will not be until 2015–2016 before we work through those properties. So a long haul.

Given that, this gets to point number two and that is, I think, policy makers should consider a number of steps to help facilitate addressing the excess inventory and foreclosure issue. There are a number of initiatives that are underway that I think are helpful.

The Neighborhood Stabilization Fund, the President proposed some more money for that in the American Jobs Act, I believe about $15 billion. I think it is a very popular program and is very helpful for blighted communities. The Administration has also proposed trying to facilitate efforts by Fannie and Freddie to partner with private investors to move their REO to rental as opposed to selling it into the marketplace and driving down prices, and I think that is a laudable goal.

And then your own effort with regard to shared appreciation mortgages, I think, is a good initiative and I think it has significant potential for helping in this regard.

I would suggest two other things that could help quickly and meaningfully. First is, and this has been proposed already by many of the members of the group, that is, I would not allow the conforming loan limits—the higher conforming loan limits to expire.

I was of a different view at the beginning of the year. I understand the argument that it is important that Government steps out of the market to see if we cannot get the private market back up and running and stepping in. That is something we need to do.

And at the beginning of the year when the housing market and the economy looked better, I thought this would be a good opportunity to take a crack at it, but given what is happening in the economy and the housing market, I think that would be an error at this point. I would at least extend the conforming loan limits, current conforming loan limits for another year.

The second thing I would do is I would HARP. You know, HARP is a reasonable program. It has fallen short of goals, but 850,000 folks have benefited from the program. The President, when he proposed the program back in '09, had a goal of 4 to 5 million. I think that should be the goal. And I think there are a few things that could be done to the program to get to that goal.

The most obvious policy step to facilitate more mortgage financing is rolling back the GSE's loan level pricing adjustments. This is a key part of Senator Boxer and Senator Isakson's legislation and why I support it. That just makes eminent sense to me, and I think that should be done.

I think efforts to streamline the underwriting process is very, very important with respect to appraisals, with respect to income

verification. The GSEs own this credit risk and we can work through these underwriting issues more quickly, lower the costs so that closing costs are lower for borrowers.

Third, I think it would be important for Fannie and Freddie to think about waiving reps and warranties on HARP loans. These are loans under the current program that had to have been originated more than several years ago, January 2009. So I think it is perfectly prudent to allow that to be waived. There are a number of other things that are in my testimony, but I think I would do that.

Finally, let me just end by saying that this is going to be hard. There is no magic bullet here. All the things we are talking about here are on the margin. This is going to take a long time. So everyone's expectations should be in the right place.

And moreover, I think it is important not to overreach. Uncertainty is an issue in the mortgage market and I think what lenders, servicers, everyone needs is policy clarity so they can nail this thing down. Thank you.

Chairman MENENDEZ. Thank you. Dr. Sanders.

STATEMENT OF ANTHONY B. SANDERS, DISTINGUISHED PROFESSOR OF REAL ESTATE FINANCE, AND SENIOR SCHOLAR, THE MERCATUS CENTER, GEORGE MASON UNIVERSITY

Mr. SANDERS. Thank you, Mr. Chairman——

Chairman MENENDEZ. If you would just put your microphone on?

Mr. SANDERS. And I will start over again. Thank you for the opportunity to speak to you today and thank you for reminding me that I wish I was at Princeton.

According to the recent data, owner equity in the household real estate fell around $7.4 trillion from the peak of the housing market to today. Headline unemployment remains at 9.1 percent. Real GDP is under 2 percent. And real personal consumption expenditures fell in the second quarter of 2011. So we can see we have a major problem still on our hands.

One way to jump-start the economy and reduce mortgages that default is to streamline mortgage financing. When you add the additional savings to borrowers' disposal income, they might spend it in the economy or reduce delinquency and default, and that is a very tempting thing to look at.

We have discussed why borrowers have not been able to refinance, due to degraded credit after the housing market collapse; negative equity; and servicing industry conflicts. To be sure, streamlining the mortgage financing process could help American households stimulate the economy and reduce defaults.

The CBO, however, using a stylized program, estimated that 2.9 million mortgages would be refinanced—again, this is not under any specific program—and that would lead to 111,000 few defaults on these loans. But 2.9 million mortgages being refinanced at 4 percent or so would generate about $7.4 billion for the economy in the first year. Depending on the assumptions, that could, of course, be higher or lower.

In many of the high LTV loans we are talking about in some of these programs are located in Florida, Arizona, and California, so the stimulus effect would be more concentrated in those States.

The stimulative benefits of $7.4 billion in 1 year, after the refis take place, are actually relatively small compared with personal consumption expenditures, which in the second quarter of 2011, were $9.43 trillion. So again, $7.4 billion as a percentage of $9.43 trillion is much less than 1 percent added. So I am not sure it is going to have the stimulative effect that someone would like to see, unless, of course, the program is much larger than the CBO is estimating.

Another way to stimulate the housing market is to raise the conforming limits for 1 year or 2 years. As I opined in previous testimony before the House Financial Services Committee with regard to a draw-down plan for Freddie and Fannie, I felt it was appropriate to reduce the conforming loan limit to allow the private sector back in the market.

However, I stated that if the housing market stalled, which it has, then alternative strategies to be considered are regarding the conforming loan limit such as letting it stay in place for an additional year or two until the housing market gets back on its feet and running.

Now, Senator Menendez has proposed an interesting idea and that is a shared appreciation mortgage solution to try to overcome the negative equity problem. The shared appreciation mortgage, or SAM, has been used in the United States for decades, although in low volumes, has been tried in the United Kingdom to permit borrowers who have paid down their principal, for example, 50 percent of their share of equity in return for, say 50 percent of future gains in house price.

The Menendez proposal has a similar intention. The borrower receives a write-down of principal, or such, in exchange for giving away a percentage of appreciation and property value in the future.

Now, there are problems with the SAMs, twofold. First, capital markets have shown very little interest in it as a product for investment, so generally, if you make it, you have to keep it on your books. But second, there are some moral hazard problems related to the incentive to maintain property once someone receives the capital gain.

The third problem in the Menendez proposal has solved and that is about trying to get independent appraisals. So again, it has some issues, but it also has tremendous potential, and it is one thing I would like to see them do a trial program for SAMs. Now, whether or not this is done by private financial institutions or the GSEs is a topic for later debate.

But again, I think it is one of the most innovative ways to try to get out of the negative equity problem, because as I said earlier, the program from Isakson and Boxer, I think, when looked at the numbers, I looked at the CBO report, I do not think that is going to get us much truck. But I think this one has better legs on it.

Thank you very much for the opportunity to testify.

Chairman MENENDEZ. Thank you, Professor. Mr. Mayer.

STATEMENT OF CHRISTOPHER J. MAYER, PAUL MILSTEIN PROFESSOR OF REAL ESTATE, COLUMBIA BUSINESS SCHOOL

Mr. MAYER. Thank you very much, Chairman Menendez. I appreciate the opportunity to be here today. Ten-year Treasury rates are

as low as they have been since the Great Depression. Nonetheless, too few borrowers have been able to take advantage of low interest rates to refinance their mortgage hampering monetary policy and dampening consumer spending.

Unable to refinance their debt the way corporations have, consumers are left with weak balance sheets and mortgage payments often above the cost of renting, contributing to excess delinquencies, foreclosures, and falling home prices.

Numerous frictions contribute to the slow rate of refinancing. The GSEs charge up-front fees for refinancing a mortgage for borrowers with moderate credit and the loan-to-value ratio of 60 percent or more. Lender fears of litigation from reps and warranties further discourage refinancing. Many borrowers are underwater.

A streamlined refinancing program could benefit 25 million or more borrowers with Government-backed mortgages. Decreasing annual mortgage payments by up to $70 billion, about $2,800 per year per borrower. The majority of savings accrue to borrowers whose original mortgage was under $200,000.

This plan would function like a long-lasting middle class tax cut without impacting the budget deficit. A copy of this proposal made with coauthors Alan Boyce and Glenn Hubbard is attached to my testimony, along with a State-by-State breakdown of benefits under this program.

Under our plan, every homeowner with a GSE or FHE or VA mortgage can refinance his mortgage at a current fixed rate of 4.2 percent or less, with the rate subject to changes in the market price of bonds. So it is a market rate. FHA borrowers would face slightly higher rates.

To qualify, the homeowner must be current on his or her mortgage, or become so for at least 3 months. This plan rewards responsible borrowers. These must be low-cost, minimal paperwork refinancing, no appraisals, no income verification, no tax returns, and a minimal title insurance policy. After all, the Government already guarantees these mortgages.

Issuers of new mortgages would be indemnified against other reps and warranties violations, a critical part of this program. Under our plan, the GSEs would charge a guaranteed fee of 40 basis points per year, more than offsetting any losses they might face.

The GSEs would also benefit through fewer defaults by borrowers with lower mortgage rates. Our plan would pay 30 basis points per year to cover the cost of originating and servicing new mortgages, making it possible for originators and servicers, making it profitable for originators and servicers, given the streamlined process.

The plan must be attractive to market participants. Servicers should have a short period of time to offer this program to their customers on an exclusive basis, but only a short time. Existing servicers, including the largest banks, benefit by lower legal liabilities associated with reps and warranties violations.

Second liens and home equity lines of credit are safer when borrowers have lower first mortgage payments. Banks should find streamlines refinancings increase both profits and customer satis-

faction. Mortgage insurers and second lien holders should be required to modify policies and claims to facilitate this plan.

The housing market benefits from our program. Lower mortgage payments, reduced future defaults helping stabilize house prices. More free financing activity should improve consumer confidence in the financial viability of being a homeowner. Reducing financial pressure on servicers, originators, and mortgage insurers will help the mortgage market start to recover, enabling new home buyers to get mortgages.

Most gains from this plan come at the expense of investors who understood and accepted interest rate risk. Private sector or foreign owners hold about two-thirds of GSE bonds. Agency bondholders have received unanticipated windfall from many Government actions during the crisis, including policies that led to extremely low refinancing rates, the decision to explicitly guarantee GSE bonds against losses, and the Federal Reserve's purchase of 1.25 trillion of agency mortgage-backed securities.

Even with potential losses, some bondholders such as PICO have publicly supported this plan because of its benefits to the economy. Implementing this proposal would have a tremendous affect and make a real difference on families. Until we fix the housing market, it will be hard for the economy to recover.

I have also responded—put forward a proposal to RFI and I very much support a number of the other proposals that people on this panel, the previous panel, have made, including the expansion of private institutional capital for rental, encouraging efforts, such efforts, to have local partners, and to provide responsible financing for investors who are going to come in and help absorb some of the excess inventory.

I also think that there are many things that one could do as shared appreciation mortgages, and one idea that I would toss out to add to the mix is the idea of not necessarily just tying it to one mortgage, but have that payback be across gains from other residential property over time which might make such a shared appreciation mortgage safer for the lenders who do it and bring it closer to kind of, I think, a cost-effective basis. So I think there is a lot of positives to do here.

So I appreciate the opportunity and be happy to answer questions.

Chairman MENENDEZ. Well, thank you all very much. It is a broad swath of ideas. Let me start off taking off of your suggestion, Mr. Mayer, and asking the panel in a broader context beyond Mr. Mayer's specific proposal, is it not, at the end of the day, I look at this and I say, Well, who is the biggest holder of the major part of—significant part of the liability here? It is Fannie and Freddie. And who is Fannie and Freddie? It is the American taxpayer at the end of the day.

So would it not make sense for Fannie and Freddie to seek initiatives that mitigate the potential of its, you know, bosses and help us moving in the mortgage market? So that is a broad proposition, but I just do not get the sense that that is where Fannie and Freddie are headed, at least at this point in time. Are there observations about that? Am I wrong on this?

Mr. STEVENS. I think like everything we talk about here, Senator, as you are well-aware and have been actively engaged, these questions are often more complicated than the answer. Actually, the answer is more complicated than the question.

The challenge of Fannie and Freddie is they are—they still are essentially independent companies in conservatorship. They have cost the taxpayers $150 billion. It is acknowledged, at least by their conservator, that they were under-pricing the guarantee fees when they originated these loans.

And so, I think the tradeoff we have to consider as we utilize these two agencies, which are critically important, obviously, considering the size and scope and influence on the housing market, is it is clearly recognizing with eyes wide open that anything they would do to participate more aggressively, whether it is lowering loan level price adjustments or changing loan-to-value requirements or reducing documentation or relieving reps and warranties or all these things are being discussed, that those are all—those bring incremental risk associated with each of those steps.

And as long as that is acknowledged and recognized in the process, I think good decisions can be made. I think it is difficult, however, because they are in conservatorship and there is no clear direct governance capability here, that it makes it much more difficult to direct them to take action, which may not be in their own best interest, especially at a time when they are trying to bring themselves back to a level of operating profitability.

Chairman MENENDEZ. But I would assume—I understand what you are saying, but I would assume the conservatorship, ultimately its goal is to maximize or limit, actually, the scope of the liabilities at the end of the day. And it just seems to me that you have this stated public policy goal of trying to limit the liabilities, and yet, not being able to do some of the things that are essential to limit those liabilities.

Mr. STEVENS. And you are absolutely right. I mean, even the CBO, which is, I am sure, not the most detailed at this point because we do not know what the proposed specifics would be on a refinance plan, but it clearly shows that it reduces risk to the GSE's portfolio to make some adjustments, at least to the HARP program, and I think all of—after hearing all the panelists so far, it sounds like there is almost universal belief that there is room to make changes there.

So I think our collective objective as stakeholders has to be to continue those discussions with FHFA and the GSEs in hopes that they do make the changes that are on the margin, would be helpful here, knowing even to Tony's point that while it may not have an extraordinary influence on stimulus, it will have some impact on the 2.9 million families who would potentially benefit from it.

Chairman MENENDEZ. Any other observations from anyone?

Mr. ZANDI. Well, I think if you look at the CBO work of the assessment of the Boxer-Isakson plan, Fannie and Freddie come out even, at least, to make a little bit of money on the deal. It costs the Federal Reserve money on a mark-to-market basis, but it is important to point out that the Fed is holding these securities to maturity, and they do not mark their books. So this is just an accounting loss. It is nothing more than that.

So, there are ways to do things here that do not cost taxpayers money at all, any money, and I think this is one of those things. Yes, it is true Fannie and Freddie are going to take on some additional risk here, there are some costs here, but they are also reducing the potential for default and credit loss, and so net looks like it is a wash, maybe a little bit down.

The thing I would point out is if HARP hits its goal of 4 to 5 million borrowers and that is another, say, 4 million borrowers who get refinanced down and let us say they go from—the average coupon or the median coupon on a Fannie or Freddie loan is 5.5 percent.

So you have got half of borrowers that are over 5.5 percent. Let us say they can refi down to 4.25 percent, or something like that. They save a little over a percentage point. You do the math, that is about $10 billion in annualized interest payments. That is not going to solve our problems, but that is not insignificant, particularly with those households, and many of them are in very distressed parts of the country which could use that cash and use that money. It is something that could happen quickly.

Chairman MENENDEZ. But we would have to change HARP from where it is now to accomplish that.

Mr. ZANDI. Well, Fannie and Freddie, through the FHFA would have to make some modest adjustments, roll back the LLPAs, make some adjustments with reps and warranties, look at underwriting and the cost of underwriting and appraisals, maybe even, I think, change policy and become a little bit more proactive in reaching out to potential borrowers because right now they do not do that.

They reach out and say, you can make a real saving on your monthly mortgage payment if you did this. These are the kinds that are reasonable to do. I do not think they are difficult to do and I think they could make a difference, a substantive difference.

Chairman MENENDEZ. Professor.

Mr. SANDERS. Thank you. First of all, I do agree with what Dave said. While it is trivial in terms of percentage of the consumption expenditures for consumers, it is 2.9 million would really appreciate the help, I am sure.

The one part of the CBO report, and I have greatest respect for the CBO, in particularly Professor Lucas, is I am a little squishy on the benefits to the GSEs from this program. I have not heard Fannie, Freddie, or the FHFA come out with any positive statements regarding it in that respect, so I am a little nervous that it may be overestimated.

So I would actually make it more on the decision, do we really think it is going to help borrowers avoid default and would it actually help stimulate the economy? I think those are the bigger selling points. But again, I think that the—I sure like the shared appreciation mortgage idea the best.

Mr. MAYER. I would observe a couple of things. One, we have referred a little bit to the CBO report. I would cite private sector estimates from Goldman and Sachs, J.P. Morgan, Morgan Stanley, even work that Mark has done that suggests an appropriately structured program would generate $25 to $50 billion a year.

The J.P. Morgan report came out after the CBO report. They respectfully disagreed. I am not sure anybody on Wall Street thinks that a well-structured program would be as small as the CBO estimated. So I do think there are good reasons to believe that this would have a much bigger stimulus on the economy than the CBO suggested.

I just point out that in 2002 and 2003, the last time rates fell like they have so far this time, about 85 percent of borrowers who could save 100 basis points on their loan took advantage of prepaying over a 2-year period. The CBO estimates a take-up rate, even among the most constrained households, of 30 percent.

So I think there the CBO estimate, predominantly on the take-up rate, has been a bit conservative relative to kind of other folks. I would go out and say, I think this can be a much bigger effort. The key is appropriately structuring this, and you rightly pointed out, Senator Menendez, that conservatorship is a real barrier to this.

I think there are a number of ways to deal with that. One of them is, if it does look like this is not so neutral to the GSEs, as Professor Sanders has talked about, you could raise the GSE fee a little bit—sorry—the GE fee, the guarantee fee a little bit under such a program, which would ensure it was a budget-neutral program to other parties and still benefit homeowners enormously.

So I think the other thing that we have not discussed that is really critical is mortgage insurance. There are a large number of people, estimated 25 percent of the population, that will not even get inside a door without a deal to think about mortgage insurance. So they have to be brought into the mix as well importantly.

Chairman MENENDEZ. What about the—I raised this with the previous panel—about the QRMs, the 20 percent? It seems to me we take out a huge class of individuals in the country who could be responsible borrowers and help us in this process. Are there views on that, Mr. Stevens?

Mr. STEVENS. Yes, I completely agree. I think that the intentions of QRM were very dead-on accurate and effective in terms of eliminating products with high risk characteristics. So the QRM, as we all know, requires limits to owner-occupied primary residence, full amortizing loans, loans that are fully documented.

When you look at the actual default data, if you isolate to those characteristics and not bring in the downpayment requirement that is in QRM, you have solved 95 percent of the problem just simply by isolating those characteristics.

The problem with downpayment, once you throw that variable in, is it becomes particularly punitive to families without amassed wealth or high income earners. And so, it tends to hit those that need access to affordable home ownership the most, first-time home buyers, African Americans, Latinos, traditionally demographics in this society that do not have large amounts of inherited wealth and maybe, at least demographically, at the lower end of the income earning spectrum simply the way that incomes are structured in this country.

So we believe that you can implement a very safe and sound QRM rule based on all the parameters, but that the loan-to-value requirement ends up being particularly punitive and is likely to set

up some sort of separate but equal financing system where a certain set of Americans go to FHA for all their mortgages and then the wealthy get some other products set through QRM, and that is something that I think we are very concerned about as an organization looking at making sure there is available liquidity for all Americans who can responsibly pay for a home mortgage over the years to come.

Chairman MENENDEZ. Ms. Griffin.

Ms. GRIFFIN. I just wanted to mention one thing, Senator, if I could on your last question. I did not respond to that. I am going to let the experts talk about the mortgage side of it. But where Fannie and Freddie are concerned, I am going to say that, you know, I just do not think they know what to do and that is why having you and our Senate and our Congress are so important.

I think they really are trying to, with the conservatorship and with FHFA, are trying to figure out a long-term profitable arrangement that will benefit the taxpayers. I can say that Fannie and Freddie both, on the ground, have created environments where they are reaching out to homeowners in a very unique way, using counseling organizations, setting up borrower help centers and mortgage help centers, and really using people who can interact on a face-to-face basis with these homeowners and influence their behavior and really help the servicers on the back end to make a determination help these people, as to whether they can keep their mortgage or not, and also help—if a lot of people are not going to be able to stay in their homes, what will happen to these families?

Someone has to deal with this, and I just want to encourage you and encourage FHFA and the GSEs and FHA. You know, the counseling environment is so important because we are on the ground with these homeowners and home buyers. We can convince them, we can work with them, we can help them to understand what they should and should not do.

Chairman MENENDEZ. Very good. Thank you. Mr. Zandi.

Mr. ZANDI. Turning back to QRM, I think the QRM, as currently proposed, is overly restrictive for two reasons. One, I think Dave said it nicely. If you look at credit risk at higher LTDs or lower downpayments, I think there is strong evidence that it makes perfect sense to allow for lower downpayment loans, that it is not—after you control for all the other risk factors, it is perfectly reasonable to allow for lower downpayment loans.

The second reason, and this goes to broader GSE reform, if you look at the FHFA data, under the current rule, I believe, over time on average, only about a third of all mortgage loans are QRM. And so, in a future world we do something about the GSEs, I think that would be very restrictive.

It would mean that Government's role in the mortgage market would be very, very limited, and I think that leads to all kinds of problems with respect to the ability for borrowers to get 30-year fixed rate mortgages, the cost of mortgage credit to borrowers.

I think a more reasonable goal would be something closer to two-thirds of mortgages, and if you adjust the LTD requirement and allow for lower downpayments, you can, I think, quite reasonably get to about two-thirds of the market and I think that is a much more reasonable goal, not only with respect to what is happening

now, but long run in what we are going to do about the mortgage market and Government's role in the mortgage market.

Chairman MENENDEZ. Dr. Sanders.

Mr. SANDERS. Just to add to what Dave and Mark said, you can actually go to the FHA Web site and they actually have the listing of the data and what loans would qualify under QRM, and it is very, very restrictive. And again, although well-intended legislation died in terms of mortgage lending, does, in a sense, represent a clear and present danger to the future of the housing market if we do not do something about it. Way too restrictive.

Chairman MENENDEZ. Well, it seems like you have universal agreement on that. Hopefully those who are going to make the decision are listening. Mr. Mayer, let me ask you two final questions here and then I will let this panel go. How does your refinance proposal differ from Boxer and Isakson's legislation? If you could give me some sense of that?

Mr. MAYER. Sure. Let me just pull up my notes here. So I think there are several things. As I commented earlier, mortgage insurers are a really big issue that I think we need to address. The mortgage insurance industry, almost all the companies, are rated Single-B. I am not sure their insurance is as good as we would like to count on, as we do now.

So we are going to have to deal with the large number of potential folks who have mortgage insurance, and I think there are ways to do it. But that is going to be one key issue, and reps and warranties is a related issue which gets to the mortgage insurance question. Those issues, I think, are really holding back a lot of people from being able to participate in HARP, and if we do not address them, I do not expect that we are going to get the take-up that we should.

I think, also, trying to take steps to bring down closing costs is important, and I think we have to take seriously what the cost is to the GSE on the balance sheet. I applaud the Congressional Budget Office for having looked at that. But I do think one may need to adjust the G-fee, the guarantee fee a little bit to help adjust to ensure that it scores as a budget-neutral program from the Congressional Budget Office.

But I do think there is some chance that a legislative solution would succeed where we may or may not succeed with an administrative one, particularly some of the parties involved are kind of holding up the process. I do not think, by the way—there was a discussion in the earlier panel on second liens.

I am not sure that resubordination of second liens is actually a big problem today. I think most of the major lenders will do what they see as in their interest, to have a lower payment on the first lien. So I am not sure that is the biggest issue. I think it is in other areas.

Chairman MENENDEZ. One question, Mr. Stevens, while I have you here. It is a question related to your tenure as the Commissioner of the Federal Housing Administration. As I understand, FHA is required to have a capital reserve ratio of 2 percent, and for the past 2 years, the FHA's capital reserve has been below that figure.

So given that number and FHA's critical role in the housing market, are you confident that it can continue to be a source of funding for low and moderate income borrowers?

Mr. STEVENS. Well, as you said, Senator, and other members of the panel have said, FHA is a critical resource for providing financing, particularly to first-time home buyers, and most data shows that in the first-time home buyer market, FHA is making up the vast majority of the funding because of the loan-to-value requirement.

The other variable I would highlight is FHA is one of the few entities in the housing finance system that has operated entirely on its own ability with its own capital.

However, that capital was stressed, it did drop below the threshold of 2 percent on the capital reserve ratio, and the actuarial studies over the last couple of years have expected that the capital ratio would grow and there would be actually net receipts, negative subsidy, as it were, on the budget side.

But all of that assumed that the home price index would show some growth which is the flattening of that index has continued to extend out year after year, and so despite a variety of measures that have been taken under, particularly, Secretary Donovan's administration with raising mortgage insurance premiums three times, changing the underwriting requirements, putting minimum FICO scores in place, changing product terms, eliminating many lenders that were not originating responsibly, it is still subject to the economics of the housing system.

I have no inside information, obviously. I have left the Administration, but I am concerned that just given the softness in the housing market and the seasoning of some of these big portfolios like the 2009 portfolio and other potential impacts from the reverse mortgage program, that there may be some impact to the capital reserve ratio, and I would hate to see it go negative.

The good news about the program, it is operated under the full faith and credit of the U.S. Treasury. But I am certain it will bring extraordinary criticism and focus should it drop negative. The study comes out at the end of the fiscal year that ends at the end of September and usually is released somewhere early November. So I am anxious to see how that fund is doing given all the additional stresses that have occurred in this housing market over the last 12 months.

Chairman MENENDEZ. Well, I am anxious as well. We will have to make sure we pay attention to the report.

Well, thank you all for your input, your expertise. I appreciate all of our witnesses sharing their insights today. I think the testimony here can be very useful in exploring both problems that homeowners face in refinancing and restructuring their loans in ways are potential actions that we can take.

The record is going to remain open—of this hearing—for a week from today if any Senators wish to submit questions for the record. And with the thanks of the Committee, this hearing is adjourned.

[Whereupon, at 3:46 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF SENATOR BARBARA BOXER OF CALIFORNIA

Thank you, Chairman Menendez and Ranking Member DeMint, for scheduling this important hearing and for the opportunity to address the Committee.

Interest rates for 30-year home mortgages are at 4.12 percent—the lowest rate in 60 years. Yet of the 27.5 million mortgages guaranteed by Fannie Mae and Freddie Mac, over 8 million still carry an interest rate at or above 6 percent.

That is why Senator Isakson and I have introduced S. 170, the Helping Responsible Homeowners Act of 2011—and I would also like to thank you, Chairman Menendez, for cosponsoring this bill.

When interest rates were higher, CBO projected this bill would allow up to 2 million additional responsible homeowners to refinance by removing the barriers that have kept them trapped in higher interest rate loans, and it would put thousands of dollars back in the pockets of struggling families. With interest rates now at record lows, we—and many economists—believe that number would be even higher.

Our bipartisan bill has been endorsed by Mark Zandi, chief economist at Moody's Analytics—who will testify later in this hearing—William Gross, managing director and co-CIO of PIMCO, housing economist Thomas Lawler, the National Association of Realtors, the National Consumer Law Center, the National Association of Mortgage Brokers, and others.

One reason existing refinancing efforts have fallen far short of their goals is that Fannie and Freddie continue to charge homeowners high, risk-based fees up front to refinance their loans. Fannie and Freddie already bear the risks on these loans; yet this policy actually makes it less likely that borrowers will be able to take advantage of low rates and increases the chance they will eventually default.

The Helping Responsible Homeowners Act would eliminate these risk-based fees on loans for which Fannie and Freddie already bear the risk, and would also remove refinancing limits on underwater properties for borrowers who have been paying their mortgages on time.

Fannie and Freddie hold or guarantee the mortgages for approximately 5 million homeowners whose homes, through no fault of their own, are now worth less than what they owe. For those borrowers who have been doing the right thing, struggling to make their payments on time, this bill gives them hope—and a reason not to simply walk away.

Although we have introduced this legislation, most of what we propose could be implemented administratively by Fannie and Freddie on their own. We have urged them to take immediate action to remove these barriers and were greatly encouraged to hear President Obama recognize the benefit that doing so could provide in his jobs speech last week.

I was also heartened by the statement issued by the Federal Housing Finance Agency following the President's speech that it is now serious about reducing the barriers that have kept millions of homeowners from refinancing, including those identified in our bill. But it will be important to make sure that FHFA follows through on this commitment.

Implementing the provisions of this bipartisan bill, whether through passage or administratively, would result in up to 54,000 fewer defaults and produce a net savings up to $100 million for Fannie Mae and Freddie Mac.

Homeowners would see immediate relief. A one and a half percent reduction in their interest rate would save the average homeowner with a $150,000 loan over $1,600 annually. And with up to two million additional borrowers refinancing, this would pump up to $3.2 billion annually into the economy.

Interest rates remain at historic lows, and they likely will remain low for the immediate future. But they will not remain low forever. Every day that we wait means more struggling homeowners who fall behind on their payments and greater losses for Fannie Mae and Freddie Mac.

We cannot wait any longer. The Helping Responsible Homeowners Act will be good for borrowers, good for Fannie Mae and Freddie Mac, and good for the economy.

PREPARED STATEMENT OF SENATOR JOHNNY ISAKSON OF GEORGIA

Chairman Menendez, Ranking Member DeMint, and Members of the Committee, thank you for permitting me to attend today's hearing.

I began my career in residential real estate in 1967 as a real estate agent specializing in FHA and VA home sales with an average price of $17,900. In 1968, I experienced the first of four housing recessions I would face during my 33 years in the

business. That first housing recession was brought on by the failed FHA 235 no-downpayment program.

In 1974, I was a branch office manager for Northside Realty in Atlanta when our country experienced what at the time was the worst housing recession our Nation had ever faced. That recession ended in 1976 after Congress passed a $2,000 income tax credit for the purchase of a single family home in 1975. That tax credit effectively reduced a standing vacant 3-year supply of housing to less than a 1-year supply.

In 1981, I was President of Northside Realty, and experienced my third housing recession. Interest rates rose to 16.5 percent, and for the first time ever lenders made negative amortization loans to make monthly payments affordable.

In the late 1980s, the savings and loan crisis caused institutional failures across the Nation, and the Resolution Trust Corporation was created. This brought on the housing recession of 1990–91, and mortgage-backed securities became the primary source of capital to fund residential conventional loans. This is when Freddie Mac and Fannie Mae became dominant in housing finance.

In 1995, I was asked to serve on the advisory board of Fannie Mae. In 1999, I was elected to Congress and stepped down as President of Northside Realty, which had grown into a residential brokerage company with 1,000 agents, 25 offices, 11,000 annual home sales and volume exceeding $2 billion dollars.

During my 33-year career in real estate, I experienced many challenges and difficult markets, but never anything like the current housing market in America. Even some 3 years after the initial collapse, our Nation is still facing a total collapse of new residential construction and development. The upcoming decline in mortgage loan limits on September 30th will only further exacerbate this problem and I encourage my colleagues to support the bipartisan Home ownership Affordability Act of 2011 which will extend, and not change, the current maximum loan limit of $729,750 for 2 years through December 31, 2013, for FHA, VA, and GSE insured home loans. These expirations will make a weak housing market even weaker, and it will make it harder for middle class home buyers in 42 States to get mortgages and buy homes when credit is already tight.

According to a recent CoreLogic report, 10.9 million Americans who borrowed to buy their homes, or 22.7 percent of all homeowners with a mortgage nationwide, are underwater. Congress should allow those that are paying their payments on time and meeting their obligations to refinance at current interest rates to free up capital.

Currently, interest rates for 30-year home mortgages remain at historically low levels—at 4.12 percent. Yet of the 27.5 million mortgages guaranteed by Fannie Mae and Freddie Mac, over 8 million still carry an interest rate at or above 6 percent. For the average homeowner—with a $150,000 loan—lowering the interest rate by 1.5 percent would save $1,600 a year. With up to two million additional borrowers refinancing, this would pump up to $3.2 billion annually into the economy.

The Boxer-Isakson Helping Responsible Homeowners Act of 2011 is a bill which I strongly support. It will help up to two million nondelinquent homeowners refinance their mortgages at historically low interest rates by keeping them in their homes and boosting economic growth.

To remove the barriers preventing responsible borrowers current on their payments from refinancing their loans, I encourage Fannie Mae and Freddie Mac to administratively:

- Eliminate risk-based fees on loans for which Fannie and Freddie already bear the risk;
- Remove refinancing limits on underwater properties;
- Make it easier for borrowers with second mortgages to participate in refinancing programs; and
- Require that borrowers are able to receive a fair interest rate, comparable to that received by any other current borrower who has not suffered a drop in home value.

I was happy to hear that President Obama recognized the benefit of these refinancing provisions in his speech before congress last week and I, along with Senator Boxer, continue to urge that these changes be done administratively by Fannie Mae and Freddie Mac. By removing the barriers that have kept these nondelinquent homeowners trapped in higher interest rate loans, it would put thousands of dollars back in the pockets of struggling families and have a direct impact on the housing sector.

Thank you.

PREPARED STATEMENT OF RICHARD A. SMITH

CHIEF EXECUTIVE OFFICER, REALOGY CORPORATION

SEPTEMBER 14, 2011

Introduction

Good afternoon, Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee. Thank you for the invitation to speak to you this afternoon regarding the state of the U.S. housing market. I am Richard A. Smith, the president and CEO of Realogy Corporation, a global provider of residential and commercial real estate franchise services, real estate brokerage, employee relocation and title insurance services. Our brands and business units include Better Homes and Gardens® Real Estate, Century 21®, Coldwell Banker®, Coldwell Banker Commercial®, The Corcoran Group®, ERA®, Sotheby's International Realty®, NRT, LLC, Cartus, and Title Resource Group. Collectively Realogy's franchise system members operate approximately 14,400 offices, with operations in all 50 States and 100 countries and territories around the world. We are headquartered in New Jersey.

State of Housing

I will open my comments with the statement that in our view existing home sales appear to have essentially bottomed, and the national average sales price for existing homes is close to its low. New home sales have reached historic lows and may still see slight downside on both unit sales and average sale prices.

From its peak at 8.3 million total new and existing home sale units in 2005 and an average national sales price of $271,000, the U.S. housing market steadily declined to 5.2 million total units in 2010 and an average national sales price of $223,000,[1] and thus far has recorded a peak-to-trough price correction of approximately 30 percent. This has been the worst housing correction on record. The headwinds of the past almost 6 years have been substantial and persistently stubborn. In spite of enormous challenges, we believe housing in the macro sense appears to have essentially stabilized for now, although at depressed levels.

The current industry forecasts for full-year 2011 and 2012 call for annualized existing home sales in the range of 4.9 million to 5.1 million units, and the median sales price is expected to go from a range of down 3 percent to down 4 percent year-over-year in 2011 to between minus 1 percent and plus 2 percent in 2012.[2] Residential real estate values and home sales are historically determined by local market influences such as the local job market, population growth, quality of the schools, quality of life, and the features of the home relative to the local market. The macroeconomics have substantially influenced home sales during the past 6 years. Insomuch that housing activity is now beginning to vary market-by-market it appears that the microeconomics are beginning to overshadow the macroeconomics, which is certainly a good sign.

The current housing market, although stabilized, is at depressed levels both in terms of sales and price. But the good news is we have a stabilizing market. The not-so-good news is that it is very fragile and only functioning for limited segments of the market. The make-up of the market is noticeably different than it was just 5 years ago. The very high end of the market, characterized as all-cash buyers, has been very active representing a large percentage of sales in many of the major markets. The balance of the market has been dominated by first-time buyers and investors. The first-time buyer is compelled by historically low mortgage rates and unprecedented pricing. In many of our markets, take Florida as an example, more than 50 percent of our sales are all cash. The middle of the market, characterized by the move-up buyer, is noticeably absent. By most accounts about 25 percent of homeowners are "underwater" on their mortgages,[3] meaning that they have little to no equity and thus cannot sell their current house to "move up" to the next home. That has clearly had a major impact on national home sales.

Investors, on the other hand, have a seemingly endless appetite for distressed and foreclosed homes. As one of the largest brokers of foreclosed homes in the United States, we currently have about 60 percent of our distressed inventory being sold to investors with the balance going to first-time buyers as owner-occupied homes. The investors are all-cash buyers and the first-time buyer is typically using FHA financing with less than a 20 percent downpayment. Our REO, or Real Estate Owned, inventory, which we believe is representative of the national foreclosed

[1] National Association of Realtors (NAR) historical data.

[2] NAR Economic Outlook, September 2011; and Fannie Mae Housing Forecast, August 2011.

[3] "New CoreLogic Data Reveals Q2 Negative Equity Declines", Sept. 13, 2011; and Zillow Q2 2011 Market Report, Aug. 9, 2011.

housing stock, is typically a 3-bedroom 2-bath home with 1,800 square feet. The list price is typically half the unpaid principal balance and sells within 80 days at 98 percent to 99 percent of the list price. The typical buyer spends $10,000 to $16,000 to prepare the home for occupancy. The market for foreclosed homes is very strong nationwide.

Distressed property sales, often called short sales, involve a lender agreeing to accept a purchase price from a prospective buyer that is less than the remaining principal value of the mortgage. If accepted, the seller is often released from the obligation and the bank avoids the cost and the difficulties of a foreclosure. According to the most recent monthly survey information from the National Association of Realtors, distressed properties—meaning foreclosures and short sales typically sold at deep discounts—accounted for 29 percent of existing home sales in July.

What are buyers experiencing? Mortgage lending, although available, is very difficult. Lenders are requiring unprecedented levels of disclosure and documentation. Appraisals are often conducted by inexperienced personnel with little to no local market experience often resulting in flawed value assessments, the outcome of which is a rejected loan. The market value is no longer determined by what the buyer and seller agrees is a fair price. It is now determined by an appraiser and often an inexperienced one at that.

Renting is certainly in vogue for the moment and given the lack of consumer confidence and the extraordinarily high rates of unemployment, it is not a surprise. In most markets it is more cost effective to own as rents continue to escalate nationally at a rate of 5 percent to 7 percent. In New York City alone, where we are the largest rental broker, year-over-year rents will likely increase this year by 10 percent. Renting is not a long-term solution. In our view, home ownership continues to be the goal of most Americans.

So what is holding back a housing recovery, and what are the solutions? Unfortunately there are no silver bullets. We believe the immediate issues are high unemployment, the persistent overhang of foreclosed properties, low consumer confidence and failed Government intervention programs.

Jobs

Unemployed and underemployed people do not buy homes. So for the purpose of housing, our focus is on the U.S. Bureau of Labor Statistics monthly underemployment report, which as of September is 16.2 percent, a staggering number.[4] When the full-time employment numbers rise, a housing recovery will follow, marked by pricing stability and the return of the move-up buyer.

Foreclosures

The Government's repeated efforts to mitigate the foreclosure problem facing our country have done little but prolong the recovery. In our view, lenders should be permitted to accelerate foreclosures in the cases where reasonable efforts to avoid foreclosures have failed. A resold foreclosed house generates economic value and aids the process of stabilizing local market home values. Delaying the process has the opposite effect. The Government's well-intentioned programs are burdened with extensive layers of red tape that have substantially limited the effectiveness of the effort.

Short Sales

A short sale, an agreement between a mortgage holder and a seller to accept a sale price that is less than the mortgage, could be an effective private sector solution. However, although short sales entail a much improved process compared to foreclosures, the process has been less effective in part because lenders are slow to respond to the purchase offer and a frustrated buyer moves on. Nevertheless, short sales should be encouraged as a superior alternative to foreclosure.

Debt-for-Equity

A debt-for-equity solution is a concept that we believe has merit for underwater homeowners as well as lenders and/or loan servicers. In place of foreclosure, a lender agrees to exchange the outstanding mortgage for a new loan with a lower principal and, equally as important, shares in the equity of the house. The homeowner agrees to maintain the house, stay current on the new loan and when the house is eventually sold the lender receives the proceeds from the retirement of the loan as well as its share of any appreciated value. The full description of the proposal is attached to our submitted comments as an addendum (*see,* Addendum 1, "Debt-for-Equity Solution for Underwater Homeowners").

[4] Bureau of Labor Statistics, Table A-15. Alternative measures of labor underutilization, Sept. 2, 2011.

Assumable Loans

Mortgage rates are at historic lows and locking in those rates for the benefit of future buyers would stimulate current sales. Any Government-backed loan originated during the next 2 years should be assumable for the term of the loan. A new buyer would be required to qualify under current underwriting standards but would assume the historically low interest rate. We believe this provision should apply to any size loan that is Government guaranteed.

Fannie Mae Rental Proposal

Much has been said of late about a Fannie Mae proposal to convert foreclosed homes into affordable rental housing. Our experience with a similar effort has thus far proven ineffective and usually detrimental to neighborhoods. In the case of a similar effort in Florida, single-family homes in owner-occupied neighborhoods were rented at rates deeply discounted to the market rental rates. The result was lower local property values and high eviction rates. In one instance, 50 percent of the renters were evicted after 6 months. At least on the basis that has been described, we strongly oppose such a strategy.

Refinance Programs

The proposed expansion of the Home Affordable Refinance Program (HARP) program to encourage the refinancing of loans guaranteed by the U.S. Government, regardless of the lack of equity, will help reduce foreclosures and stabilize select housing markets in the near term. We caution, however, that an improved economy and value appreciation are essential to any long-term solution. Underwater equity today that remains underwater equity 5 years from now does little to improve the long-term state of housing.

Loan Limits

A reduction in conforming loan limits for Fannie Mae, Freddie Mac, and the FHA is scheduled to occur on October 1, 2011. It is often argued that higher loan limits only benefit higher-cost markets but that is not supported by the facts. The National Association of Realtors estimates that reducing the current loan limits would reduce the availability of mortgage loans in 612 counties in 40 States plus the District of Columbia. We believe the current loan limits should be extended for two or more years.

National Flood Insurance

The National Flood Insurance Program is the only source of insurance in the case of at least 500,000 annual home sales according to the National Association of Realtors. About 8 percent of the Nation's housing inventory—or 10 million homes—is located in FEMA's 100-year flood plains. Until such time that an alternative private market solution is available, the current National Flood Insurance Program must be extended in order to avoid the risk of another near term set-back for housing.

Dodd-Frank

The residential mortgage provisions of the Dodd-Frank Act will negatively impact housing, which we addressed in our formal reply to the Notice of Proposed Rulemaking released on March 29, 2011, specifically with respect to the proposed Qualified Residential Mortgage (QRM) and risk-retention criteria for securitization. As written, the proposed QRM definition focuses almost entirely on a minimum downpayment requirement. Had the proposed QRM definition's 20 percent downpayment requirement been in effect in 2009, 2010 and 2011, then more than 70 percent of all home buyers would not have qualified for a mortgage that could be securitized, resulting in higher costs to the borrower.

Realogy supports the position taken by the Coalition for Sensible Housing Policy that urges the redesign of QRM to make loans accessible to a broad range of creditworthy borrowers. The data is very clear that a 20 percent downpayment would be punitive to low- to moderate-income borrowers, clearly not an intended outcome. This requirement will make homes less affordable for the vast majority of the population that doesn't have the means to make a 20 percent downpayment. The higher rates that low- to moderate-income borrowers will be forced to pay means that middle-class Americans who are otherwise prudent borrowers from an underwriting standpoint would be priced out of home ownership. That's an unintended consequence waiting to happen, but it is avoidable. The focus should be on underwriting standards, the inadequacy of which caused this crisis, not on a minimum downpayment, which as best we can determine played little to no role in creating the current circumstances.

Dodd-Frank requires that lenders retain 5 percent of the face value of the securities sold into the secondary market. The 5 percent retention rule, although clearly

well intentioned, will effectively limit the private mortgage market to those lenders with the balance sheets sufficient to commit such high amounts of capital. By some estimates, more than 75 percent of private lending would accrue to the top five FDIC lenders, further limiting the availability of mortgage financing. In our response to the request for public comments, Realogy outlined an alternative proposal that we labeled an "Enhanced Disclosure Approach", requiring extensive loan portfolio data that surpasses any previous SEC requirement (*see,* Addendum 2, "Realogy's Comments to Regulators Regarding Dodd-Frank Mortgage Rules", July 22, 2011). The required disclosures would provide prospective residential mortgage-backed securities investors with data that provides a thorough and transparent risk profile of the securities (and the underlying mortgage portfolio). Independent of rating agencies, investors will be better able to evaluate the risks and the quality of the investment. We believe the Enhanced Disclosure Approach is far more effective than the proposed retention/QRM provisions of Dodd-Frank.

GSE Reform

The uncertainty regarding the future of the GSEs and the onerous provisions of Dodd-Frank are contributing to the headwinds preventing a housing recovery. The Federal Government's role in the housing finance industry is institutionalized and will not change easily. Those advocating no Government role fail to adequately appreciate the circumstances that originally created Fannie Mae and Freddie Mac. Both were created to support housing finance when the private markets completely shut down, just as they did in 2008.

A pure private sector solution is not practical unless Congress is willing to accept extended periods of time during which home mortgage financing would not be available. In addition, it is also very unlikely that the 30-year fixed conventional mortgage would survive in a purely private market, resulting in almost exclusively variable rate mortgages with higher rates, which is a less than desirable outcome for millions of American families.

We have proposed a solution that consolidates all Federal Government home lending—VA, FHA, U.S. Department of Agriculture, *etc.*—into a restructured Fannie Mae and spins off Freddie Mac to the private sector, in effect reducing its capacity and role, paving the way for a stronger private sector. Redundant costs would be eliminated, streamlining the Federal Government's role in home lending. Fannie Mae would continue to operate as the Government guarantor, and, when necessary, as the market maker in times of economic stress. The U.S. Government would take warrants in Freddie Mac, and in the event it is acquired and/or taken public, the U.S. taxpayer would recoup some or all of its value.

Closing Comments

In summary, it is noteworthy that when housing sales improved in the first two quarters of last year as a result of the Homebuyer Tax Credit, we clearly saw the economy begin to follow an upward trend in the third and fourth quarters. Likewise, once housing sales declined in the third and fourth quarters of 2010, the effect on the economy was visible as GDP fell noticeably in the first and second quarters of 2011.

That said, housing will recover when unemployment and underemployment decline and consumer confidence is restored. Private sector alternatives to foreclosure should be encouraged but when they fail, lenders must be permitted to expeditiously pursue their legal rights under the applicable foreclosure laws and regulations. Prolonging the inevitable is not helpful to the housing market or the economy. And last, but certainly not least, GSE reform and Dodd-Frank entail major structural issues that must be approached with great care and caution.

Thank you again for the opportunity to appear before this Committee.

ADDENDUM I

ADDENDUM 1

Realogy Corporation
August 31, 2011

DEBT-FOR-EQUITY SOLUTION FOR UNDERWATER HOMEOWNERS

Background:

According to latest data available[1] through the first quarter of 2011, there are approximately 11 million homeowners in the United States who owe more than their home is currently worth. Referred to in the industry as being "underwater," those figures represent approximately 23 percent of all those homeowners with mortgages.

The reality is there were a lot of homebuyers back in 2004 to 2006 who bet that home prices would continue to climb and a host of misguided lenders and investors in mortgage-backed securities (MBS) that were ready and willing to take that wager. The daunting problem facing the housing industry and the general economy today is how to unwind the aftermath of the boom years in a fair and equitable manner.

Foreclosures continue to mount, and many homeowners can't make their payments and are tempted to simply walk away from their debt. Meanwhile, the lenders and investors who own the loans are unwilling to work out a deal if, as is usually the case, means losing money. If not addressed, this staggering load of underwater homeowners poses a real impediment to a recovery in housing, and the overall U.S. economy.

When you consider the dilemma, an underwater homeowner has five choices:

1) Continue to pay the mortgage and hope that their equity is restored over time (not likely if the loan to value ratio is greater than 125%),
2) Default on the mortgage and attempt to qualify for a loan modification,
3) Mail the keys back to the lender in a "deed in lieu of foreclosure" arrangement,
4) Sell the property at a loss in a short sale transaction, or finally,
5) Default on the loan and wait for an eviction notice at some future date.

With the exception of the first choice, in all other cases, families are displaced, credit scores are destroyed, lenders and MBS investors suffer significant losses, average home prices continue to decline and neighborhoods are blighted. The magnitude of the problem is daunting, but there is a private-sector solution.

[1] New CoreLogic Data Shows Slight Decrease in Negative Equity, June 7, 2011

Debt-for-Equity Concept:

The reality is homeowners, lenders and MBS investors all made bad financial decisions. Rather than be at odds now when the investment has soured, these private parties should partner with each other in a long-term equity sharing arrangement. Specifically, the lender would retire the existing loan, write a new loan based on the current appraised value and then take an ownership position in the property. The lender's deeded share of the property ownership would be based on the percentage reduction the lender would take from the current mortgage note principal balance.

Here are two examples:

1. Let's say the homeowner purchased a home for $300,000 with no money down and the property is now worth $150,000. That represents a 50% reduction in asset value. In an equity-share arrangement the lender would write a new loan for $150,000 (assuming the homeowner qualifies) while retiring the original $300,000 loan, and in consideration for that loss, take a 50% deeded ownership interest in the property. The homeowner would contractually agree to split 50% of the net proceeds of any future sale of the property with the lender. Should the homeowner wish at any time to buy out the lender's interest, a pre-determined lump sum cash buyout payment would be negotiated when the new loan was written.

Example 1	Amount	Notes
a. Home Purchase Price	$300,000	
b. Down Payment	--	0% down payment
c. Current Mortgage Principal Balance	$300,000	
d. Current Appraised Value	$150,000	
e. Difference between c & d	$150,000	
f. Percentage difference between e & c	50%	This percentage equates to how much of a deeded interest the lender or MBS investor will have in the property and will be their share of the net proceeds of any future sale of the home. The homeowner could buy out the lender's interest via a predetermined lump sum cash buyout payment negotiated when the new loan is written.

2. In the second example, the homeowner purchased a home for $300,000 with a 20% down payment, resulting in a $240,000 first-lien mortgage. The property now has an appraised value of $150,000. In this equity-share arrangement the lender would write a new loan for $150,000 (assuming the homeowner qualifies) while retiring the original $240,000 loan, and in consideration for that loss, take a 37.5% deeded ownership interest in the property (the $90,000 difference between the original note amount and the current appraised value is 37.5% of the original note amount). The homeowner would contractually agree to

share 37.5% of the net proceeds of any future sale of the property with the lender. Again, should the homeowner wish at any time to buy out the lender's interest, a pre-determined lump sum buyout payment would be negotiated when the new loan was written.

Example 2	Amount	Notes
a. Home Purchase Price	$300,000	
b. Down Payment	$60,000	20% down payment
c. Current Mortgage Principal Balance	$240,000	
d. Current Appraised Value	$150,000	
e. Difference between c & d	$90,000	
f. Percentage difference between e & c	37.5%	This percentage equates to how much of a deeded interest the lender or MBS investor will have in the property and will be their share of the net proceeds of any future sale of the home. The homeowner could buy out the lender's interest via a predetermined lump sum cash buyout payment negotiated when the new loan is written.

Securitization:

Either scenario would be relatively straightforward to implement, assuming the lender held the loan in its own portfolio. In most cases, however, the lender sold the loan to an MBS investor and has retained only the servicing rights (collect monthly payments, send statements, etc.).

In that circumstance, the lender would purchase the loan out of the securitization pool and pay a small premium over the appraised value to the MBS investor. Using the above example, a premium of $3,000 to $5,000 would be adequate and clearly more financially attractive to the MBS investor than a foreclosure or short sale (especially when you consider the time value of money and the related selling costs of a distressed asset). The lender would then write a new loan on the property for the appraised value (in this case $150,000). In addition, they would receive a deeded interest in the property based on the write-down amount as a percentage of the current mortgage note principal balance (either 50% or 37.5% as described in the above examples). Not only would the lender be able to sell the new mortgage in the secondary market (and recoup their cost of buying the original loan out of the securitization pool), they would have the potential to more than offset the $3,000 to $5,000 premium paid to the original MBS investor when the property is sold in the future. That premium could also be recouped by offering the homeowner a lump sum cash buyout payment option in excess of the premium paid to the MBS investor.

Other Important Considerations:

In a Debt-for-Equity transaction, several factors would be critical to the overall success of the transaction.

- First, although the lender would have an ownership interest in the property, they would have no responsibility whatsoever for utilities, maintenance, property taxes, homeowners

insurance, property assessments, homeowner association fees (if any), or capital improvements to the property. Those responsibilities would remain solely with the resident homeowner.
- Second, the lender would have approval rights on any subsequent sale or use of the property to or by a third party.
- Third, there would be a pre-established and agreed upon timeframe (e.g., 5 years) for the lender to monetize their ownership position in the property. This monetization would occur by either a lender approved sale, or the homeowner's exercise of the lump sum cash buyout payment option.
- Fourth, this Debt-for-Equity solution is intended to keep underwater homeowners in their homes. As such, they must remain owner occupants of the property until they either sell the property (with lender approval), or exercise the lump sum cash buyout payment provision. For the sake of clarity, the homeowner would not be allowed to rent or lease the property to a third party without first exercising the lump sum cash buyout payment option, or obtaining lender approval.
- Fifth and finally, all of the above terms, conditions and restrictions would be clearly articulated in the closing documents provided to the homeowner prior to the completion and of a Debt-for-Equity transaction.

Outcomes:

With a well structured and implemented Debt-for-Equity solution, a number of positive outcomes are achieved.

- First and foremost, homeowners and their families would stay in their homes. Resetting their loans would create the incentive for them to take better care of their property (certainly more so than in a short sale or foreclosure situation) because they can see the potential equity upside as the housing market improves.
- Second, their credit rating would be preserved or restored, assuming they stay current on the new loan.
- Third, a distressed sale is avoided as is its chilling effect on property values in the neighborhood.
- Fourth, the lender and/or MBS investor could avoid a potentially much greater loss as a result of foreclosure or short sale.
- Fifth, this approach reduces the moral hazard typically associated with loan forbearance. In order to participate, homeowners must give up something meaningful – an ownership percentage of their home to the lender.
- Finally, with today's historically low interest rates and the new lower loan balance, not only would the homeowner be in a better position to afford ongoing loan payments, they would have more disposable income that could provide a needed stimulus to the economy.

We got into this mess one house at a time. The way out is one house at a time. A debt-for-equity arrangement offers a private-sector solution that won't cost U.S. taxpayers a dime.

ADDENDUM II

ADDENDUM 2

July 22, 2011

Via Overnight Mail and Electronic Submission

The Honorable Shaun Donovan
Secretary
U.S. Housing & Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Docket No. : FR-5504-P-01
Proposed Risk Retention Criteria and QRM Standards

Dear Secretary Donovan:

Realogy Corporation appreciates the opportunity to provide comments on the Notice of Proposed Rulemaking released on March 29, 2011 ("NPR") discussing proposed QRM standards and risk retention criteria for securitizations.

Realogy, a global provider of real estate and relocation services, has a diversified business model that includes real estate franchising, brokerage, relocation and title services. Realogy's brands and business units include Better Homes and Gardens® Real Estate, CENTURY 21®, Coldwell Banker®, Coldwell Banker Commercial®, The Corcoran Group®, ERA®, Sotheby's International Realty®, NRT LLC, Cartus and Title Resource Group. Collectively, Realogy's franchise systems have approximately 14,600 offices and 260,400 sales associates doing business in 100 countries and territories around the world.

1. INTRODUCTION

Realogy agrees with the numerous groups who have commented publicly that the proposed QRM rule is unnecessarily narrow and frustrates Congressional intent to provide creditworthy borrowers access to well-underwritten products at good prices, to support a housing recovery and to help shrink

the government presence in the market.[i] Given the wide disparity between the draft rule and Congressional goals, Realogy supports the position taken by the Coalition for Sensible Housing Policy that QRM be redesigned to make QRM loans accessible to a broad range of creditworthy borrowers, without exclusions based solely on down payment or other unduly restrictive criteria, and allow private mortgage insurance and other credit enhancements to be a factor in determining whether a loan meets the QRM standard.[ii] In determining whether a mortgage loan should be a QRM, the focus should be on applying rigorous underwriting standards looking at various factors, not simply on the magnitude of the down payment. Further, any minimum down payment percentage as a QRM requirement should not exceed the percentage required under FHA rules in effect at any given time.

Alternatively, Realogy suggests that lawmakers and the regulators rethink this portion of Dodd-Frank and consider a fundamentally different approach that we refer to herein as the "Enhanced Disclosure Approach." We strongly believe that requiring issuers of publicly or privately traded mortgage-backed securities ("MBS's") to comply with a newly enhanced regime of strict disclosure rules drawing attention to risk – a regime that goes further than current disclosure requirements and that we propose be administered by the Securities and Exchange Commission – is a superior method of achieving the Congressional goals described above. Simply stated, issuers would be required to go beyond today's SEC rules, which require disclosure of certain characteristics of the loan portfolio underlying an MBS, and highlight the risks in the mortgages backing the MBS being sold. The issuers would be required to prominently disclose such data in a meaningful, clearly summarized fashion that displays how loans in the portfolio distribute across a range from lower risk practices to higher risk practices. In addition, there should be a narrative discussion and analysis that synthesizes the data and provides the reader with a thorough understanding of the risk profile of the loan portfolio underlying

the MBS. The Enhanced Disclosure Approach would allow buyers – independent of rating agencies – to better evaluate the risks and the quality of the MBS. Whichever approach Congress and the Agencies determine to take should be a balanced, prudent, sustainable plan because it will affect who can and cannot buy a home for years to come.[iii]

In addition to comments on QRM and a discussion of the Enhanced Disclosure Approach, we set forth in Section 4 of this letter the reasons that certain corrections must be made to the definition of "fees and points" contained in the Dodd-Frank "ability to repay" safe harbor. By limiting the safe harbor to mortgages that are well underwritten and where fees and points are 3% or less of the mortgage amount, Congress intended to eliminate certain predatory lending practices. However, by defining "fees and points" broadly to embrace fees from other non-mortgage services (e.g., title and escrow), this portion of Dodd-Frank has the harmful consequence of effectively preventing affiliates of a mortgage company from offering legitimate services such as title and escrow. Unless these corrections are made, companies will terminate their affiliated business arrangements resulting in fewer competitors in the market place, the loss of many reliable and experienced providers and the loss to the consumer of the convenience of "one-stop shopping." Also, ironically, consumers would not necessarily be protected by including in the calculation of "fees and points" charges for title insurance and escrow. Companies without affiliated service providers would have a competitive advantage over companies that do have them because the companies without them would be able to, and most probably would, charge higher fees and points than their competitors with affiliated service providers and still have the protection of the safe harbor.

2. BACKGROUND

Realogy acknowledges the need for changes to eliminate inappropriate practices that led to the breakdown of the mortgage and home financing system. With one in seven borrowers delinquent on their mortgage or already in foreclosure[iv] and more than one in four mortgages underwater, continued weakness in the housing sector is already impairing economic recovery and hampering efforts to create jobs and reduce unemployment. We are acutely aware that a sustained economic recovery in our country is dependent on a sustained housing recovery. The answer, however, is a balanced set of provisions that are neither too restrictive nor too aggressive. Impeding market access for creditworthy home buyers through narrow, unnecessarily restrictive criteria not only will harm existing homeowners who need to sell their home in order to relocate for a job, to accommodate a growing family, or to scale back in retirement,[v] it also prevents a large number of qualified borrowers from pursuing homeownership.[vi] Nearly nine in 10 Americans say homeownership is an important part of the American dream, according to the latest New York Times/CBS News poll.[vii]

We agree with the conclusions reached by many of the organizations who responded to the NPR that, while QRM is designed to create a class of loans that have a lower likelihood of default, the proposed definition is unnecessarily restrictive and has the potential to exclude a substantial number of creditworthy buyers.[viii] In particular:

- The proposed QRM criteria would accommodate as few as one out of five current homeowners.
- Down payment levels are not the most significant factor in loan performance, and a 20% requirement precludes performance evaluation of other pertinent factors such as verification and documentation of income, past borrower performance (e.g., missed payments, bankruptcy, foreclosure, short sale), loan term, whether the mortgage has

any non-amortizing features such as a required balloon payment, and average debt-to-income (DTI) ratio for monthly housing expenses and total debt obligations.

- Consumers and financial markets would be damaged because only the very largest banks, which could afford meeting risk retention requirements on significant percentages of all mortgages, would participate in housing. The real estate markets and the economy are not served by shrinking the pool of banks participating in mortgage lending. Strong, competitive markets need a large diverse group of mortgage originators. Moreover, it is not clear that even large banks want to participate in mortgage services that require retentions on substantial portions of the portfolio.[ix]
- The proposed QRM criteria so narrows the range of loans to be managed by private capital that it prevents achievement of Congress' other stated goal of moving private capital back into the residential loan market and thereby significantly reducing reliance on government-backed funding for residential mortgage loans through Fannie Mae and Freddie Mac.[x] Taxpayers will be forced to continue to bear significant exposure to housing finance markets indefinitely.[xi]
- Non-QRM loans, which will comprise the lion's share of all residential loans, will feature higher interest rates, more points and fees and more onerous terms than QRM loans.
- The proposed QRM criteria are generally very conservative and leave little room for the exercise of lender discretion.[xii] Originators need the flexibility necessary to respond to market conditions and manage risk.

Given the wide disparity between the proposed QRM criteria and Congressional goals to provide creditworthy borrowers access to well-underwritten products at good prices, to support a housing recovery and to help shrink the government presence in the residential loan market, Realogy supports

the position taken by the Coalition for Sensible Housing Policy that QRM be redesigned to make QRM loans accessible to a broad range of creditworthy borrowers, without exclusions based solely on down payment or other unduly restrictive criteria, and allow private mortgage insurance and other credit enhancements to be a factor in determining whether a loan meets the QRM standard.

Apart from the problems discussed above regarding the proposed QRM criteria, we also have certain general concerns – both procedural and substantive – regarding Dodd-Frank's risk retention requirements. These include:

- There is no assurance that retention requirements by themselves will incentivize securitizers to ensure that the securities they issue are backed by well underwritten loans. Many of the subprime securitizers such as New Century routinely retained 5% of their loans.[xiii]
- Risk retention itself may not attract investors to securitizations backed by non-QRMs.
- The implementation and oversight of the risk retention requirements is a massive undertaking.[xiv] It can be expected to be time consuming and will entail significant additional government resources.
- The risk retention regulations are not the only changes taking place in the financial services industry.[xv] Multiple rulemakings (e.g., overlap of QRM provisions with QM provisions of the Federal Reserve's future regulations implementing the Dodd-Frank Act's revisions to the Truth in Lending Act) perpetuate uncertainty in the market and may create compliance difficulties, especially for smaller community lenders.

In light of these concerns regarding retention requirements in general, combined with the QRM problems raised by us and others who have commented on the NPR, we suggest that lawmakers and the regulators rethink this portion of Dodd-Frank and consider a fundamentally different method – the Enhanced Disclosure Approach. If the determination is nevertheless made to follow a retention/QRM approach, the focus should be on applying rigorous underwriting standards looking at various factors, not simply on the magnitude of the down payment. Further, any minimum down payment percentage as a QRM requirement should not exceed the percentage required under FHA rules in effect at any given time.

3. ENHANCED DISCLOSURE APPROACH

The Enhanced Disclosure Approach is a direct approach that requires less government intervention in the MBS markets. Issuers would be required to go beyond today's SEC rules, which require disclosure of certain characteristics of the loan portfolio underlying an MBS, and highlight the risks in the mortgages backing the MBS's being sold. The issuers would be required to prominently disclose such data in a meaningful, clearly summarized fashion that displays how loans in the portfolio distribute across a range from lower risk practices to higher risk practices. In addition, there should be a narrative discussion and analysis that synthesizes the data and provides the reader with a thorough understanding of the risk profile of the loan portfolio underlying the MBS. The Enhanced Disclosure Approach would allow buyers – independent of rating agencies – to better evaluate the risks and the quality of the MBS. Although the Enhanced Disclosure Approach will require changes to the Dodd-Frank Act, we believe it is a more straightforward and effective method than the retention/QRM approach to prevent the type of inappropriate practices that led to the breakdown of the mortgage and home financing system. The breakdown that occurred was indicative of a failure by investors, regulators and

credit rating agencies to understand the significant risk profile of the loan portfolios backing MBS's (and thus the risk profile of the MBS's) being offered to investors. Had the level of inherent risk and the vulnerability of the MBS to changes in home values and other factors been more transparent, necessary corrections might have occurred before a crisis as investors moved away from MBS's backed by

increasingly poor quality subprime mortgages with increasingly risky profiles. Armed with enhanced, transparent disclosure, investors will question any ratings that do not appear to be justified by the characteristics of the underlying mortgage portfolio.

Issuers would be required to provide detailed disclosure regarding the profile of the underlying loan portfolio containing the following minimum components:

- Average loan-to-value (LTV) ratio
- Degree of verification and documentation of income of borrowers
- Debt-to-income (DTI) ratio of the borrowers (both for monthly housing expenses and total debt obligations)
- Average loan term
- Percentage of loans to self-employed borrowers
- Ratio of fees and points to loan amount
- A measure of past borrower performance (e.g., FICO score)
- Whether and to what extent the loan is insured

See **Table 1** below for a hypothetical illustration of how certain profile data might be presented. Although **Table 1** does not contain a comprehensive list of factors that may be of concern to an investor (for example, investors might also care about the degree of geographic diversification), it is indicative of the type of information that the offering should disclose to provide the investor with a meaningful snapshot of the risk profile of the mortgage portfolio that will be backing an issuer's securities. The

profile data should be arrayed, as is the case in **Table 1**, starting from the lowest risk category and moving progressively to the highest risk category. Following such table, a second chart (see **Table 2**

below) should display the percentage of the dollar value of the loans in the portfolio having the specified number of "Higher Risk" factors.

Following the tabular type of disclosure described above, the issuer would be required to provide a narrative description of what would happen to the value of the loan portfolio and the MBS's for each 1% drop in average home values in the United States (or perhaps for the particular region(s) in which the loans are concentrated), as well as for each 1% increase in unemployment in the United States (or for the region where the loans are concentrated). In addition, the issuer would be required to discuss the effect of any other variables the issuer believes would create material changes in the risk profile of the MBS's and the loan portfolio.

TABLE 1

PROFILE OF A HYPOTHETICAL $100 MILLION LOAN PORTFOLIO ($ values represent magnitude of loans in the portfolio meeting applicable criteria)						
	Lower Risk		Medium Risk		Higher Risk	
Loan-to-value ratio (LTV)	0% $0	1 -9% $5,000,000	10 – 19% $25,000,000	20 - 29% $40,000,000	30 – 39% $15,000,000	>39% $15,000,000
% loans with documented income	> 89% $65,000,000	80 – 89% $15,000,000	70 – 79% $20,000,000	20 – 69% $0	1 – 19% $0	0% $0
Mort payment/ income	<9% $10,000,000	9 – 18% $45,000,000	19 – 28% $20,000,000	29 – 38% $20,000,000	39 – 48% $5,000,000	>48% $0
Debt-to-income ratio (DTI)	<17% $10,000,000	17 – 26% $20,000,000	27 – 36% $45,000,000	37 – 46% $10,000,000	47 – 56% $10,000,000	>56% $5,000,000
Loan Term	<5 years $10,000,000	5 – 9 years $10,000,000	10 – 14 years $10,000,000	15 – 25 years $50,000,000	26 – 30 years $20,000,000	>30 years $0
Loans to Self-employed borrowers	<20% $10,000,000	20 – 29% $15,000,000	30 – 39% $25,000,000	40 – 59% $15,000,000	60 – 79% $20,000,000	80 – 100% $15,000,000
Points and fees/loan amt	<0.5% $5,000,000	0.5% $10,000,000	1% $20,000,000	2% $40,000,000	3% $15,000,000	>3% $10,000,000
FICO score	780 – 850 $15,000,000	760 – 779 $15,000,000	720 – 759 $20,000,000	680 – 719 $40,000,000	640 – 679 $5,000,000	<640 $5,000,000
Private Mortgage insurance	Yes $15,000,000					No $85,000,000

TABLE 2

$ Value of Loans/% of Portfolio	Number of Higher Risk Factors
$2,000,000 / 2%	0
$4,000,000 / 4%	1
$3,000,000 / 3%	2
$6,000,000 / 6%	3
$20,000,000 / 20%	4
$18,000,000 / 18%	5
$23,000,000 / 23%	6
$15,000,000 / 15%	7
$8,000,000 / 8%	8
$1,000,000 / 1%	9

For profile data that cannot be or is less easily presented in table format, clear, comprehensive narrative disclosure would be required. Types of profile data that fall into this latter category include:

- Material assumptions and methodology used to determine the aggregate dollar amount of MBS's issued in the securitization transaction, including those related to the discount rate and estimated cash flows
- Amount spent on, and method of calculating, fees paid for loan servicing (a fixed level of compensation might be indicative of inadequate servicing)
- Description of mortgage servicing standards (e.g., are there financial incentives to servicers to consider options other than foreclosure when those options will maximize value for investors?)
- All non-amortizing features (e.g., balloon payment, interest only, negative amortization, etc.)

We believe there is great merit in the Enhanced Disclosure Approach, including:

- It is consistent with various provisions of the Dodd-Frank Act. For example, Section 942(b) of Dodd-Frank requires the SEC to adopt regulations requiring an issuer of an MBS to disclose, for each tranche or class of security, information regarding the assets backing the security. In

addition, Section 945 of Dodd-Frank requires the SEC to issue rules requiring an MBS issuer to perform a review of the assets underlying the MBS and disclose the nature of the review.

Under the final rules adopted by the SEC in January 2011 to implement Section 945, the type of review conducted may vary, but at a minimum must be designed to provide reasonable assurance regarding the accuracy of the disclosure about the assets.

- It is consistent with previous SEC rulemaking. On April 7, 2010, the SEC proposed substantial enhancements to Regulation AB and other SEC rules regarding MBS's in an effort to improve investor protection and promote more efficient MBS markets.[xvi] The Enhanced Disclosure Approach is also consistent with the SEC's proposal that, with some exceptions, prospectuses for public offerings of MBS's contain specified asset-level information about each of the assets in the pool.[xvii]
- Whereas the retention/QRM approach would probably entail significant additional government resources, the Enhanced Disclosure Approach should require relatively little in terms of additional government infrastructure. The SEC is already tasked with ensuring the disclosure of important information to investors.
- While the Enhanced Disclosure Approach helps to ensure strong loan underwriting, it does not place reliance on any single underwriting factor. As noted by the Acting Assistant Secretary for Housing and FHA Commissioner, the crisis has highlighted the importance of strong underwriting standards and the need for a lender to truly assess a borrower's capacity to repay a loan, a buyer's credit experience, the value of the property being financed, and the type of mortgage.[xviii] The Enhanced Disclosure Approach provides the investor with insight into every factor, not only risk retention, analyzed by the lender in underwriting the relevant mortgage loans.

- The Enhanced Disclosure Approach would allow private mortgage insurance to play a role in creating a more liquid MBS market by allowing potential investors to consider the presence of such insurance in performing their risk analysis. Since a private mortgage insurer will be willing to insure the performance of a mortgage loan only if it determines the underwriting risk to be acceptable, investors might consider the existence of private mortgage insurance to be an important factor in their risk analysis. Fannie Mae and Freddie Mac traditionally required any loan they purchased to be insured. It was when Fannie Mae and Freddie Mac broke with this tradition that they faced a crisis.
- The Enhanced Disclosure Approach is more flexible than the retention/QRM approach, and, therefore, may be expected to result in the availability of a greater number of quality sub-prime loans than the retention/QRM approach. According to a mortgage market survey conducted by Century 21 Real Estate LLC with its franchisees and sales professionals, 93% of all respondents estimated they could be doing more home sale transactions – 32% more on average – if their customers had available to them a quality subprime mortgage alternative (defined as being fully documented with down payment, income verification and reasonable credit requirements).[xix]

4. 3% CAP ON FEES AND POINTS

We request that certain corrections be made to the definition of "fees and points" contained in the Dodd-Frank "ability to repay" safe harbor. As noted above, by limiting the safe harbor to mortgages that are well underwritten and where fees and points are 3% or less of the mortgage amount, Congress intended to eliminate certain predatory lending practices. However, by defining "fees and points" broadly to embrace fees from other non-mortgage services (e.g., title and escrow), this portion of Dodd-

Frank has the harmful consequence of effectively preventing affiliates of a mortgage company from offering legitimate services such as title and escrow.

We agree with both RESPRO and NAR that the current "fees and points" definition discriminates against lenders with legitimate affiliated business arrangements under the Real Estate Settlement Procedures Act.[xx] It is particularly discriminatory because the charges for title services are regulated heavily by the states, meaning they would not differ greatly whether the firm was affiliated or not. Likewise, escrow is largely made up of property taxes and homeowners insurance, also outside of the control of the lender. Neither charge inures to the benefit of the lender – it is simply a pass-through charge.[xxi]

Unless the definition of "fees and points" is amended to exempt title and escrow charges from the 3% threshold, companies will terminate one or more of their affiliated business arrangements resulting in fewer competitors in the market place, the loss of many reliable and experienced providers and the loss to the consumer of the convenience of "one-stop shopping." The Department of Housing and Urban Development has stated that "[c]ontrolled business arrangements and so-called 'one-stop shopping' may offer consumers significant benefits including reducing time, complexity, and costs associated with settlements."[xxii] As noted by RESPRO, certain companies with affiliated business arrangements may choose to terminate their lending operations while others may choose to terminate their title operations. In either case, the consumer will suffer as a result of there being fewer competitors in the market place.[xxiii]

Ironically, consumers would not necessarily be protected by including in the calculation of "fees and points" charges for title insurance and escrow. Companies without affiliated service providers would have a competitive advantage over companies that do have them because the companies

without them would be able to, and most probably would, charge higher fees and points than their competitors with affiliated service providers and still have the protection of the safe harbor.

5. **CONCLUSION**

Realogy agrees with other groups who have commented publicly that the proposed QRM rule is unnecessarily narrow and frustrates Congressional goals. We have also described certain general concerns we have with the Dodd-Frank retention requirement. For these reasons, we suggest that lawmakers and the regulators rethink this portion of Dodd-Frank and consider a fundamentally different approach that we refer to as the "Enhanced Disclosure Approach." MBS issuers would be obligated to go beyond today's SEC disclosure requirements and would also be obligated to disclose loan portfolio data in a meaningful, clearly summarized fashion together with a narrative discussion and analysis that synthesizes the data and provides the reader with a thorough understanding of the risk profile of the loan portfolio underlying the MBS. Armed with enhanced, transparent disclosure, investors – independent of rating agencies – will be better able to evaluate the risks and the quality of MBS's and will question any ratings that do not appear to be justified by the characteristics of the underlying mortgage portfolio. We believe the Enhanced Disclosure Approach has great merit because it is consistent with various provisions of Dodd-Frank as well as previous SEC rulemaking; requires relatively little in terms of additional government infrastructure; helps to ensure strong loan underwriting while not placing reliance on any single underwriting factor; would allow private mortgage insurance to play a role in creating a more liquid MBS market; and is more flexible than the retention/QRM approach, and, therefore, may be expected to result in the availability of a greater number of quality sub-prime loans than the retention/QRM approach.

If the determination is nevertheless made to follow a retention/QRM approach, the focus should be on applying rigorous underwriting standards looking at various factors, not simply on the magnitude of the down payment. Further, any minimum down payment percentage as a QRM requirement should not exceed the percentage required under FHA rules in effect at any given time.

Our comments also address the definition of "fees and points" contained in the Dodd-Frank "ability to repay" safe harbor. By defining "fees and points" broadly to embrace fees from other non-mortgage services (e.g., title and escrow), this portion of Dodd-Frank has the harmful consequence of effectively preventing affiliates of a mortgage company from offering legitimate services such as title and escrow.

Unless the definition of "fees and points" is amended to exempt title and escrow charges from the 3% threshold, consumers will be harmed because the market place for both mortgage lending and non-mortgage services will become less competitive with fewer reliable and experienced providers, and they will experience the loss of the convenience of "one-stop shopping." Therefore, we request that certain corrections be made to the definition of "fees and points" contained in the Dodd-Frank "ability to repay" safe harbor.

Realogy appreciates the opportunity to comment on this important subject. Should you have any questions regarding these comments, or if we may be of further assistance to you in addressing this matter, please do not hesitate to contact me at 973.407.5311 or richard.smith@realogy.com.

Sincerely,

/s/ Richard A. Smith

Richard A. Smith

[i] Coalition for Sensible Housing Policy, "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery," (June 22, 2011) (hereinafter, "White Paper") at 2-3.

[ii] White Paper at 2-3.

[iii] Testimony of Henry V. Cunningham Jr. on behalf of the Mortgage Bankers Association before the House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention," (April 14, 2011) (hereinafter, "Cunningham Testimony") at 3.

[iv] MBA National Delinquency Survey (August 2010).

[v] Testimony of Ellen Harnick on behalf of Center for Responsible Lending before the House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention," (April 14, 2011) (hereinafter, "Harnick Testimony") at 15.

[vi] Testimony of Tom Deutsch on behalf of American Securitization Forum before House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention," (April 14, 2011) (hereinafter, "Deutsch Testimony") at 30.

[vii] New York Times, "Despite Fears, Owning Home Retains Allure, Poll Shows" (June 29, 2011).

[viii] For example, see Cunningham Testimony at 2.

[ix] Comment made by Jamie Dimon, Chief Executive Officer of JPMorgan Chase & Co. (July 2011).

[x] "Reforming America's Housing Finance Market – A Report to Congress," United States Department of the Treasury and United States Department of Housing and Urban Development (February 2010) at 12-13.

[xi] Deutsch Testimony at 7-8.

[xii] Deutsch Testimony at 26.

[xiii] American Banker, "Meet QM, QRM's Sister – Only Tougher" (May 9, 2011). See also, Mark Zandi, "Reworking Risk Retention", Moody's Analytics (June 20, 2011) at 1.

[xiv] Cunningham Testimony at 3-4.

[xv] Cunningham Testimony at 12.

[xvi] Testimony of Meredith Cross on behalf of SEC Division of Corporation Finance before House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention," (April 14, 2011) (hereinafter, "Cross Testimony") at 7.

[xvii] Cross Testimony at 8.

[xviii] Testimony of Bob Ryan on behalf of U.S. Department of Housing and Urban Development before House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention," (April 14, 2011) at 2.

[xix] Press release issued by Century 21 Real Estate LLC on May 12, 2011, "Century 21 Real Estate Releases Mortgage Market Survey."

[xx] Letter from RESPRO to Board of Governors of the Federal Reserve System (July 22, 2011) at 1. See also, Kenneth Trepeta, Esq., National Association of Realtors, "Dodd Frank Predatory Lending Provisions Treat Affiliates Unfairly."

[xxi] Kenneth Trepeta, Esq., National Association of Realtors, "Dodd Frank Predatory Lending Provisions Treat Affiliates Unfairly."

[xxii] U.S. Department of Housing and Urban Development, proposed RESPA regulation, 59 Fed. Reg. 37360 (July 21, 1994).

[xxiii] Letter from RESPRO to Board of Governors of the Federal Reserve System (July 22, 2011) at 1 at 3-4.

PREPARED STATEMENT OF MARK A. CALABRIA

DIRECTOR, FINANCIAL REGULATION STUDIES, CATO INSTITUTE

SEPTEMBER 14, 2011

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

State of the Housing Market

The U.S. housing market remains weak, with both homes sales and construction activity considerably below trend. Despite sustained low mortgage rates, housing activity has remained sluggish in the first half of 2011. Although activity will likely be above 2010 levels, 2011 is expected to fall below 2009 levels and is unlikely to reach levels seen during the boom for a number of years. In fact I believe it will be at least until 2014 until we see construction levels approach those of the boom. As other witnesses are likely to provide their economic forecasts of housing activity, which are generally within the consensus estimates, I will not repeat that exercise here.

Housing permits, on an annualized basis, decreased 3.2 percent from June to July (617,000 to 597,000). While permits for both single family units and smaller multifamily units increased slightly, the overall decline in housing permits was driven by an 11.9 percent decline in permits for larger multifamily properties (5+ units). Single family permits increased from 402,000 to 404,000 in July. Permits for 2–4 unit properties climbed to the highest level of the year (21,000 to 22,000) in July. Permits for 5+ units dropped to 171,000 in July from 194,000 in June.

According to the Census Bureau, July 2011 housing starts were at a seasonally adjusted annual rate of 604,000, down slightly from the June level of 613,000. Overall starts are slightly up, on an annualized level, from 2010's 585,000 units. This increase, however, is completely driven by a jump in multifamily starts, as single-family starts witnessed a significant decline. Total residential starts continue to hover at levels around a third of those witnessed during the bubble years of 2003 to 2004.

As in any market, prices and quantities sold in the housing market are driven by the fundamentals of supply and demand. The housing market faces a significant oversupply of housing, which will continue to weigh on both prices and construction activity. The Federal Reserve Bank of New York estimates that oversupply to be approximately 3 million units. Given that annual single family starts averaged about 1.3 million over the last decade, it should be clear that despite the historically low current level of housing starts, we still face a glut of housing. NAHB estimates that about 2 million of this glut is the result of "pent-up" demand, leaving at least a million units in excess of potential demand.[1] Add to that another 1.6 million mortgages that are at least 90 days late. My rough estimate is about a fourth of those are more than 2 years late and will most likely never become current.

The Nation's oversupply of housing is usefully documented in the Census Bureau's Housing Vacancy Survey. The boom and bust of our housing market has increased the number of vacant housing units from 15.6 million in 2005 to a current level of 18.7 million. The rental vacancy rate for the 2nd quarter of 2011 declined considerably to 9.2 percent, although this remains considerably above the historic average. The decline in rental vacancy rates over the past year has been driven largely by declines in suburban rental markets. Vacancy rates for both rental and homeowner units remain considerably higher for new construction relative to existing units.

The homeowner vacancy rate, after increasing from the 2nd and 3rd quarters of 2010 to the 4th quarter of 2010, declined to 2.5 percent in the 2nd quarter of 2011, a number still in considerable excess of the historic average.

The homeowner vacancy rate, one of the more useful gauges of excess supply, differs dramatically across metro areas. At one extreme, Orlando has an owner vacancy rate approaching 6 percent, whereas Allentown, PA, has a rate of 0.5 percent.

[1] Denk, Dietz, and Crowe, "Pent-up Housing Demand: The Household Formations That Didn't Happen—Yet", National Association of Home Builders. February 2011.

Other metro with excessive high owner vacancy rates include: Toledo, OH (5.5), Las Vegas (5.1), Raleigh, NC (5.0), Riverside, CA, and Jacksonville, FL. Relatively tight owner markets include: Springfield, MA (0.7), San Jose, CA (0.9), and Honolulu, HI (1.0).

The number of vacant for sale or rent units has increased, on net, by around 1 million units from 2005 to 2011. Of equal concern is that the number of vacant units "held off the market" has increased by about 1.5 million since 2005. In all likelihood, many of these units will re-enter the market once prices stabilize.

The 2nd quarter 2011 national home ownership rate fell to 65.9 percent, the first time it broken the floor of 66 percent since 1997, effectively eliminating all the gain in the home ownership rate over the last 12 years. Declines in the home ownership rate were the most dramatic for the youngest homeowners, while home ownership rates for those 55 and over were stable or saw only minor declines. This should not be surprising given that the largest increase in home ownership rates was among the younger households and that such households have less attachment to the labor market than older households. Interestingly enough, the percentage point decline in home ownership was higher among households with incomes above the median than for households with incomes below the median.

While home ownership rates declined across the all Census Regions, the steepest decline was in the West, followed by the Northeast. The South witnessed the smallest decline in home ownership since the bursting of the housing bubble.

Homeowner vacancy rates differ dramatically by type of structure, although all structure types exhibit rates considerably above historic trend levels. For 2nd quarter 2011, single-family detached homes displayed an owner vacancy rate of 2.2 percent, while owner units in buildings with 10 or more units (generally condos or co-ops) displayed an owner vacancy rate of 8.7 percent. Although single-family detached constitute 95 percent of owner vacancies, condos and co-ops have been impacted disproportionately. Interestingly enough, over the last year homeowner vacancy rates have been stable for single-family structures, but have declined, albeit from a much higher level.

Owner vacancy rates tend to decrease as the price of the home increases. For homes valued under $150,000 the owner vacancy rate is 3.1 percent, whereas homes valued over $200,000 display vacancy rates of about 1.4 percent. The vast majority, almost 75 percent, of vacant owner-occupied homes are valued at $300,000 or less. Owner vacancy rates are also the highest for the newest homes, with new construction displaying vacancy rates twice the level observed on older homes.

While house prices have fallen considerably since the market's peak in 2006—over 23 percent if one excludes distressed sales, and about 31 percent including all sales—housing in many parts of the country remains expensive, relative to income. At the risk of oversimplification, in the long run, the size of the housing stock is driven primarily by demographics (number of households, family size, *etc.*), while house prices are driven primarily by incomes. Due to both consumer preferences and underwriting standards, house prices have tended to fluctuate at a level where median prices are approximately 3 times median household incomes. Existing home prices, at the national level, are close to this multiple. In several metro areas, however, prices remain quite high relative to income. For instance, in San Francisco, existing home prices are almost 8 times median metro incomes. Despite sizeable decline, prices in coastal California are still out of reach for many families. Prices in Florida cities are generally above 4 times income, indicating they remain just above long-run fundamentals. In some bubble areas, such as Phoenix and Las Vegas, prices are below 3, indicating that prices are close to fundamentals. Part of these geographic differences is driven by the uneven impact of Federal policies.

Household incomes place a general ceiling on long-run housing prices. Production costs set a floor on the price of new homes. As Professors Edward Glaeser and Joseph Gyourko have demonstrated,[2] housing prices have closely tracked production costs, including a reasonable return for the builder, over time. In fact the trend has generally been for prices to about equal production costs. In older cities, with declining populations, productions costs are often in excess of replacement costs. After 2002, this relationship broken down, as prices soared in relation to costs, which also included the cost of land.[3] As prices, in many areas, remain considerably above production costs, there is little reason to believe that new home prices will not decline further.

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[2] Edward Glaeser and Joseph Gyourko, "The Case Against Housing Price Supports", *Economists' Voice,* October 2008.

[3] *Also see,* Robert Shiller, "Unlearned Lessons From the Housing Bubble", *Economists' Voice,* July 2009.

It is worth noting that existing home sales in 2010 were only 5 percent below their 2007 levels, while new home sales are almost 60 percent below their 2007 level. To a large degree, new and existing homes are substitutes and compete against each other in the market. Perhaps the primary reason that existing sales have recovered faster than new, is that price declines in the existing market have been larger. Again excluding distressed sales, existing home prices have declined 23 percent, whereas new home prices have only declined only about 10 percent. I believe this is clear evidence that the housing market works just like other markets: the way to clear excess supply is to reduce prices.

State of the Mortgage Market

According to the Mortgage Bankers Association's National Delinquency Survey, the delinquency rate for mortgage loans on one-to-four-unit residential properties increased to a seasonally adjusted rate of 8.44 percent of all loans outstanding for the end of the 2nd quarter 2011, 12 basis points up from 1st quarter 2011, but down 141 basis points from 1 year ago.

The percentage of mortgages on which foreclosure proceedings were initiated during the second quarter was 0.96 percent, 12 basis points down from 2001 Q1 and down 15 basis points from 2010 Q2. The percentage of loans in the foreclosure process at the end of the 2nd quarter was 4.43 percent, down slightly at 9 basis points from 2011 Q1 and 14 basis points lower than 2010 Q2. The serious delinquency rate, the percentage of loans that are 90 days or more past due or in the process of foreclosure, was 7.85 percent, a decrease of 25 basis points from 2011 Q1, and a decrease of 126 basis points from 2010 Q2.

The combined percentage of loans in foreclosure or at least one payment past due was 12.54 percent on a nonseasonally adjusted basis, a 23 basis point increase from 2011 Q1, but was 143 basis points lower than 2010 Q2.

Mortgage Policies

For those who can get a mortgage, rates remain near historic lows. These lows rates, however, are not completely the outcome of the market, but are driven, to a large degree, by Federal policy interventions. Foremost among these interventions is the Federal Reserve's current monetary policy. Of equal importance is the transfer of almost all credit risk from market participants to the Federal taxpayer, via FHA and the GSEs. Given massive Federal deficits as far as the eye can see, and the already significant cost of rescuing Fannie Mae and Freddie Mac, policy makers should be gravely concerned about the risks posed by the current situation in our mortgage markets. Immediate efforts should be made to reduce the exposure of the taxpayer.

In transitioning from a Government-dominated to market-driven mortgage system, we face the choice of either a gradual transition or a sudden "big bang." While I am comfortable with believing that the remainder of the financial services industry could quickly assume the functions of Fannie Mae and Freddie Mac, I recognize this is a minority viewpoint. Practical politics and concern as to the state of the housing market point toward a gradual transition. The question is then, what form should this transition take? One element of this transition should be a gradual, step-wise reduction in the maximum loan limits for the GSEs (and FHA).

If one assumes that higher income households are better able to bear increases in their mortgage costs, and that income and mortgage levels are positively correlated, then reducing the size of the GSEs' footprint via loan limit reductions would allow those households best able to bear this increase to do so. As tax burden and income are also positively correlated, the reduction in potential tax liability from a reduction in loan limits should accrue to the very households benefited most by such a reduction.

Moving beyond issues of "fairness"—in terms of who should be most impacted by a transition away from the GSEs—is the issue of capacity. According to the most recent HMDA data (2009), the size of the current jumbo market (above $729k) is approximately $90 billion. Reducing the loan limit to $500,000 would increase the size of the jumbo market to around $180 billion. Since insured depositories have excess reserves of over $1 trillion, and an aggregate equity to asset ratio of over 11 percent, it would seem that insured depositories would have no trouble absorbing a major increase in the jumbo market.

Given that the Mortgage Banker Association projects total residential mortgage originations in 2011 to be just under $1 trillion, it would appear that insured depositories could support all new mortgages expected to be made in 2011 with just their current excess cash holdings. While such an expansion of lending would require capital of around $40 billion, if one is to believe the FDIC, then insured de-

positories already hold sufficient excess capital to meet all new mortgage lending in 2011.

Moving more of the mortgage sector to banks and thrifts would also insure that there is at least some capital behind our mortgage market. With Fannie, Freddie, and FHA bearing most of the credit risk in our mortgage market, there is almost no capital standing between these entities and the taxpayer.

The bottom line is that reducing the conforming loan limit to no more than $500,000, if not going immediately back to $417,000, would represent a fair, equitable and feasible method for transitioning to a more private-sector driven mortgage system. Going forward, the loan limit should be set to fall by $50,000 each year. As this change could be easily reversed, it also represents a relatively safe choice.

Reducing the competitive advantage of Fannie Mae and Freddie Mac via a mandated increase in their guarantee fees would both help to raise revenues while also helping to "level the playing field" in the mortgage market. Given that the Federal taxpayer is covering their losses and backing their debt, along with the suspension of their capital requirements, no private entity can compete with Fannie Mae and Freddie Mac. We will never be able to move to a more private market approach without reducing, if not outright removing, these taxpayer-funded advantages.

An increase in the GSE guarantee fee could also be used to recoup some of the taxpayer "investment" in Fannie Mae and Freddie Mac. Section 134 of the Emergency Economic Stabilization Act of 2008, better known as the TARP, directed the President to submit a plan to Congress for recoupment for any shortfalls experienced under the TARP. Unfortunately the Housing and Economic Recovery Act of 2008, which provided for Federal assistance to the GSEs, lacked a similar requirement. Now is the time to rectify that oversight. Rather than waiting for a Presidential recommendation, Congress should establish a recoupment fee on all mortgages purchased by Fannie Mae and Freddie Mac. Such a fee would be used directly to reduce the deficit and be structured to recoup as much of the losses as possible. I would recommend that the recoupment period be no longer than 15 years and should begin immediately. A reasonable starting point would be 1 percentage point per unpaid principal balance of loans purchased. Such as sum should raise at least $5 billion annually and should be considered as only a floor for the recoupment fee.

In any discussion regarding costs in our mortgage market, we must never forget that homeowners and home buyers are also taxpayers. Using either current taxes or future taxes (*via* deficits) to fund subsidies in the housing market reduces household disposable income, which also reduces the demand for housing. None of the subsidies provided to the housing and mortgage markets are free. They come at great costs, which should be included in any evaluation of said subsidies.

Contribution of Federal Policy

Federal Government interventions to increase house prices, including Federal Reserve monetary and asset purchases, have almost exclusively relied upon increasing the demand for housing. The problem with these interventions is they have almost the opposite impact between markets where supply remains tight and those markets with a housing glut. In areas where housing supply is inelastic, that is relatively unresponsive (often the result of land use policies), these programs have indeed slowed price declines. Areas where supply is elastic, where building is relatively easy, have instead seen an increase in supply, rather than price. For these areas the increase in housing supply will ultimately depress prices even further.

A comparison of San Diego, CA, and Phoenix, AZ, illustrates the point. Both are of similar population (2.5 million for Sand Diego, 2.2 million for Phoenix), and both witnessed large price increases during the bubble. Yet the same Federal policies have drawn different supply and price responses. In 2010, about 8,200 building permits were issued for the greater Phoenix area; whereas only about 3,500 were issued for San Diego. Existing home prices (2010) in Phoenix fell over 8 percent, whereas prices in San Diego actually grew by 0.6 percent. This trend is compounded by the fact that prices are almost three times higher in San Diego than in Phoenix. The point is that Federal efforts to "revive" the housing market are sustaining prices in the most expensive markets, while depressing prices in the cheapest markets, the opposite of what one would prefer. As home prices are correlated positively with incomes, these policies represent a massive regressive transfer of wealth from poorer families to richer.

Among policy interventions, the Federal Reserve's interest rates policies are perhaps having the worst impact. It is well accepted in the urban economics and real estate literature that house prices decline as distances from the urban core increase. It is also well accepted that the relative price of urban versus suburban house prices is influenced by transportation costs. For instance, an increase in the price of gas, will, all else equal, lower the price of suburban homes relative to urban. If loose

monetary policy adds to increases in fuel prices, which I believe it has, then such monetary policies would result in a decline in suburban home prices relatives to urban. One can see this dynamic play out in California. In general, prices in central cities and urban cores, have witnessed only minor declines or actual increases over the last year. According to the California Association of Realtors, overall State prices are down just 2 percent from January 2010 to January 2011. Yet prices in the inland commuting counties—Mariposa (-27 percent), San Benito (-14 percent), Butte (-29 percent), Kings (-16 percent), Tulare (-16 percent)—are witnessing the largest declines, in part driven by increases in commuting (gas) costs.

Foreclosure Mitigation and the Labor Market

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

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

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

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

Conclusion

The U.S. housing market is weak and is expected to remain so for some time. Given the importance of housing in our economy, the pressure for policy makers to act has been understandable. Policy should, however, be based upon fostering an unwinding of previous unbalances in our housing markets, not sustaining said

unbalances. We cannot go back to 2006, and nor should we desire to. As the size and composition of the housing stock are ultimately determined by demographics, something which policy makers have little influence over in the short run, the housing stock must be allowed to align itself with those underlying fundamentals. Prices should also be allowed to move towards their long run relationship with household incomes. Getting families into homes they could not afford was a major contributor to the housing bubble. We should not seek to repeat that error. We must also recognize that prolonging the correction of the housing market makes the ultimate adjustment worse, not better. Lastly it should be remembered that one effect of boosting prices above their market-clearing levels is the transfer of wealth from potential buyers (renters) to existing owners. As existing owners are, on average, wealthier than renters, this redistribution is clearly regressive.

PREPARED STATEMENT OF IVY ZELMAN

CHIEF EXECUTIVE OFFICER, ZELMAN & ASSOCIATES

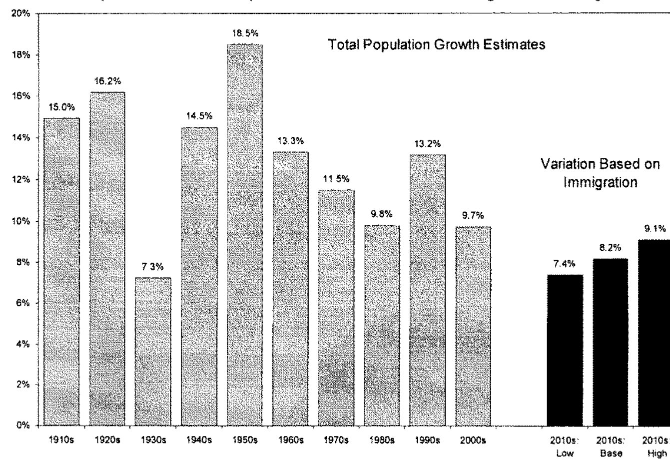
SEPTEMBER 14, 2011

Thank you Chairman and Honored Senators for the opportunity to testify on the State of the Housing Market.

As we sit here today in the sixth year of the worst housing crash since the Great Depression, many have suggested that we have become a "Renter Nation" and the American Dream of homeownership is dead. I do not believe this to be the case. Our great nation is still forming new households and I expect population and household growth to support building activity at levels nearly triple the current pace.

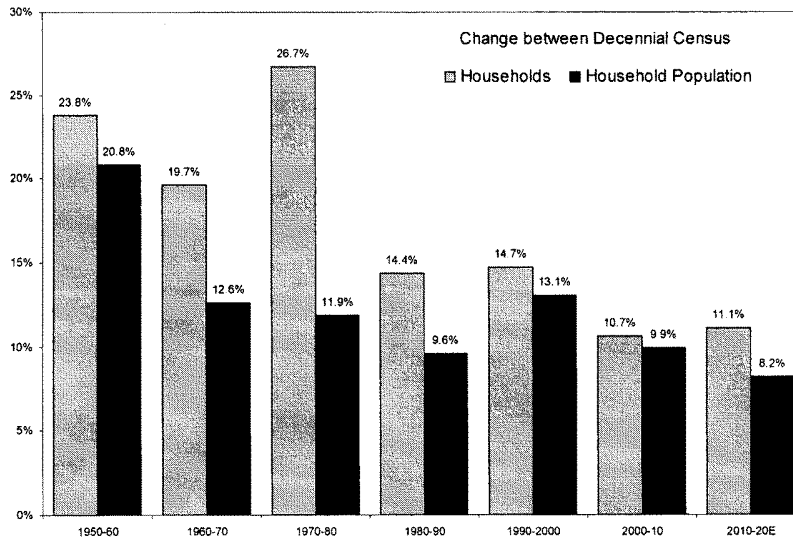
Currently, Zelman & Associates is forecasting 11% household growth for the current decade supported by 8% population growth, which I believe should eventually translate into a normal level of 1.4-1.6 million total housing starts per annum. For reference, in 2011, I estimate that total housing starts will be roughly flat from 2010 at 590,000 units. However, I expect single-family starts to hit a new post World War II low of 420,000 units, down 11% from 2010. To put today's depressed levels in perspective, the current level of total starts would compare to 1.06 million in 1982 when unemployment was as high as 10.8% and 30-year fixed mortgage rates were in the 16-18% range. I do not expect housing starts to get back to over one million units until 2014.

Exhibit 1: Population Growth Expected to Slow; However, Immigration is a Big Wildcard



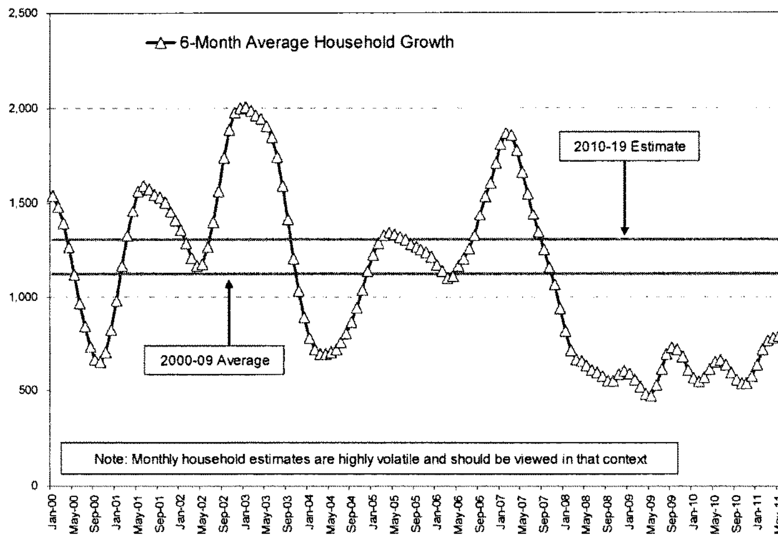
Source: Census Bureau, Zelman & Associates analysis

Exhibit 2: Demographics Drive Variance Between Households and Population Growth



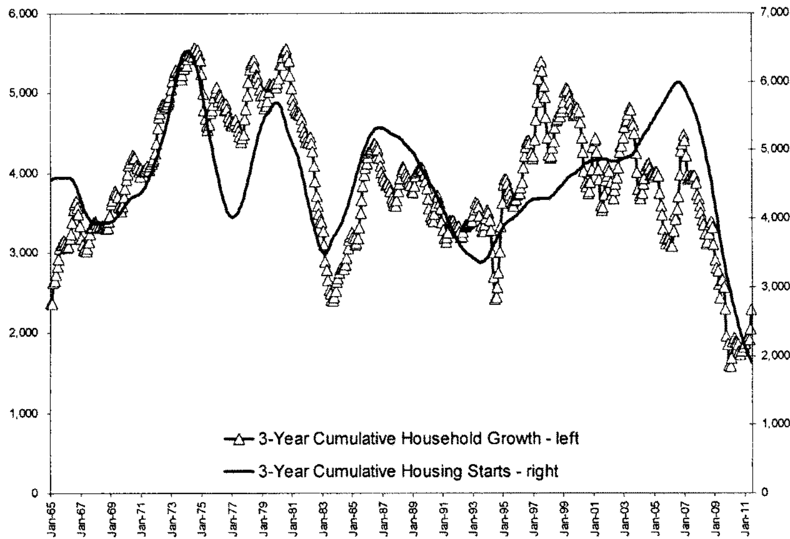
Source: Census Bureau, Zelman & Associates analysis

Exhibit 3: Depressed Household Formation Temporarily Reducing Need for New Stock



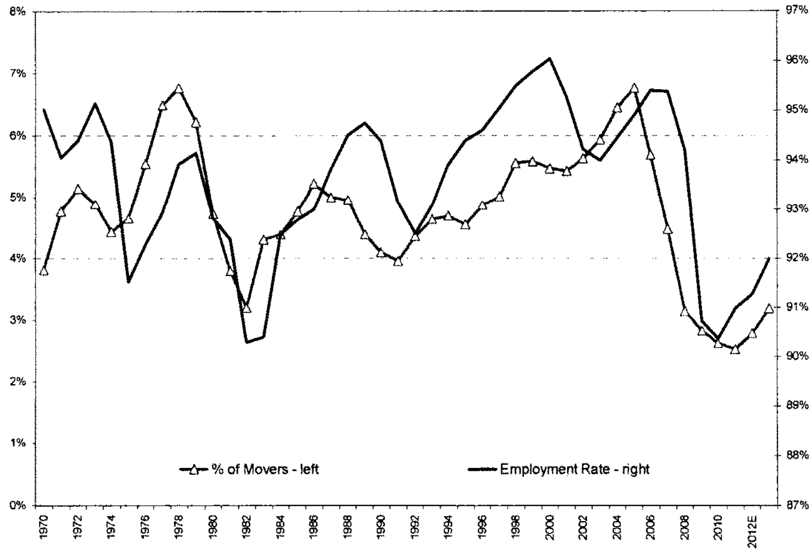
Source: Census Bureau, Zelman & Associates analysis

Exhibit 4: Eventually, Household Growth Should Drive Cyclical Recovery in Starts



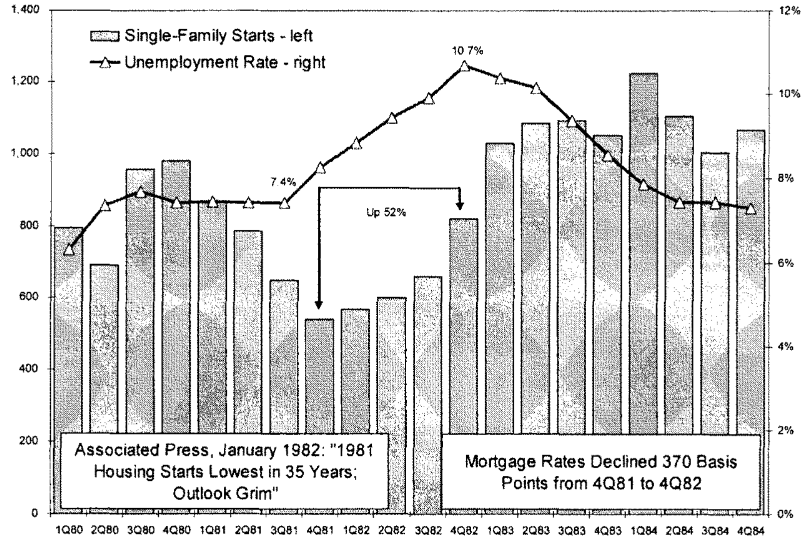
Source: Census Bureau, Zelman & Associates analysis

Exhibit 5: For Now Turnover Negatively Impacted by Employment, Consumer Confidence



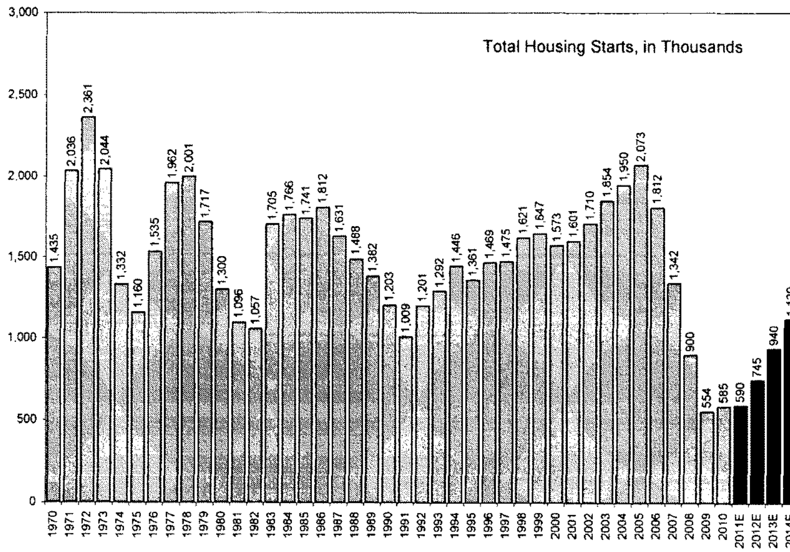
Source: BLS, Census Bureau, CoreLogic, NAR, Zelman & Associates analysis

Exhibit 6: However, Recovery Does Not Have to be Driven by Employment



Source: Census Bureau, Zelman & Associates analysis

Exhibit 7: Near-Term Starts View Absolutely Bearish, But Relatively Bullish

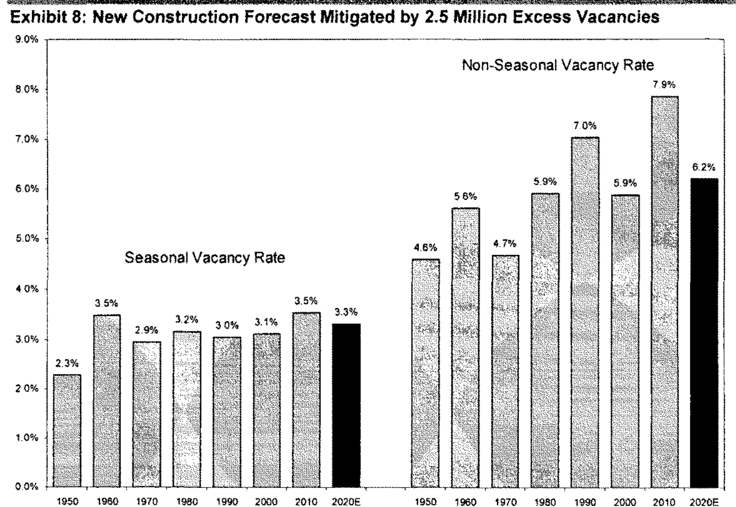


Source: Census Bureau, Zelman & Associates analysis

With that said, there has clearly been a disconnect between longer-term demographics and the near-term reality. I estimate there are currently 2.5 million "excess" vacancies that need to be absorbed before a return to "normal" building levels can be justified. For reference, seasonal homes accounted for only 14% of the excess while the other 86% is defined as for-rent, for-sale, sold, rented or the ambiguous catch-all category of "other". These vacancies have to be absorbed before new construction returns to normalized levels.

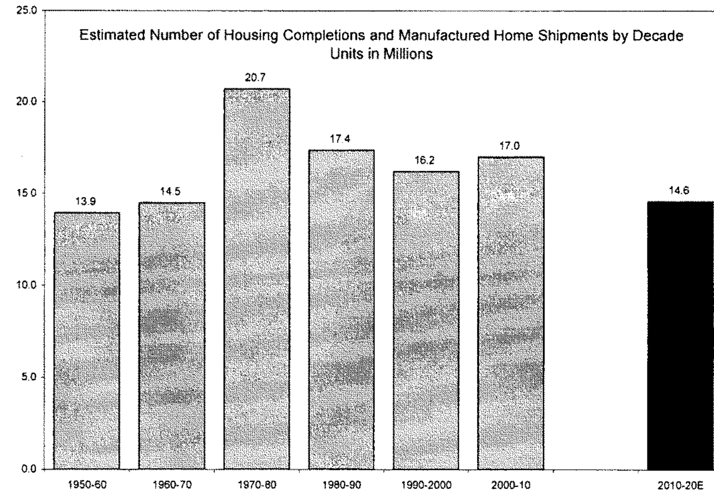
I expect seasonal vacancy rates to decline from the 2010 level, but remain slightly ahead of the 1990 and 2000 rates. For non-seasonal units, I expect a significant decrease in the vacancy rate to levels more consistent with the preceding 50 years as unoccupied, distressed properties transfer to more financially-sound investors that seek a rental yield and other household formations absorb the units. Our sustainable vacancy rate forecast of 9.5% in 2020 would compare to 9.0% in 2000 and 10.1% in 1990, and imply that 1.44 million units that are currently vacant would be occupied by the end of the decade, net of new intentional vacancies, partially satisfying incremental housing demand.

Exhibit 8: New Construction Forecast Mitigated by 2.5 Million Excess Vacancies



Source: Census Bureau, Zelman & Associates analysis

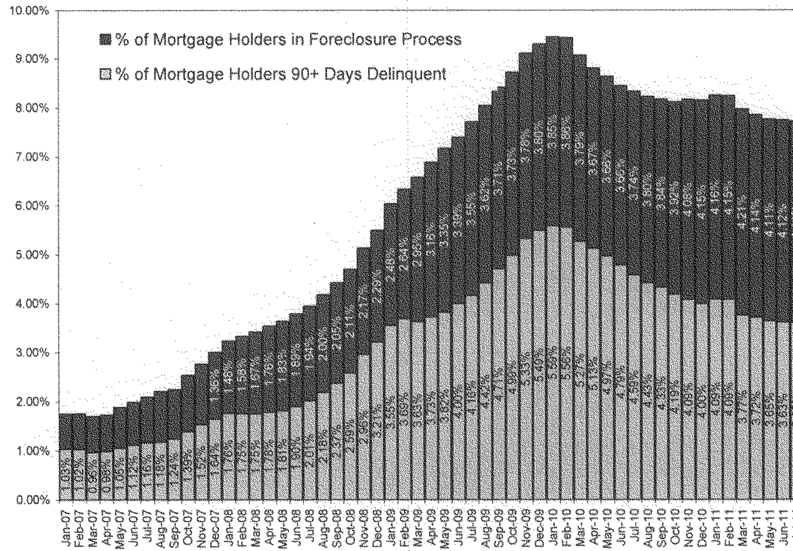
Exhibit 9: But We Will Have a Cycle Once Excess Supply Is Absorbed



Source: Census Bureau, Zelman & Associates analysis

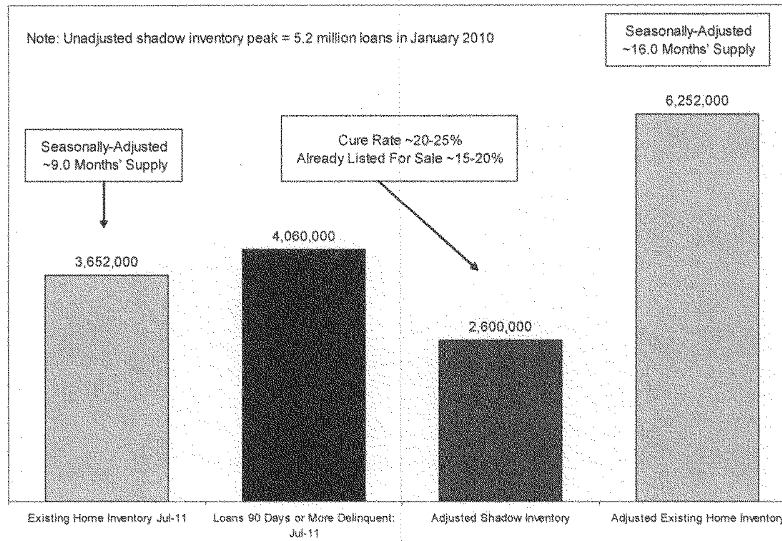
Furthermore, the number of excess vacancies has the potential to move even higher given the current pipeline of 4.1 million loans that are either in the foreclosure process or at least 90 days delinquent as of July 2011, according to Lender Processing Services. While some of these late-stage delinquencies and foreclosures in process would already be included as vacancies, many of the dwellings remain occupied by the delinquent borrower. It is worth noting that I do believe a material portion of these 4.1 million borrowers that are presently at least 90 days delinquent or in the foreclosure process will be "cured", mainly through modification efforts. Specifically, when calculating today's "shadow inventory", I assume a 20-25% cure rate on these loans as the effectiveness and sustainability has continually increased on newer vintage modifications. On the other hand, I am not incorporating the 2.5 million loans 30-89 days delinquent, or any future early-stage delinquencies that will ultimately flow through the process.

Exhibit 10: 4.06 Million Borrowers Are at Least 90-Days Behind on Their Mortgage



Source: LPS Applied Analytics, Zelman & Associates analysis

Exhibit 11: Shadow Inventory Remains Significant and Adds to Excess Supply

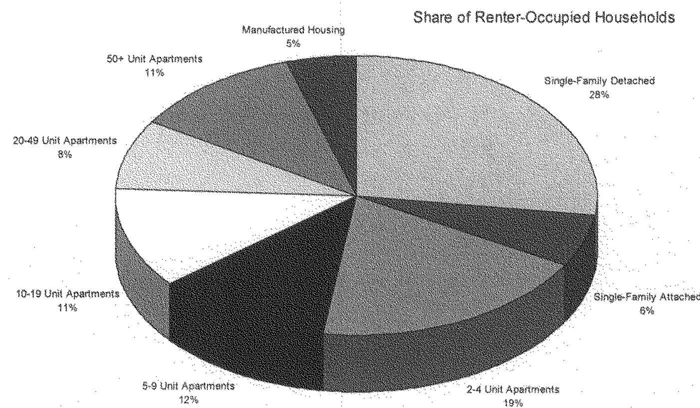


Source: LPS Applied Analytics, NAR, Zelman & Associates analysis

I believe the most powerful tool that Washington can provide is a rental program to dispose of these vacant REO and future foreclosures in an orderly manner. The most efficient and cost effective way to achieve this goal is for the GSEs to ease financing terms and expand financing options to investors that would purchase properties at low LTVs and pursue a single-family rental strategy.

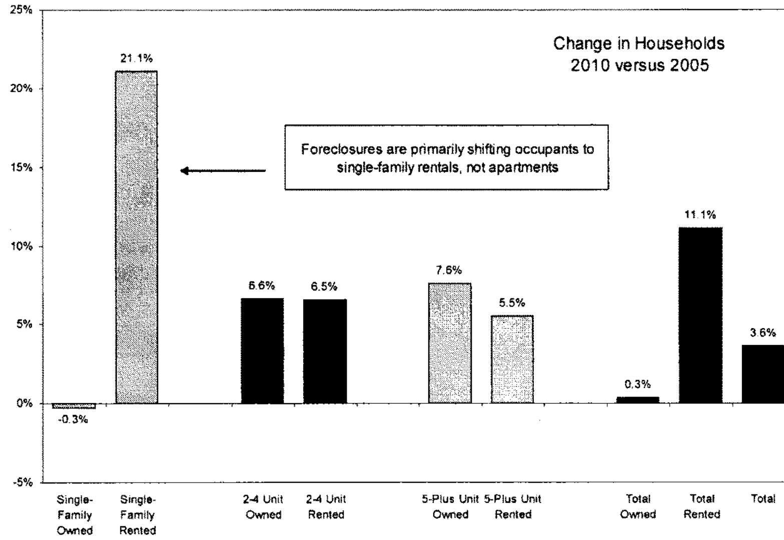
Over the past five years, single-family rental has been the fastest growing residential asset class. From 2005 to 2010, single-family rentals grew at 21% versus just a 4% increase in total housing units. In the hardest hit markets, such as Nevada, Arizona and Florida, single-family rental units increased 48%, while apartment units were virtually unchanged.

Exhibit 12: Do Not Underestimate the Single-Family Rental Market



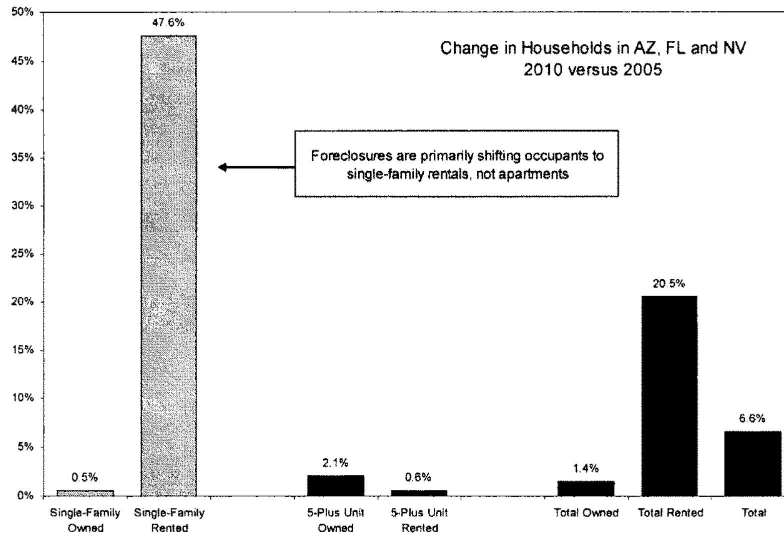
Source: Census Bureau, Zelman & Associates analysis

Exhibit 13: In Fact, SF Rentals Have Been the Biggest Beneficiary of Foreclosures



Source: Census Bureau, Zelman & Associates analysis

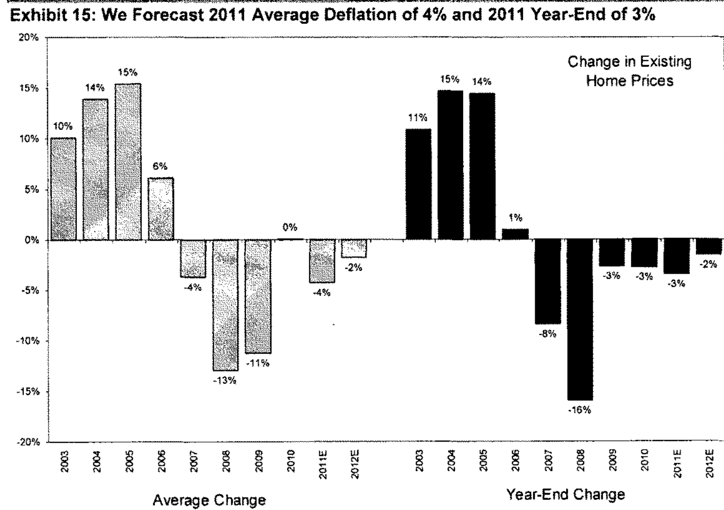
Exhibit 14: Apartments Seeing Virtually No Boost in Most Distressed Markets



Source: Census Bureau, Zelman & Associates analysis

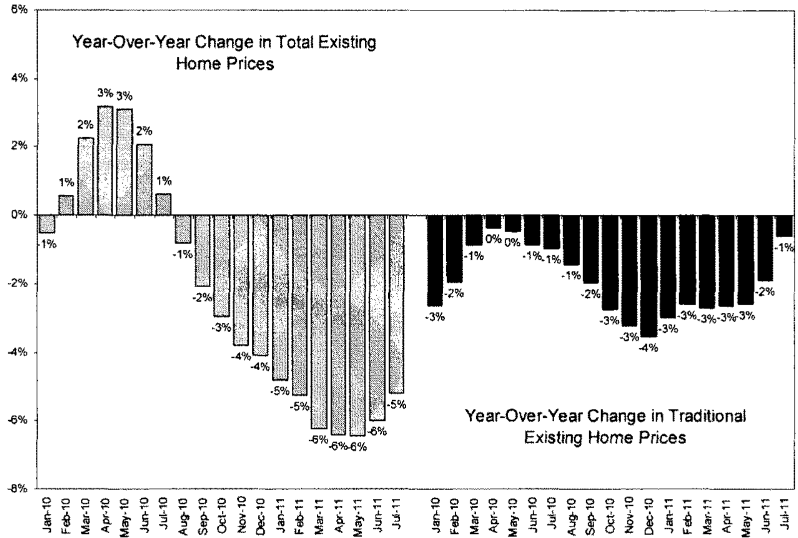
Facilitating an orderly transfer of these distressed units should also have a favorable impact on pricing. Given modest improvement in the economy, record levels of affordability and a reduction in inventory, through the first seven months of 2011 home price deflation has diminished. In fact, prices of traditional homes, excluding foreclosures and short sales, were down just 1% on a year-over-year basis in July according to CoreLogic versus a 5% decline for the total market, suggesting double-digit pressure for distressed sales, which currently account for approximately one-third of all transactions.

Exhibit 15: We Forecast 2011 Average Deflation of 4% and 2011 Year-End of 3%



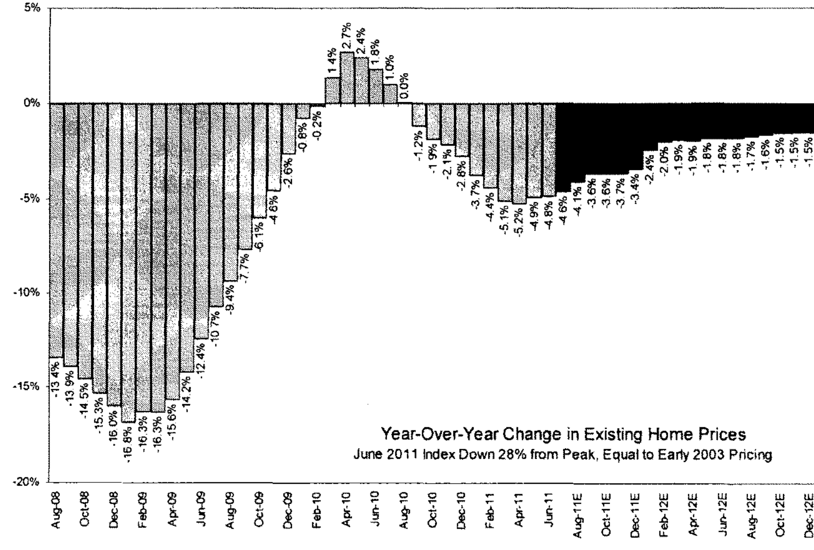
Source: Zelman & Associates analysis

Exhibit 16: Distressed Sales Leading the Way on Deflation; Traditional Market Stabilizing



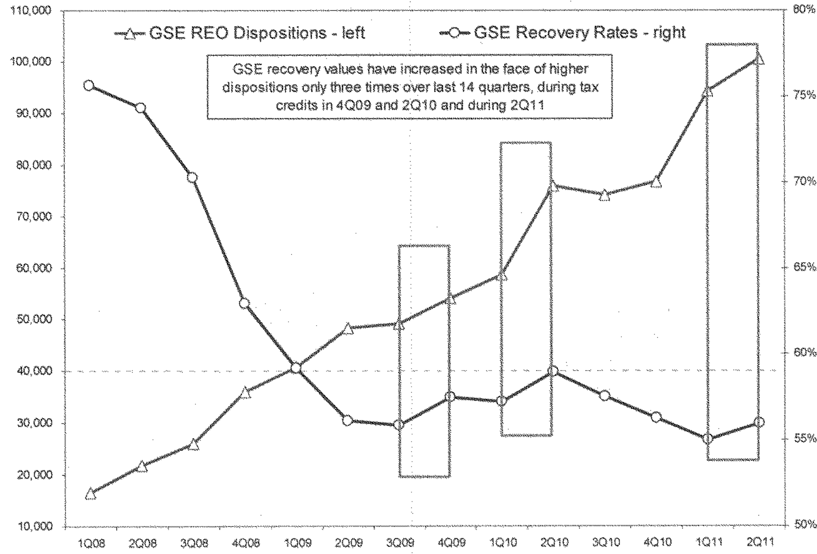
Source: CoreLogic, Zelman & Associates analysis

Exhibit 17: Monthly Home Price Comps Expected to Get Less Negative into 2012



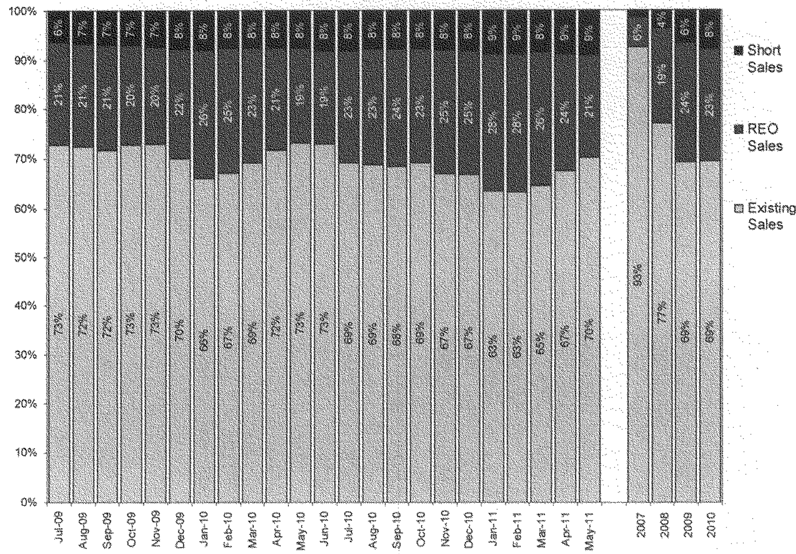
Source: Zelman & Associates analysis

Exhibit 18: While Further Deflation Expected in 2012, Recent Data Has Been Encouraging



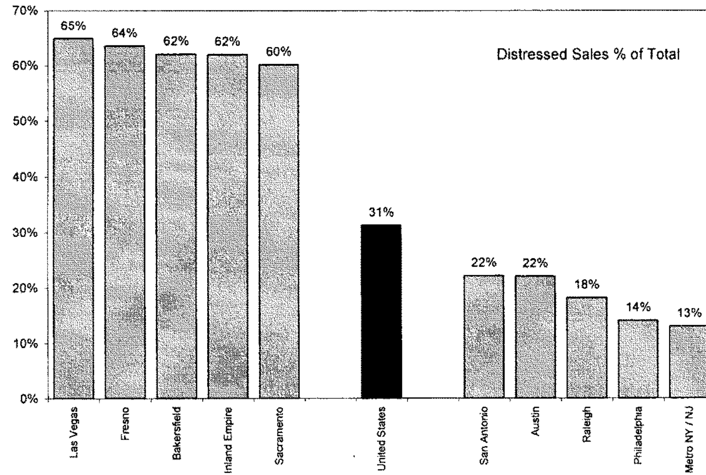
Source: Fannie Mae, Freddie Mac, Zelman & Associates analysis

Exhibit 19: Distressed Sales Have Grown to Unprecedented Levels in Recent Years…



Source: CoreLogic, Zelman & Associates analysis

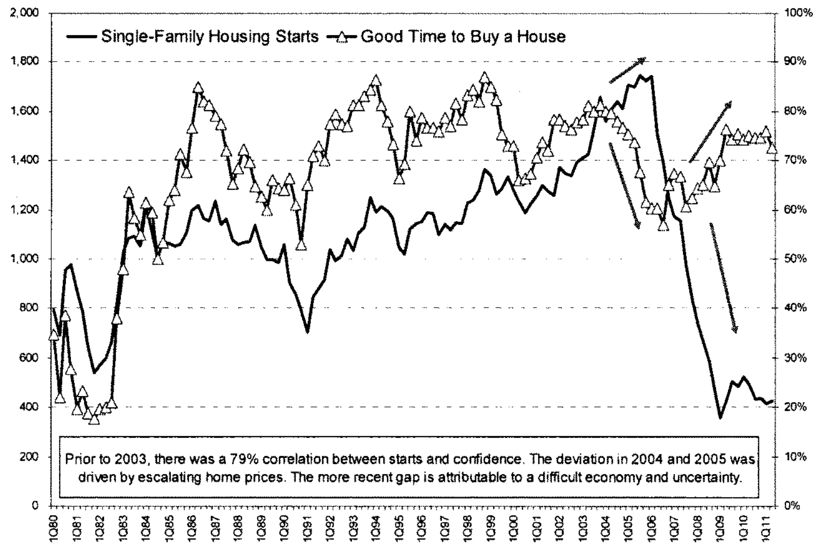
Exhibit 20: ...Particularly in Former Hotbed Markets...



Source: CoreLogic, Zelman & Associates analysis

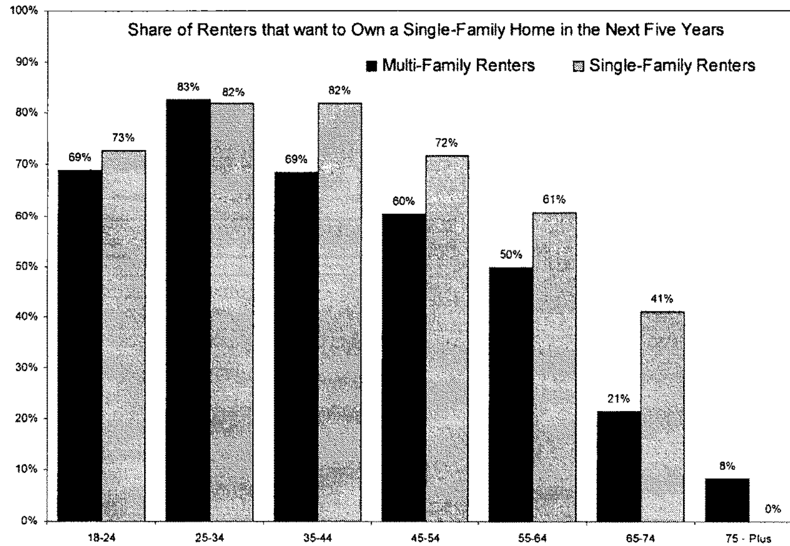
The second piece of the equation is demand, which remains at all-time record lows when measured by sales activity. Despite favorable affordability and historic low interest rates, this has not been enough to move buyers off the sideline. Nevertheless, according to the University of Michigan Consumer Sentiment Survey, 72% of respondents believe that now is a good time to buy a home. Furthermore, a recent survey by our firm of 1,500 renters conducted in five markets showed that 67% of those surveyed want to become homeowners over the next five years, with 82% of renters in the key 25-34 age group expressing their desire to buy a home.

Exhibit 21: Despite Desire to Own, Consumers are Not Pulling the Trigger



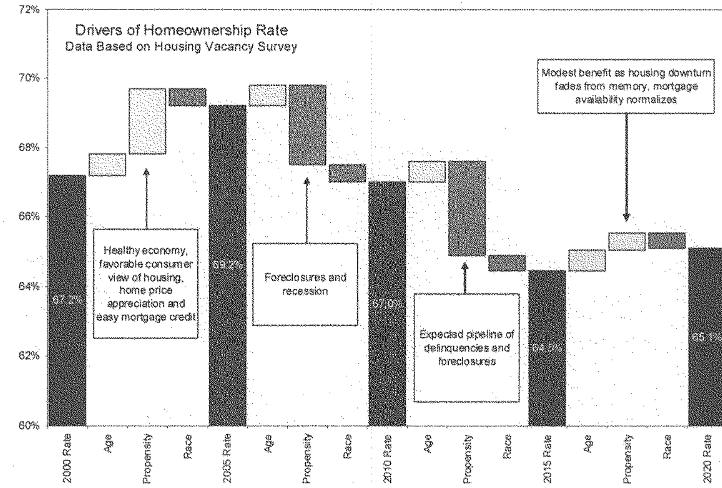
Source: Census Bureau, University of Michigan Surveys of Consumers, Zelman & Associates analysis

Exhibit 22: The American Dream is Still Alive; 67% of Renters Want to Own



Source: Zelman & Associates Renter Survey

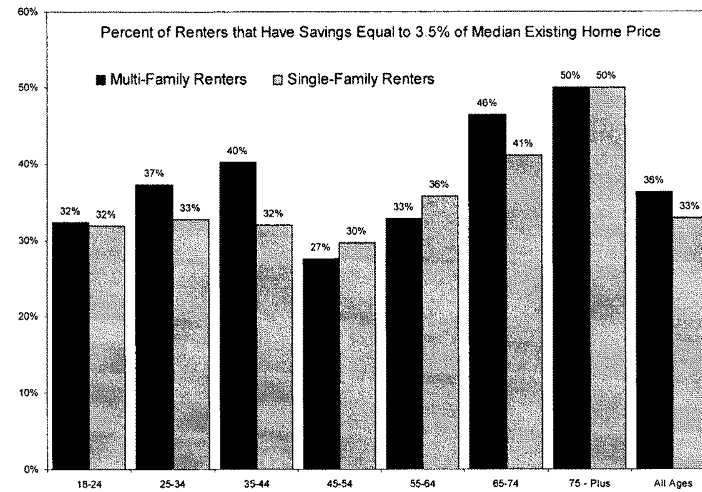
Exhibit 23: Homeownership Rate to Remain Under Pressure During First Half of Decade



Source: Census Bureau, Zelman & Associates analysis

So if people want to purchase a home and think now is a good time to do so, why aren't they acting on those desires? The answer, I believe, is twofold. The first issue is the weak condition of consumers' balance sheets, which are still laden with high levels of net debt and negative equity. Indicative of these challenged consumers, our renter survey showed that just 33% of respondents were able to come up with the minimum 3.5% down payment necessary to purchase a median priced home using FHA financing today.

Exhibit 24: Few Households Can Afford Down Payment Today

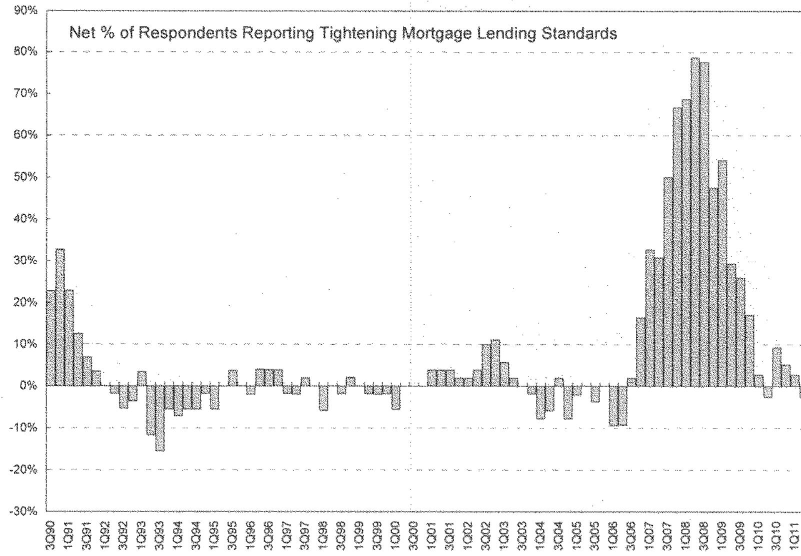


Source: Zelman & Associates Renter Survey

The second issue is uncertainty, which I believe is a nationwide problem negatively impacting home sales and prices given the volatility created by prior tax credits, fear of job loss and mixed messages sent by the government around future housing policy. However, regional differences are significant, with major dichotomies dependent upon levels of unemployment, distressed inventory, negative equity, delinquencies and vacancies.

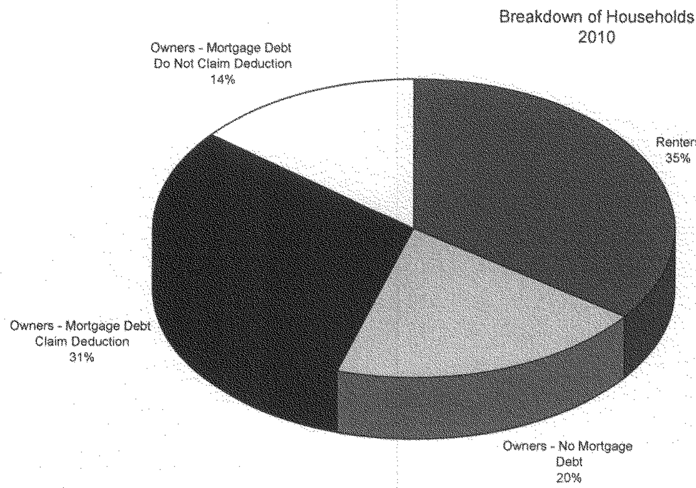
Nationally, one of the most significant problems prospective homebuyers face today relates to stringent underwriting criteria, magnified by strict credit overlays being imposed by banks due to unknown risk related to putbacks or other future unexpected government burdens. As a result, many qualified homebuyers are being turned away. Creating a business environment that would encourage banks to remove these stringent overlays that are above and beyond already-tight lending criteria would be a catalyst to spur housing activity. I also believe that given the still-tenuous nature of the housing market, allowing the GSE and FHA loan limits to roll back to lower levels on October 1st is a significant mistake and should be put off until the market is on more solid footing. Similarly, any legislation related to eliminating or reducing the mortgage interest deduction should be carefully crafted and only considered with a longer-term implementation in mind.

Exhibit 25: Mortgage Underwriting Standards at Extremely Stringent Levels



Source: Fed Loan Survey, Zelman & Associates analysis

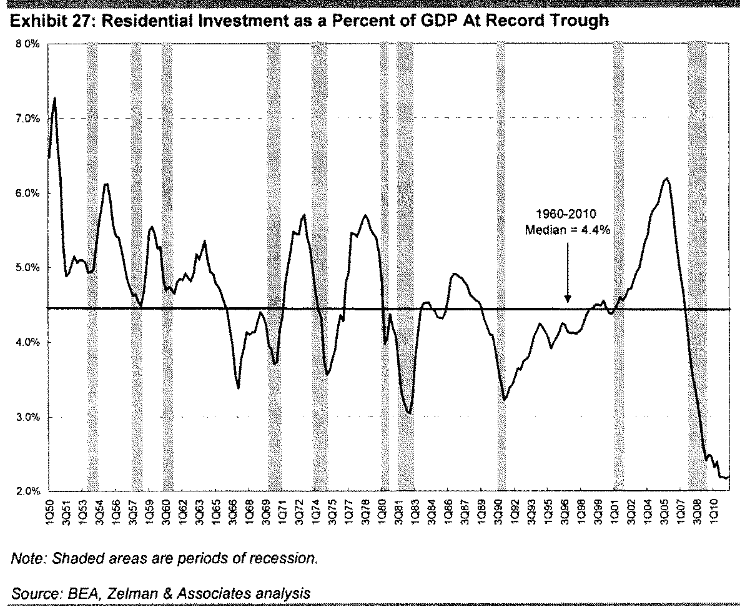
Exhibit 26: Minority Gain from Mortgage Interest Deduction But Important to Psychology



Source: IRS, Zelman & Associates analysis

In closing, housing has historically been a significant driver of recessions and recoveries. Currently, residential investment represents just 2.2% of GDP, representing an all-time trough and well below the long-term median of 4.4%, suggesting that the industry has been a significant headwind on economic growth. Housing's recovery is essential to the overall success of a broad economic recovery, and without it the economy will continue to languish.

Exhibit 27: Residential Investment as a Percent of GDP At Record Trough



Note: Shaded areas are periods of recession.

Source: BEA, Zelman & Associates analysis

Thank you again for the opportunity to testify today.

PREPARED STATEMENT OF DAVID STEVENS

President and Chief Executive Officer, Mortgage Bankers Association

September 14, 2011

I. Introduction

Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee, thank you for the opportunity to provide this statement on behalf of the Mortgage Bankers Association (MBA)[1] on the occasion of this hearing on new ideas for refinancing and restructuring mortgage loans. My name is David Stevens and I am MBA's President and Chief Executive Officer. Immediately prior to assuming this position, I served as Assistant Secretary for Housing at the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) Commissioner.

My background prior to joining FHA includes experience as a senior executive in finance, sales, mortgage acquisitions and investments, risk management, and regulatory oversight. I started my professional career with 16 years at World Savings Bank. I later served as Senior Vice President at Freddie Mac and as Executive Vice President at Wells Fargo. Prior to my confirmation as FHA Commissioner, I was President and Chief Operating Officer of Long and Foster Companies, the Nation's largest, privately held real estate firm.

We all know there is plenty of blame to go around for the mistakes made in getting to where we are today. Rating agencies overrated bonds; Fannie Mae and Freddie Mac relaxed the terms of their loan requirements; insurers provided credit enhancements to loans that were not creditworthy; borrowers falsified key credit characteristics like income, employment and occupancy status; lenders relied on overly optimistic property appreciation assumptions; servicers were ill-prepared to address significant loan performance and volume shifts, and so on. Although I have said this publicly many times, it bears repeating—mortgage lenders need to take responsibility for their share of excesses during the recent housing boom. Since the market collapsed in 2008, we have had to face some basic, if unpleasant truths—some people who were given loans should not have received them. And as an industry we excused, or at least overlooked, the unethical people and practices, and the perverse incentives that motivated them.

I am encouraged by the fact that the focus of today's hearing is toward the future and the role that private capital can play in recovering from this extraordinary collapse of the housing market. MBA is grateful for the variety of relief efforts undertaken by Congress and two Administrations to bolster the markets such as the Home Affordable Refinance Program (HARP), first-time home buyer tax credits, and the Hardest Hit Funds. Clearly, the challenge is greater than these programs could support on their own. The private sector also has risen to the challenge of assisting borrowers in need by refinancing approximately four million mortgages—five times as many as all Federal programs combined. This is why MBA believes a long-term sustainable remedy will only come from a return of private capital to the housing finance sector.

Unfortunately, significant, but not insurmountable, obstacles are preventing sufficient levels of private capital from returning to the market. But I am convinced these obstacles can be overcome and we will eventually be able to replace the Federal Government with private investors as the primary source of housing finance liquidity. MBA recognizes that our ability to affect change depends on rebuilding badly shaken trust by restoring credibility, transparency and integrity to our industry.

I also want to highlight the fact, as shown in recent MBA data on delinquencies and foreclosures, that the foreclosure overhang is heavily concentrated in just a handful of States. This has important policy implications because more aggressive measures may be required in some areas, while they may not be needed in others. For example, bulk sales of real estate owned (REO) properties may be necessary and

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand home ownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: *www.mortgagebankers.org*.

helpful in severely impacted markets, but may be harmful in markets that are currently muddling through. Different prescriptions may be needed in different geographies.

In my remarks below, I will identify what MBA views as the primary obstacles to a more robust level of housing finance transactions. I will then offer possible solutions with which they can be overcome.

II. Obstacles to Recovery

Obstacle 1: High Unemployment

In his address to Congress last week, the President acknowledged that the number one impediment to an economic recovery is the current jobs situation. MBA looks forward to learning more about the Administration's proposed solutions. In the meantime, I would like to amplify the President's concerns by providing context to the relationship between today's high unemployment rate and low real estate finance activity.

- Economic growth was disappointingly slow in the first half of 2011, and job growth essentially halted during the summer.
- The unemployment rate remained stuck at 9.1 percent as of August, as no new jobs were created during the month. Private sector job growth remains weak, while State and local governments continue to cut back employees.
- MBA expects the unemployment rate to be little changed through the remainder of 2011, and only slight declines in the unemployment rate in 2012, decreasing to 8.8 percent by the end of 2012.
- MBA forecasts economic growth to run at 1.3 percent for 2011, and 2.2 percent for 2012—barely enough to bring down the unemployment rate over time.
- On the housing front, we expect the purchase market will remain slow. In short, the key obstacle to a more robust market continues to be unemployment.

Obstacle 2: Conflicting Policy Objectives

Another obstacle to a sustained economic recovery is the numerous conflicts that exist for policy makers. For example, as conservator of Fannie Mae and Freddie Mac, the Federal Housing Finance Agency (FHFA) has a duty to preserve the value of these two Government sponsored enterprises (GSEs). However, using the GSEs as vehicles to support the housing recovery could further jeopardize their long-term viability.

It is well-recognized that the mortgage market is functioning today because of heavy Government support—a position that is neither sustainable nor desirable long-term. Providing borrower relief through the GSEs or existing Government channels could make it even harder for that to change.

Nevertheless, MBA believes it is possible for the GSEs to increase their support for housing finance without significantly impacting their safety and soundness profile. For example, MBA believes the GSEs could expand their lending guidelines, or the origination deadline for HARP-qualification could be extended. Specific consideration should be given to maintaining the existing conforming loan limits in high cost areas.

Obstacle 3: Regulatory Uncertainty

We also recognize that changes are needed to ensure such excesses will not be repeated in the future. Nevertheless, the continuing onslaught of regulations and supervisory actions, all targeting the mortgage industry, are doing more harm than good to the mortgage market, and are clouding the future of our business. The sheer quantity of new rules under consideration is placing great stress on lenders, particularly smaller lenders who serve communities throughout the Nation every day. Lenders are scaling back the number of production employees as business declines, but are offsetting those cuts with new compliance hires. This unfortunate allocation of resources runs counter to any hope of recovery in the housing sector.

The avalanche of regulations triggered by passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) is intended to ensure that no single financial institution becomes too big to fail; it also has spawned concerns about being too small to comply, raising the very real possibility that borrowers may ultimately suffer from decreased credit availability and the economic inefficiencies of a less competitive market. For example, rules to implement Dodd-Frank's risk retention and "ability to repay" frameworks have yet to be finalized. Unless both of these overlapping frameworks are resolved with clear and specific safe harbors, uncertainty will persist in the housing finance markets. Evidence from Securities and Exchange Commission (SEC) filings from Real Estate Investment Trusts (REITs) and other hedge funds suggest an increasing level of interest in the housing market

from private investors. Unfortunately, these investors have expressed a willingness to either refrain from participation or impose an "uncertainty premium" until the level of regulatory ambiguity dissipates.

Obstacle 4: Repurchase and Litigation Risk

Another key obstacle that prevents many qualified borrowers from being able to refinance is the loan repurchase demands made by the GSEs to lenders. These repurchase demands are based on representations and warranties (reps and warrants) to the GSEs when lenders sell the loan to them. These reps and warrants certify that the lenders have met the investors' standards on the loans, covering items like property valuation, and borrower characteristics such as income, employment status, assets and liabilities, and required documentation to evidence these.

Under normal circumstances, if a loan goes into default, the GSE may demand that the originator repurchase the loan if the originator cannot prove the loan was adequately underwritten. Nowadays, the GSEs are reportedly using repurchase requests to manage their own performance profile by requiring lenders to buy back loans even though the rep and warrant breach was unrelated to the performance of the loan.

Additionally, refinancing a loan extinguishes the original loan's reps and warrants and subjects the refinancing lender to a new set of reps and warrants. As a result, few lenders are willing to accept the rep and warrant risk on refinancing a higher-risk loan, even one with a reasonably clear payment history and existing GSE guaranty. This is because the GSEs consider a newly refinanced loan that defaults in the first 6 months an "early payment default" and subject to repurchase regardless of the payment history of the original loan.

MBA believes legitimate repurchase requirements are an effective means of holding originators accountable for the quality of the loans they underwrite. However, MBA believes originators should not be held accountable for the performance of a loan if it met the GSEs' guidelines and all applicable laws and regulations, but failed due to changing economic circumstances. In light of the elevated repurchase activity from the GSEs recently, MBA anticipates that lenders will remain concerned about underwriting new mortgages, even if they are already guaranteed by Fannie Mae and Freddie Mac. All lenders are necessarily cautious with respect to protecting their capital base given the widespread uncertainties in this environment.

For these reasons, MBA believes policy makers should consider setting a clear limit on the duration of an originator's repurchase obligation following the origination date.

Policy makers also should be mindful that litigation and penalties to make reparations for past mistakes reduce the availability of funds to extend to borrowers in the future. The ultimate impact of both increased litigation and repurchase activity could be lenders holding back capital to hedge against growing litigation and repurchase risk, liquidity that is needed not just for mortgages, but for all sorts of lending that helps drive investment in the economy and creates jobs.

Obstacle 5: Inconsistent Foreclosure Regimes

Foreclosures continue to be highly concentrated in just a few States. According to MBA's National Delinquency Survey, in the second quarter of 2011 five States accounted for 52 percent of the Nation's foreclosure inventory. The single biggest factor determining whether or not a State has a large backlog of foreclosures is whether the State has a judicial foreclosure system, meaning whether or not a foreclosure needs to go through the courts. In nonjudicial States, foreclosures can proceed much more quickly simply because the procedure is not limited by available court dates. Moreover, the process tends to be less cumbersome. Particularly during this downturn, judicial States have been overwhelmed by a backlog of foreclosure cases, while nonjudicial States have been able to process the volume much more quickly. In the second quarter of 2011, of the nine States that had foreclosure inventory rates above the national average, eight have judicial regimes. The only exception was Nevada, which has been particularly hard hit.

One of the reasons the percentage of loans in foreclosure in California (3.6 percent) is considerably lower than States like Florida (14.4 percent), New Jersey (8.0 percent), Illinois (7.0 percent), and New York (5.5 percent) is that California has a nonjudicial foreclosure system. Therefore, as we work toward resolving the foreclosure overhang in the housing market, we should be careful to distinguish between the economic impediments to resolution and the legal impediments to resolution.

Obstacle 6: Excess Housing Inventory

Today the Nation faces a disproportionately large inventory of homes in the face of weak market demand. As of July 2011, there were roughly 3.8 million new and existing homes for sale representing a combined total of 9 months' supply. These numbers do not include the so-called shadow inventory of properties with owners who are significantly behind on their mortgages. These properties will likely come on the market in the upcoming months as distressed sales, short sales, foreclosure auctions, or as bank-owned properties. MBA estimates that this shadow inventory of loans that are three or more months delinquent or already in the foreclosure process totals approximately four million homes across the country. MBA expects about one to 1.2 million foreclosure sales and short sales per year; based on that estimate it will take the market 3.5 to 4 years to digest this shadow inventory overhang.

Credit availability to borrowers who traditionally would have comprised the demand for these homes has been limited. An Amherst Securities Group study conducted in 2011 indicates that of the borrowers with mortgages in June 2007, 19 percent of those borrowers would not qualify for a mortgage today due to their credit histories. For the population of potential home buyers who currently are interested in purchasing a home, credit availability is an issue. The average individual home buyer must meet increasingly stringent credit qualifications. As it has been widely reported, average loan-to-value (LTV) ratios for GSEs have declined from 75 percent to 68 percent in 2010 and average credit scores are 762.

First-time home buyers and minority home buyers are often the engine in the purchase money market; however, the recession has impacted these groups dramatically, and proposed regulations regarding the Qualified Residential Mortgage (QRM) and the Qualified Mortgage (QM) may further tighten underwriting. Therefore, we cannot rely on these populations to fuel the housing recovery. Thus, our historical home buying population is declining, the need for rental housing is growing, and the economy is stagnating.

III. MBA's Recommended Solutions

With these obstacles as a possible backdrop, I will now offer possible solutions that the public and private sectors can jointly implement to overcome them. They are not mutually exclusive solutions; rather they should be undertaken in a combined approach.

Solution 1: Restructuring Existing Mortgages

In addition to the significant numbers of foreclosed properties and mortgages in some stage of delinquency or default, many borrowers are unable to refinance to take advantage of historically low mortgage rates. The unusually low level of refinancing has prompted policy makers to introduce programs such as HARP, and others offered by FHA. Although those programs have helped some borrowers, program features and eligibility criteria exclude a significant number of borrowers who would benefit from a refinancing.

In response, some advocates have called for other types of large-scale mortgage refinance programs that would include principal forgiveness by lenders. Mandatory principal write down raises several serious concerns regarding the contractual rights of investors and determining whether sufficient documentation exists upon which to execute the transaction. MBA does not support mandatory principal write down but does, however, support voluntary principal write down programs such as the FHA Refinance Option, where such a transaction is appropriate under the factual circumstances. We however stress that these write downs must originate from a voluntary agreement between the parties, not a Government imposed mandate.

Others have called for refinancing programs that would offer borrowers new mortgage rates below current market rates. Although such programs could have a positive impact on the housing market and the economy, the Congressional Budget Office (CBO) and other analysts indicate that the programs would entail significantly higher costs to the Government.

Shared appreciation mortgage modifications also have been discussed as a potential vehicle to help reduce the home foreclosure rate. Under a shared appreciation mortgage modification, a lender agrees to reduce the principal balance of a troubled borrower's mortgage in exchange for the borrower sharing any future increase in the home's appreciation with the lender. The shared appreciation is based on a predetermined calculation and occurs upon the sale of the property. While we endorse all safe and sound efforts to assist borrowers in need, we note that shared appreciation mortgage modifications involve additional risk layering to the lender who, in this scenario, is now reliant on the home increasing in value in order to make this a truly favorable transaction.

This type of instrument can also be quite complicated and confusing for borrowers who, upon selling the home, may actually find themselves owing more to their lender then they anticipated if the property does increase in value. We also note shared appreciation loan modifications can raise tax issues for borrowers, as described in an Internal Revenue Service (IRS) revenue ruling.[2] For these reasons, MBA continues to have some concerns about this product and its value to homeowners.

MBA believes the preferred approach is adjusting the guidelines of existing programs. However each possible adjustment has its own unique policy conflict. For example, reducing the GSEs' loan level price adjustments (LLPAs) on otherwise HARP-eligible loans would reduce borrower refinancing costs and are arguably unnecessary because the GSEs already assume the credit risk of the existing loan to be refinanced. On the other hand, reducing LLPAs increase taxpayer exposure to paying for the GSEs' credit losses while the GSEs are under Federal conservatorship. Another option to consider is streamlining appraisal and other closing requirements in order to reduce the time and expense of refinancing. Raising HARP's 125 percent LTV requirement also could enable more otherwise qualified "underwater" borrowers to refinance into a lower interest rate mortgage. However, existing requirements of the "To-Be-Announced" (TBA) market and tax law may pose insurmountable constraints to pricing securities with loans in excess of 125 percent LTV at a level that attracts investor interest.

Given the multitude of conflicting policy objectives, MBA believes programmatic changes should be conducted in a deliberate and transparent manner that appropriates sufficient funding to offset additional expenditures.

Solution 2: REO Inventory Sales

Of the excess inventory on the market a significant number of properties are bank owned, or real estate owned (REO), properties. In August, the FHFA, in consultation with the Department of Treasury (Treasury) and HUD, released a request for information (RFI) soliciting input on new options for selling single-family REO properties held by Fannie Mae, Freddie Mac, and FHA. To respond to the RFI, MBA formed an interdisciplinary REO Asset Disposition Working Group of industry practitioners with expertise in this area.

MBA believes a top priority should be to stabilize neighborhoods and long-term home prices through actions to reduce the overhang of distressed properties. A reduction in the current REO inventory will provide for the swiftest and most efficient return to market stability. However, it is critical that public and private lenders balance consumer protections and taxpayer interests to ensure responsible asset disposition.

As many economists and policy makers have noted, the ideal disposition of REO properties is sale to owner occupants because of the market stabilizing nature of such transactions. Home buyers who intend to occupy REO properties are likely to have the longest time horizon, and the largest incentive to rehabilitate and maintain the homes. Getting more REO properties into the hands of owner-occupiers would be the best option for stabilizing neighborhoods. While sales to home buyers, including first-time home buyers, cannot be the entire solution for reasons stated previously, Fannie Mae, Freddie Mac, and FHA programs that provide preferential financing to owner-occupiers (such as the "FirstLook" programs) should be retained, expanded and marketed to a much greater extent to enable them to reach their maximum potential.

The next best option for REO disposition is sale to local investors. Local investors understand their local rental market and have a long-term stake in the stabilization of the neighborhood. Existing Government programs should be modified to support the financing and availability of local investment. Providing affordable, responsible financing options to investors not only eliminates REO properties, but also empowers neighborhoods by giving local residents an increased stake in its success. These tools would be especially beneficial in older, urban neighborhoods that face the challenges of aging housing stock and neighborhood blight.

For example, FHA should introduce an investor program, specifically one that includes a renovation option. One solution would be to temporarily lift the moratorium on investors participating in the Section 203(k) Rehabilitation Loan Program. The FHA Section 203(k) Rehabilitation Loan Program helps buyers of properties in need of repairs reduce financing costs, thereby encouraging rehabilitation of existing housing. With a Section 203(k) loan, the buyer obtains one FHA-insured, market-rate mortgage to finance both the purchase and rehabilitation of a home. Loan amounts are based on the lesser of the sum of the purchase price and the estimated

[2] Rev. Rul. 83-51; 1983-1 C.B. 48 (1983).

cost of the improvements or 110 percent of the projected appraised value of the property, up to the standard FHA loan limit.

HUD began promoting Section 203(k) to homeowners, private investors and nonprofit organizations in 1993. Private investors were often able to find undervalued properties, renovate them and sell them for more than the purchase price plus the cost of improvements, or provide much needed rental housing. Motivated by this profit potential, many investors successfully renovated and sold properties ranging from individual homes to entire blocks, thereby expanding home ownership opportunities, revitalizing neighborhoods, creating jobs, and spurring additional investment in once-blighted areas.

In 1996, however, following a report by the Inspector General describing improprieties concentrated in New York and insufficient HUD oversight, HUD placed a moratorium on all Section 203(k) loans to private investors. The Inspector General noted rampant fraudulent activity that resulted in financial gain for the participants and unrehabilitated houses in the neighborhoods.

MBA recommends that FHA lift the moratorium on investors participating in the 203(k) and reinstate it as a pilot to facilitate the purchasing and rehabilitating of REO properties by local investors. In recognition of the historical abuses of the program, MBA also recommends that the program be modified to ensure responsible lending and minimize fraudulent activity. Potential program requirements could include, but would not be limited to, the following:

1. Requiring a 15–20 percent downpayment, depending on the number of units;
2. Requiring that investors demonstrate a proven track record in managing properties;
3. Providing financing to REO property owned by FHA, the Department of Veterans Affairs, the Department of Agriculture, Fannie Mae, and Freddie Mac;
4. Requiring contractors to be insured and bonded;
5. Requiring an inspection by an independent third party to ensure that all of the work was completed, thus mitigating against fraud; and
6. Limiting the number of 203(k) loans that any single investor can have at any given time to ten, as well as limiting the number of homes in the process of rehabilitation at one time to four properties, with the option of a higher amount on an exception basis.

Fannie Mae and Freddie Mac can also implement temporary program changes to their HomePath and HomeStep programs respectively, such as adjustments to LLPAs and an increase in the maximum number of properties owned, if the investor has demonstrated the ability to manage multiple properties. To illustrate, currently, with the Fannie Mae's HomePath program, investors who put down 20 percent on an investment property have to pay three points in fees (or about an additional 1.5 percent in rate). If the investor puts down 40 percent, the fees are 1.75 percent.[3] These fees assume that the investor has a credit score above 700. If the credit score is below 700, the investor must pay another one point. Thus, a typical investor's rate could be seven percent to 7.5 percent even in this historically low rate environment.

Additionally, Freddie Mac limits investors to four properties[4] and Fannie Mae limits investors to ten properties, in certain circumstances.[5] Care should be taken not to stretch the capacity of the small, single-family investor; however, for investors who can demonstrate significant experience with managing multiple properties, FHFA should consider making the policy consistent between Fannie Mae and Freddie Mac.

So long as the concerns raised above are addressed, MBA supports bulk investor sales in an effort to move the U.S. housing market out of its problematic housing supply and demand imbalance and alleviate the REO inventory; however, it is imperative that safeguards be implemented to protect against fraud and that the process chosen to dispose of the assets be clear, transparent, and equitable to all interested and qualified investors. The challenge in designing appropriate safeguards is to avoid constraining the disposition process or to make the program so restrictive as to sabotage its success. MBA recognizes in order for the any program to be successful it should be simplistic, quick to administer, and attractive to investors.

[3] Fannie Mae, Loan-Level Price Adjustment (LLPA) Matrix and Adverse Market Delivery Charge (AMDC) Information, 12.23.2010, 2011.
[4] Freddie Mac Seller Servicer Guide, 22.22.1.
[5] Fannie Mae Seller Servicer Guide, B2-2-03.

Bulk Sales Should Incorporate Mandatory Hold or Recapture Provisions

One of MBA's chief concerns is to ensure that bulk property purchases do not contribute to the destabilization of home prices. Any program must also protect Fannie Mae, Freddie Mac, and FHA against fraud and provide the greatest recovery so as to protect the taxpayer. To achieve these objectives we believe that FHFA and HUD should consider adopting one of the following approaches:

- *Mandatory Hold Period*—One of the objectives of the RFI is to remove the significant numbers of REO from the market that are placing enormous downward pressure on home prices. Ideally, converting these homes to rental properties removes at least some of the REO supply from the market and helps improve the stock of affordable rental housing. To increase the likelihood that REOs sold to investors actually become rental properties and do not simply get flipped, we suggest that Fannie Mae, Freddie Mac, and FHA consider a mandatory hold period of 3 years. Such a hold requirement could be managed through deed restrictions. We recognize, however, those deed restrictions may reduce the pool of bidders or negatively impact bid prices.
- *Profit or Equity Sharing*—Profit sharing would allow Fannie Mae, Freddie Mac, and FHA to share in gains on sales of REO properties later sold by the investor. MBA prefers equity sharing provisions over mandatory hold periods because it allows more asset liquidity. Such equity sharing could be structured as a waterfall so that Fannie Mae, Freddie Mac, and FHA would share in a greater percentage of the profit from sales in earlier years. The equity sharing should decrease incrementally over a period of time, such as 3 to 10 years. The equity sharing concept might be preferable over a mandatory hold period because it allows the investor to sell homes at any time when the housing market improves more rapidly than anticipated or for other liquidity purposes, but protects the Fannie Mae, Freddie Mac, and FHA against fraud in valuation (*e.g.,* flopping). Importantly, terms of the waterfall may be unique to each bulk deal, with clearly defined terms outlined in the prospectus of the deal and the bidding process, and an open and transparent bidding process. Profit or equity sharing should not apply if companies sold the homes to a related company, to achieve balance sheet management for example. MBA notes that equity sharing agreements currently exist in the market, so model agreements are readily available.

Evaluate Capital Gains Treatment

Currently the long-term capital gains rate is 15 percent but assuming that the 2001–2003 tax provisions will expire, and with the new Medicare tax on investment income the long-term capital gains rate will increase to almost 25 percent. Thus, any policy which would shield investors from this tax would be a significant incentive, as it could increase the after-tax return substantially. It might be possible to design a program that provided relief from these high capital gains tax rates for investors in REO properties. However, it might be operationally difficult to ensure that only REO investors benefit, and may perhaps be inequitable to investors in distressed assets that may have been purchased through short sales or foreclosure auctions. The goal of such a policy would be to stabilize the market through incentives to buy now, regardless of the channel of purchase.

The CBO would likely score any reduction in the capital gains tax as revenue negative. However, if the policy works to stabilize certain housing markets, in actuality it could be revenue neutral or positive because the Government would gain revenue if home prices begin to increase again, and if the pace of home sales were to return to more typical levels.

As noted above, policy makers should consider methods provide neighborhood stability such as requiring certain holding periods for the properties, perhaps 3 to 5 years, or to mandate profit sharing over the first 3 years after purchase so that investors have little incentive to flip the properties.

This recommendation would require a change in the current tax code, which would be difficult to accomplish in these budgetary sensitive times. However, providing targeted, favorable tax relief would provide significant incentive for investors and help expedite the return of a normal balance of supply and demand as well as positively impacting bid prices as the assets are sold.

Create Incentives for Investors To Rehabilitate REO Properties

MBA estimates that 30–40 percent of the existing REO properties require significant renovation. A focus of the RFI is to address housing needs in strong rental markets by turning REO properties into safe rental properties for families who are no longer homeowners. MBA is concerned that REO properties will transfer from

the Government's balance sheet to the private sector's balance sheet without addressing the goals of the RFI. MBA is also mindful of over-interference by the Government in an already highly regulated market and does not want to suggest program restrictions that constrain the investor or are cumbersome for the Government to administer.

MBA recommends that FHFA conduct extensive due diligence on investors who bid on the pools, with an emphasis on evaluating the investor's record on properties being rented and experience with rehabilitation. This due diligence would provide an indication of the investor's willingness and ability to meet the program goals outlined in the RFI.

Moreover, to incent investors to rehabilitate and rent or sell properties quickly, Fannie Mae, Freddie Mac, or FHA could escrow a percentage of the investor's proceeds, which would be returned if a portion of the pool was rented within a predetermined time period, such as 6 to 12 months. Being able to rent the home would indicate that the property met local code requirements without Fannie Mae, Freddie Mac, or FHA having to perform on-site inspections. If the homes were not rented, there would not be a penalty imposed on the investor.

Limiting the bidding to qualified investors might reduce bid prices to some extent. However, this cost is offset by the substantial benefit of having long-term dollars committed to stabilizing neighborhoods. Over time, this will help the market.

IV. Implementation Logistics

MBA notes that even minor changes to existing programs will entail significant modifications to a host of customer service, sales, underwriting, and servicing operations platforms. With relatively low origination volumes in recent years and significant investments required in the servicing area to handle delinquent loans and foreclosures, many lenders may lack the resources to accommodate greater demand. Existing personnel also will need to be educated and retrained. Successful implementation, therefore, depends on providing lenders and servicers as much lead time as possible.

V. Conclusion

MBA believes that restoring a strong and stable housing market in a safe and sound manner is imperative to the financial well-being of this country. MBA urges policy makers to carefully consider our suggestions. We look forward to working with you on this very important initiative.

PREPARED STATEMENT OF MARCIA GRIFFIN

PRESIDENT AND FOUNDER, HOMEFREE-USA

SEPTEMBER 14, 2011

Introduction

Thank you Chairman Menendez, Ranking Member DeMint, and distinguished Members of the Subcommittee for the opportunity to participate in this hearing today. My name is Marcia Griffin and I am President and Founder of HomeFree-USA. HomeFree-USA is a HUD-approved 501(c)(3) not-for-profit home ownership development, foreclosure intervention and financial empowerment organization. As a HUD intermediary, HomeFree-USA funds 66 nonprofit organizations, 21 of which focus their attention on the foreclosure crisis. These organizations spend every day working to marry the needs of mortgage loan servicers and homeowners who are in need of a mortgage loan modification.

Since 2008, we have worked with more than 30,000 homeowners. Many of the families we've worked with can afford to pay a mortgage, just not the mortgage that they currently have. While many assume that those in crisis bought homes they could not afford, or were in no financial position to be homeowners, in many cases, the opposite is true. We have worked with thousands of people who had good credit and a stable financial life before they ran into mortgage trouble. Many of these people are employed, they want to do the right thing, they want to pay their mortgage, they want to stabilize their neighborhoods, and they want to keep their families together. What they need is an opportunity. After working in this space for several years, it has become more and more evident that innovative ways need to be brought to the table and tested in order to restore the housing and mortgage industry in this country.

At HomeFree-USA, we share your sense of urgency to find a lasting solution to our daunting foreclosure crisis—a crisis that lies at the very heart of our Nation's economic problems and threatens millions of families with the loss of their American Dream—their home.

With the bursting of the housing bubble, home prices declined dramatically in virtually every market throughout the United States. As a result, many American families are now living in homes that are worth less than their mortgages. According to published statistics, this "underwater mortgage" or "negative equity" problem affects some 11 million homeowners, or about 24 percent of all mortgages in the United States.

Upwards of two million underwater homeowners are expected to go into foreclosure. Many will be the result of "strategic defaults"—borrowers driven to give up home ownership in favor of renting rather than to continue to make monthly payments with no real prospect of regaining positive equity in their home. From our work in foreclosure prevention, we find that homeowners in a negative equity position are far more likely to default on their mortgages than those with positive equity.

Principal Reduction Modifications

The most effective way to prevent foreclosures due to the negative equity problem is to modify delinquent mortgages by both reducing the interest rate and forgiving a portion of the outstanding principal. The principal should be reduced at least by the amount the home is underwater, based on a reliable property valuation. In so doing, the homeowner is provided a reduced monthly payment that is affordable and restored hope of regaining positive equity in the home—for many families, this is the primary, if not the only, means by which to build net worth and financial stability. To build in an incentive for the homeowner to stay current on the modified payment obligation, the principal can be forgiven in increments over time so long as the homeowner does not redefault.

Along with modifications, I would like to stress the importance of financial counseling. One way that lenders can get consumers to be more proactive about their financial troubles is to enlist the help of HUD-approved counseling agencies, which can serve as intermediaries between consumers and the mortgage industry. Consumers do not blame nonprofit counseling agencies for their financial troubles, as they do the big banks. Therefore, they are more likely to approach counseling agencies for help. Also, HUD-approved counseling intermediaries spend the majority of their time communicating with people in their communities and developing relationships with them—relationships that mortgage servicers do not have.

Of course, all modifications—with or without principal reductions—must be designed to return to the loan investor greater cash flow, on a net present value basis, than foreclosure proceeds. This is what is referred to as a "NPV-positive" modification. The lender or servicer designing the modification must take into account a number of factors such as homeowner income, home valuation, degree of delinquency, borrower acceptance of the modification, prepayment and redefault probabilities, resolution timelines, and other relevant data. With home prices so severely depressed in many areas, however, we believe that principal reduction modifications of underwater mortgages can be fashioned to be NPV-positive in the overwhelming majority of cases.

The Shared Appreciation Feature

We are familiar with and support the idea of adding a shared appreciation feature to principal reduction modifications. In a Shared Appreciation Modification, the homeowner agrees to pay to the loan owner a portion of any postmodification gain in the value of the home upon a sale or refinance. In determining the percentage sharing, the right balance must be struck between, on the one hand, maximizing borrower acceptance of the modification—thereby avoiding foreclosure—and, on the other hand, providing the loan owner with the prospect of a meaningful payback in the future against the loss sustained due to the principal write down. We believe most underwater homeowners would be willing to make this trade off. The shared appreciation feature thus ameliorates, to some extent, concerns that loan modifications create the so-called "moral hazard" by rewarding imprudent over-borrowing by consumers.

The shared appreciation feature also provides a fair opportunity and an incentive for people to stay in their homes rather than walk away from an underwater mortgage. It creates a level of fairness within the mortgage industry. Right now everyone is pointing fingers at everyone else. There is no trust among homeowners, lenders, and investors. But in order to get through the mortgage crisis, we have to pull everyone together to work profitably. The shared appreciation feature will benefit all involved.

In addition, the shared appreciation feature holds everyone accountable. Lenders and investors must offer sustainable solutions. Families can stay in their homes and

keep their families together, but they have got to pay their mortgage on time. So this creates a level of responsibility on the part of everyone.

In sum, we believe the principal reduction modification that is NPV-positive and contains a shared appreciation feature is an effective and balanced approach to preventing foreclosures of underwater mortgages to the benefit of mortgage loan investors, homeowners, and, ultimately, the housing market and our national economy. We recommend that this idea not only be tried out across the country, but that HUD-approved intermediaries like HomeFree-USA, be utilized as a resource to bring homeowners and servicers together. We can create mutual benefit for the mortgage industry, the homeowners and the local communities.

I thank you again for inviting me to testify today. I will answer any of your questions and I ask that my full written statement be entered into the record.

PREPARED STATEMENT OF MARK ZANDI

CHIEF ECONOMIST AND CO-FOUNDER, MOODY'S ANALYTICS

SEPTEMBER 14, 2011

Written Testimony of Mark Zandi
Chief Economist and Co-Founder Moody's Analytics

Before the Senate Committee on Banking, Housing, & Urban Affairs

"New Ideas for Refinancing and Restructuring Mortgage Loans"

September 14, 2011

The nearly six-year-old housing crash continues to threaten the U.S. economic expansion. Home sales and construction remain weak, while prices are falling again in many parts of the country because of the unprecedented volume of foreclosures and short sales.

It is hard to be enthusiastic about the struggling economy's prospects as long as house prices are declining. A house is usually a household's most important asset; many small-business owners use their homes as collateral for business credit, and local governments rely on property tax revenues tied to housing values.

Most worrisome is the risk that housing will resume the vicious cycle seen at the depths of the last recession, when falling prices pushed more homeowners under water—their loans exceeded their homes' market values—causing more defaults, more distress sales, and even lower prices. That cycle was broken only by unprecedented monetary and fiscal policy support.

The gloom in the housing and mortgage markets notwithstanding, there are reasons to be optimistic that housing's long slide will end soon. While a mountain of distressed property remains to be sold, investor demand appears strong. Prices have fallen enough to allow investors to profitably rent out these homes until the market recovers. Rental vacancy rates have fallen meaningfully over the past year, suggesting that new construction is slow enough to let builders work down the still-considerable number of excess vacant homes.

Nonetheless, the risks remain uncomfortably high. Policymakers may thus want to consider taking additional steps to support housing temporarily. These might include facilitating more mortgage refinancing and supporting mortgage loan modifications more aggressively.[1] Although none of the potential steps are particularly satisfying or likely to be popular, the outcome will be worse if policymakers stand by while a weakening housing market undermines the economic expansion.

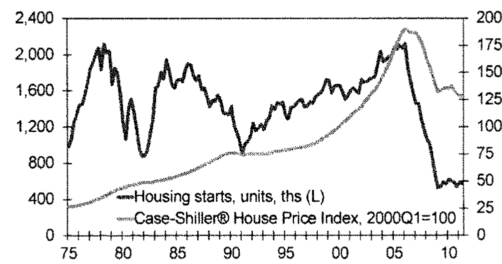
Six lean years

The housing crash is nearly six years old. Sales of existing homes—a measure of housing demand—languish near an annual rate of 5 million units, of which about a third are foreclosures and short sales. Sales of new homes are even bleaker, running at a record

low rate of close to 300,000 units per year. In a well-functioning market, about a million more new and existing homes would change hands per year and less than a tenth would be distress sales.[ii]

Housing construction—the marker for housing supply—is even more depressed. Single- and multifamily starts are running at close to 550,000 units annualized, and manufactured home placements barely reach 50,000 per year (see Chart 1). This is the weakest pace of residential construction since World War II. A well-functioning housing market would be producing closer to 1.75 million units annually.[iii]

Chart 1: The Housing Crash Continues



Sources: Fiserv, BEA, Moody's Analytics

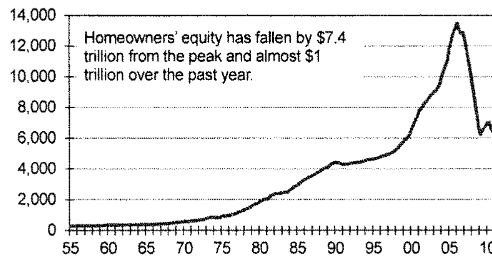
Nationwide, house prices remain very fragile. The Fiserv Case-Shiller national house price index has dropped by a third since peaking in the first quarter of 2006. Prices remain under pressure as more distressed properties are sold. In a well-functioning housing market, prices should rise nearly 3% per year.[iv]

Economic fallout

Although housing is not the drag it was during the worst part of the recession, it remains a significant weight on growth. This is particularly disappointing since housing is often a major source of growth early in an economic recovery.

Falling house prices and the resulting hit to household wealth remain serious problems. Some $7.4 trillion in homeowners' equity has been lost in the housing crash, with almost $1 trillion of it just in the past year (see Chart 2). Given the estimated impact on consumer spending from lost housing wealth, this will shave about half a percentage point from real GDP growth this year.[v] The loss is particularly hard on middle-income households, who have benefited less from rising stock prices than have their higher-income neighbors.

Chart 2: Homeowners' Equity Is More Than Halved



Sources: Federal Reserve Flow of Funds, BEA, Moody's Analytics

Shaky house prices have also made it difficult for small-business owners to use their homes as collateral loans. Bank lending to small businesses has picked up over the past year, but it is hard to see how credit will flow freely until house prices rise again. Since small businesses are a key part of job creation, this is a significant impediment to a stronger job market.

Strapped local governments are also struggling with the impact of falling house prices on property tax revenues. Despite rising millage rates in many parts of the country, tax revenue is growing at near its slowest pace on record. Given the lag between market price changes and tax assessments, revenues are likely to slow even more in the coming year. Local governments will thus have little choice but to continue cutting budgets and laying off workers. Local government payrolls are down more than 400,000 below their peak and are shrinking by about 10,000 jobs per month.

There are other serious but harder to quantify effects from falling house prices such as a reduction in labor mobility—an important way for the economy to adjust to shocks—and the erosion of retirement savings for low- and middle-income homeowners.

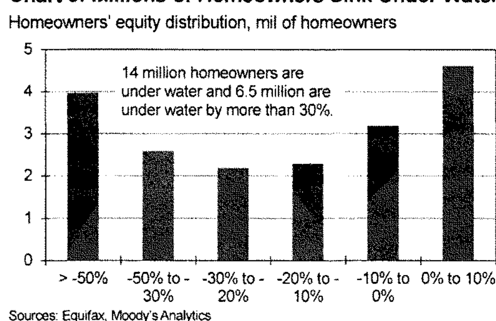
Vicious cycle

Falling house prices could threaten the economic expansion if they become self-reinforcing, pushing more homeowners under water, prompting more mortgage defaults and more distress sales and thus more price declines.

With an estimated 14 million homeowners under water, half by more than 30%, this is a real possibility (see Chart 3).[vi] Adding to the concern, the average underwater homeowner's debt exceeds market value by nearly $50,000. It does not take much to induce many in that situation to turn their keys over to their lenders; a leaky roof or broken air conditioner might be sufficient, particularly if rental housing is available nearby for less than the cost of the mortgage. Studies based on credit file data suggest

that the share of strategic defaults—involving homeowners who are current on other debt obligations—has risen and now accounts for approximately one-fourth of all defaults.

Chart 3: Millions of Homeowners Sink Under Water



Decisions to default depend critically on expectations about future house prices. If homeowners think prices will rise, they are more likely to hold on; if they believe more price declines are coming, they are likely to give up. This can quickly become a vicious cycle, as occurred during the depths of the recession. Only a massive policy effort broke that cycle. The federal government put Fannie Mae and Freddie Mac into conservatorship and the FHA aggressively expanded its lending. Today the federal government originates more than 90% of new mortgages.

In addition, conforming loan limits were increased and three rounds of housing tax credits were enacted as part of the federal fiscal stimulus. The Federal Reserve purchased $1.25 trillion in mortgage securities to bring mortgage rates down as part of its first round of quantitative easing. The government also took part in the mortgage-loan modification effort via the HAMP plan and encouraged refinancing via the HARP plan.

Although it is easy to criticize individual elements of this policy response, it is important to remember that it was devised and implemented quickly, under extreme circumstances. Moreover, in its totality, the policy response worked; the housing market began to stabilize in 2009.

Yet if housing were to begin another dark cycle, the policy response, if any, would not be nearly as aggressive. There is little political appetite for another big government intervention in the economy, particularly given Washington's precarious fiscal situation.

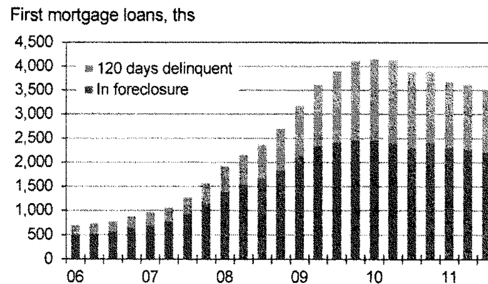
Righting the wrongs

Perhaps the government will not need to come to housing's rescue again. There are hopeful signs that the problems in the housing market are being worked out. While the process will not be clean, housing should find its footing next year.

It is encouraging that the flow of first mortgage loans into foreclosure, or more than 120 days delinquent (and thus likely to go into foreclosure), has peaked. An enormous number of mortgages remain in this situation—3.5 million out of 50.6 million loans outstanding—and most will end as distress sales over the next 12 to 24 months, but the key for house prices is the share of sales that are of distressed properties (see Chart 4). Prices fall when the share rises, but prices stop falling once the distress share peaks, even if it remains elevated.

Chart 4: A Mountain of Distressed Homes

First mortgage loans, ths



Sources: Equifax, Moody's Analytics

It is difficult to forecast when the distress share will peak, as this depends on negotiations between mortgage servicers and state attorneys general related to the robo-signing scandals. Yet the peak seems most likely to occur in early 2012. The share of distress sales will remain high in 2012—probably above a third of all home sales—but prices should stabilize.

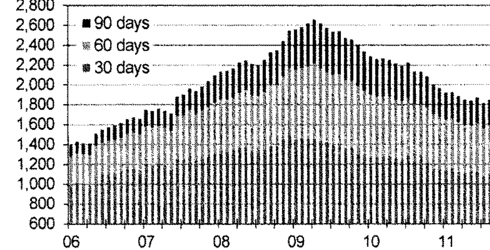
Investor demand for distressed properties appears strong, particularly in the hardest-hit markets. Prices have fallen so sharply in Atlanta, much of Florida, Nevada, and Arizona that investors can purchase distressed properties and cover their costs by renting them out. Many of these markets actually appear undervalued when house prices are compared with household incomes and effective rents. Unlike the house flippers who tried to make quick profits during the bubble, today's distressed-property investors seem willing to hold on longer. They include both individuals and institutions and appear to have investment horizons of more than a few years.

Meanwhile, prices for nondistressed homes are holding up better than they did earlier in the foreclosure crisis, according to data from CoreLogic and FNC. Many distressed properties may be in less desirable areas and no longer in direct competition with nondistressed properties. This suggests that damage to homeowners' wealth will be less severe, with less economic fallout.

The flow of mortgage loans entering foreclosure should also begin to slow soon, since fewer troubled loans are in the early stage of delinquency. The number of first mortgage loans between 30 and 90 days delinquent is declining rapidly (see Chart 5). This reflects a better job market and improvements in underwriting standards since the recession. Mortgage loans originated during the past three years are of excellent quality.

Chart 5: Early-Stage Mortgage Delinquencies Falling Fast

First mortgage loans 30-90 days delinquent, ths, SA



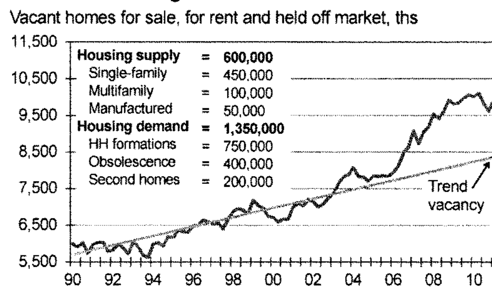
Sources: Equifax, Moody's Analytics

Excess inventory

At the same time, builders are slowly working down the number of new vacant homes for sale. Yet the rampant overbuilding during the housing bubble remains a significant impediment to any pickup in new construction.

We estimate that close to 1.25 million excess vacant homes are either for sale, for rent, or being held off the market (see Chart 6). The Census Bureau's Housing Vacancy Survey counts 9.7 million actual vacant homes; almost 8.5 million vacancies would be consistent with a well-functioning housing market. At the current level of demand and supply, it will take two full years to work off this excess inventory.

Chart 6: Housing Inventories Have Peaked



Sources: Census Bureau, Moody's Analytics

The situation is not as bleak as this suggests, however, because the Housing Vacancy Survey likely overstates the problem. Recent data from the 2010 census suggest there are fewer rental vacancies than the survey implies.[vii] It is also unclear how well many of the vacant homes are being cared for, especially in heavily overbuilt markets such as Florida and California's Central Valley.

This highlights another important point, namely that the excess inventory problem is regionally concentrated. Atlanta, Florida, Nevada, Arizona, and the Central Valley are awash in vacant homes; elsewhere the inventory problem is much less pronounced and will be resolved sooner.

Demand and supply also will not change together; it is likely that demand for vacant homes will pick up more quickly than will new construction. The principal component of demand is household formation, which has been depressed recently because of the weak job market. With fewer job opportunities, young people have been staying in school; labor force participation has plunged among those from 16 to 29 years old. While the data here are sketchy, it appears that at its low point, household formation slowed to an annualized pace of close to 300,000 in early 2010. It picked up over the past year to closer to 750,000; this has fueled a surge in rental absorption but is still well below the 1.25 million households expected to be formed each year in a well-functioning economy.

As the job market comes back to life and young people go to work, household formation should accelerate. Given that many young people have lived with their parents longer than in normal times, there is a fair amount of pent-up household formation that should be unleashed in the next year or two. Formations in 2013 and 2014 could be closer to 1.5 million per year.

Housing construction, specifically single-family homebuilding, will take longer to get going. Even as demand revives for new homes, it will take time for builders to obtain new construction and land development loans from banks that still are digesting the sour loans they made during the bubble.

It will also take time for builders to ramp up the process of new-home construction, which includes everything from acquiring land and obtaining permits to assembling equipment on site. Multifamily construction will come back much sooner, likely during the second half of 2011, given strong absorption, declining vacancy rates, improving rents, and more ample multifamily mortgage credit. But single-family home construction should also be well off bottom by this time next year, when there are far fewer excess vacant homes.

There are reasons to hope the housing market can at least limp through the next year without additional government support, but the risks are still uncomfortably high. A weaker than anticipated housing market poses a serious threat to the economic expansion—probably one of the most serious on the current horizon. It may thus be worthwhile for policymakers to consider steps to ensure housing remains on track.

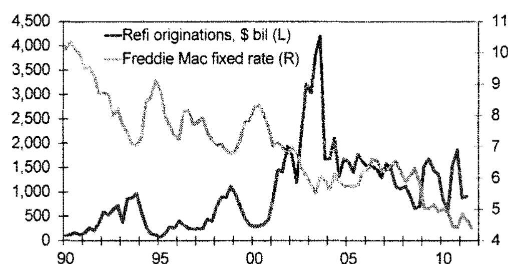
Restringing HARP

With 30-year fixed mortgage rates recently falling to a record low of slightly more than 4%, a policy step we proposed a year ago appears attractive again.[viii] This is requiring Fannie Mae and Freddie Mac to facilitate more refinancings via the Home Affordable Refinancing Program (HARP).

Congress has been considering legislation to do just that, and President Obama provided new vigor to the effort in his September speech to Congress introducing his jobs plan, the American Jobs Act.[ix] Obama said the administration would work with housing agencies to reduce impediments to refinancing. The FHFA—Fannie and Freddie's regulator—subsequently affirmed that it is working on improving HARP.[x]

Refinancing has been disappointing given record-low borrowing costs. In 2003, when fixed mortgage rates were between 5.5% and 6%, home loans were being refinanced at an annualized rate above $4 trillion. The current level of activity is less than half that (see Chart 7). The 2003 boom was fueled by the large number of mortgages that had been originated when rates were much higher, making a sub-6% rate very attractive. Yet even today, about half of all outstanding mortgages carry coupons above 5.5%. Millions more U.S. homeowners should be refinancing, significantly reducing their monthly payments and boosting their financial fortunes and the ailing economic recovery.

Chart 7: Rates Plunge, Refis Putter



Sources: Federal Reserve, Freddie Mac, Moody's Analytics

Impediments to refinancing

HARP was introduced in early 2009 to help refinance loans insured or owned by Fannie and Freddie; at the time, the administration said the program would allow between 4 million and 5 million homeowners to lower their interest rates to market levels. Yet to date, only about 850,000 homeowners have refinanced using HARP, and a very small number of underwater homeowners have refinanced.

This is surprising, since HARP provides significant incentives for borrowers to refinance at up to 125% of a property's value, specifically in order to help those who are under water. To qualify, a homeowner's recent payments must have been on time. And borrowers must be able to show they have sufficient income to meet the new payment schedule. HARP refinancings are even available for vacation homes and investment properties.

But none of this has helped raise the level of participation much, because Fannie Mae and Freddie Mac (the GSEs) have at the same time imposed additional interest rate charges—called loan level price adjustments—for refinancers with higher loan-to-value (LTV) ratios or lower credit scores. Specifically, borrowers' credit scores must be above 720 to qualify for the current market rate.[xi] This is a high bar, according to the credit bureau Equifax; just over half of the nation's households score below 720. For context, in the past, a subprime borrower was defined as one with score below 620. A HARP applicant with a sub-720 credit score or a high LTV ratio would be offered interest rates several percentage points above the current market level. For example, a borrower with a 90% to 95% LTV and a 640 to 659 score would pay nearly a half percentage point more. At these levels, the incentive to refinance is much lower.

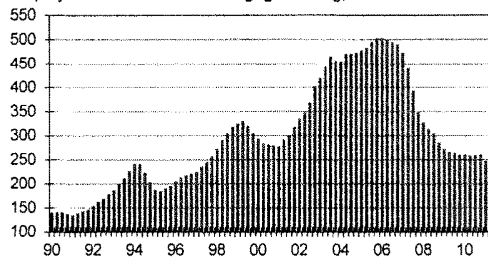
This is an especially large problem in parts of the country where the housing market crash and economic downturn have been most severe—ironically, the areas that HARP was supposed to help. In Florida, for example, 52% of households have credit scores below 720. In the Central Valley of California, 54% of households fall below the bar. In Nevada, an astonishing 56% do.

Fannie and Freddie are not breaking precedent in charging higher interest rates to borrowers with less equity and weaker credit. The agencies have always done so, to account for the fact that such borrowers are more prone to default. But this standard practice is undermining HARP. It also is not clear what use the traditional rules have in this situation, since Fannie and Freddie already insure these loans and are on the hook if they default. HARP refinancing would lower borrowers' monthly mortgage payments, increasing the chance they will stay current and reducing the number of payouts on the insurance Fannie and Freddie provide.

Another impediment to refinancing is the wide interest rate spread between rates offered by mortgage lenders and the rates Fannie and Freddie are charging. The wide spreads are due in large part to the lack of competition in mortgage lending. The industry went through significant rationalization and consolidation during the financial crisis and recession, with the top three lenders now accounting for well over half of all mortgage originations. There is little indication that existing lenders are interested in expanding their origination capacity. The number of those employed in the mortgage lending industry has been cut by more than half since the peak during the housing boom, and employment continues to decline (see Chart 8). Moreover, given the severe stress and substantial uncertainty in the housing and mortgage markets, it is unlikely that any new major lenders will enter the market any time soon.

Chart 8: Mortgage Lending Capacity Declines

Employment in real estate mortgage lending, ths



Source: Bureau of Labor Statistics

Lenders may also be holding rates higher to compensate for Fannie's and Freddie's recently more aggressive efforts to put back problem loans. If lenders violate the agencies guidelines and their loans go into default, Fannie and Freddie can require the loan originators to shoulder the financial burden themselves. Expecting more such put-backs, lenders may be building that into their current rates. The FHFA also recently filed suit charging that major banks sold Fannie and Freddie mortgage securities backed by negligently underwritten mortgage loans.

Any refinancing includes closing costs—fees to process applications or obtain appraisals and other taxes or costs. With so many households facing uncertainty about employment and the time before they may need to relocate, borrowers may prefer to conserve cash rather than pay such fees up front. Under the HARP, these fees can be capitalized into the borrower's mortgage balance, but such a "no-cost" refinancing increases the borrower's interest rate. For underwater borrowers, it also delays the day when they will again be able to accumulate equity in their homes, thus reducing the incentive to refinance.

Another potential impediment are holders of second liens (such as home equity lines and closed-end second loans), who also need to agree to put their claims on a refinanced home after those of the first mortgage holder.

Private mortgage insurers who provide insurance on Fannie and Freddie loans with LTVs above 80% must also agree to continue coverage on refinanced loans (although they do not need to increase their risk exposure if a borrower's LTV ratio has increased since origination).

Although mortgage insurers and second lien holders should have little incentive to block a refinancing that will leave the borrower less likely to default, the incentives for cooperation may not be strong, given the time and paperwork involved. Some second-lien holders may even see the refinancing as an opportunity to pressure first lien holders to buy them out. First-lien holders in turn may be unwilling to do this, believing that the second lien holder should in many cases be wiped out.

Jump-starting HARP

Jump-starting HARP requires that Fannie and Freddie not charge add-on rates, even for refinancing borrowers who have lost a lot of equity in their homes or have relatively low credit scores. Keep in mind that Fannie and Freddie already bear the credit risk on these loans; anything that makes it easier for borrowers to pay their mortgages on time and avoid default will reduce the agencies' ultimate cost.

Even borrowers in an early stage of delinquency may benefit from a HARP refinancing, although many of these borrowers likely have other financial problems that make loan modification or some other foreclosure mitigation the more prudent choice. But

refinancing may help. Under current rules, borrowers who refinance under HARP are then ineligible for loan modification through the government program HAMP. This restriction should be eliminated.

To accelerate the refinancing process, Fannie and Freddie could also provide more streamlined refinancing that forgoes income verification and a full-blown appraisal to keep costs down. To further reduce paperwork and costs, it may even be possible to devise a simple form to substitute for required TILA, RESPA and HMDA filings. Unlike new borrowers, HARP candidates have already proven their ability to pay by making timely payments throughout the tough economy. Streamlining the process will not materially change the risk the GSEs are exposed to.

Fannie and Freddie could also help identify which homeowners are the best prospects for refinancing—those with the highest coupons, best credit scores, and lowest LTVs. The agencies could provide this information to their networks of mortgage lenders and brokers, who could then contact homeowners and originate the refinancings.

Refinance costs cannot be eliminated completely as process checks and controls must be in place to avoid fraud and keep loans eligible for securitization. Thus, a bolder step—as it would cost taxpayers money and may be deemed unfair—would be to subsidize refinance closing costs directly or through a tax rebate. With so much uncertainty in the job market, many borrowers fear they will be unable to recoup the upfront costs of refinancing if they have to move in a year or two. Many borrowers are still operating with a survival mentality and a preference for conserving cash rather than paying for a refinance with long-run benefits.

It would be helpful if Fannie and Freddie were to wave existing mortgage lenders' liability for past "rep and warranty" violations as long as a given mortgage is current and at least a year old. This will alleviate lenders' concerns that refinancing existing loans could uncover past errors and leave them vulnerable to put-backs by the GSEs.

To ensure that mortgage lenders do not charge extraordinary rates given their increased market power, they could be required to originate and service newly issued mortgages at a fixed spread to be determined by the GSEs. The spread needs to be large enough to entice existing lenders to temporarily expand their origination capacity. Historically, the spread has been near 25 basis points, suggesting that a spread between 25 and 50 basis points should be adequate. Given the other steps taken to lower origination costs and the scale economies involved, originating and servicing these mortgages should be highly profitable at these spreads. Perhaps an even better alternative is that if lenders do not voluntarily keep spreads close to historical norms, the GSEs could reduce the amount of business they do with these lenders in the future.

Economic logic

Economic logic strongly favors action to promote refinancing. With current mortgage rates near 4% and the median rate on outstanding mortgages above 5.5%, the potential rate reduction could average almost 150 basis points. If all Fannie, Freddie and FHA borrowers with rates above the median refinance at 4%, the gross saving to borrowers would be almost $50 billion a year (18 million borrowers x $150,000 average mortgage balance x 1.5%).

Clearly, not all those savings would be realized. Some borrowers would be unable or unwilling to refinance: they are too deeply under water or unemployed or have such small loan balances that it is not worth the closing costs to refinance. Borrowers who expect to sell soon will also not want to incur the cost. Given these considerations, closer to 4 million borrowers are in a good position to refinance at current market rates, saving them more than $10 billion per year in interest payments.[xii] [xiii]

The savings would provide a quick boost for middle-income homeowners. Some of the cash would be used to repay other debt, but the bulk would likely be spent on home improvements or other needs. Assuming three-fourths of the extra cash, or some $7.5 billion, is spent within 12 months, real GDP growth will see a small but meaningful 10-basis point boost in 2012.[xiv] The fragile U.S. economy can clearly use all the help it can get.

More refinancing would also further the immediate goals of the Federal Reserve. Monetary policymakers are considering a new round of quantitative easing—a process in which the Fed purchases Treasury securities in an effort to bring down long-term interest rates, including fixed mortgage rates. Indeed, the recent decline in mortgage rates is due in part to expectations that the Fed will soon resume quantitative easing again. If that happens, it arguably would help the economy most significantly by increasing the amount of home loan refinancing. Anything fiscal policymakers can do to support the Fed's effort would be a plus.

A revamped HARP should not add significantly to Fannie and Freddie's costs and therefore should not be a burden to taxpayers. The two mortgage finance agencies would lose some interest income as refinancing lowers their return on more than $1.2 trillion in mortgage securities and whole mortgage loans that they own directly. But under reasonable assumptions, this cost would be offset by lower default rates on the loans that are refinanced. Borrowers are more likely to stay current if their monthly payments drop by $100 or $200. Fannie and Freddie would break even if the probability of default on the loans and securities they own and insure falls by about 25 basis points.[xv] Even if the default does not decline by this much, it is clear that the cost to Fannie and Freddie, and by extension to taxpayers, will be small.

Downsides

While homeowners would clearly benefit from a restrung HARP, and taxpayers would be largely unaffected, global investors in agency mortgage-backed securities (MBS) would be hurt financially. As more loans are refinanced, higher-yielding MBS would be retired and replaced with lower-yielding MBS. To be precise, if a more effective HARP resulted in 4 million more refinancings, investors would receive approximately $6.5 billion less in annual interest income.[xvi]

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

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

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

Another potentially unwelcome side effect of boosting refinancing today could be less labor mobility in the future. Borrowers who lock in record-low mortgage rates will be less willing to move when rates start to climb. Given that homeowners tend to be more skilled than renters, this impediment to labor mobility could aggravate the U.S. economy's current skills mismatch. However, it is difficult to know the scale of this consideration; it seems small against the sizable near-term benefits of a refinancing program. It is also worth noting that those homeowners who refinance out of adjustable-rate mortgages to fixed-rate loans will be insulated from the increase in interest rates that is ultimately coming.

Further government intervention in the mortgage market could also send the wrong message to current and potential homeowners, encouraging them to delay decisions in hopes of receiving more federal assistance in the future. The three housing tax credits implemented over the past several years were instrumental in breaking the housing market's deflationary psychology, but the sharp decline in home sales after the most recent credit expired likely stems in part from potential buyers waiting for yet another credit.

Principal reduction modifications

A more dramatic and costly policy step, but one with the best odds of ending the housing crash quickly and definitively, would have the government facilitate loan modifications with substantial principal write-downs. The current Home Affordable Modification Program (HAMP) was reworked late last year to promote this, but the change has accomplished little so far.[xvii]

A broader principal reduction program has economic positives and negatives but would be a positive on net if it were well designed. The main concerns are moral hazard and fairness. To deal with these, the program must be well targeted, with clearly articulated eligibility requirements, a long vesting period—as much as five years—and some type of clawback provision for future capital gains to guard against potential fraud.

To get a sense of scale, suppose the program were to require that, to qualify:

- Homes had to be owner-occupied.
- Homes had to have been bought before December 31, 2008.
- The owners could take no cash out in the refinancing.
- First mortgages had to be less than conforming loan limits.
- A loan's principal could be reduced by no more than $50,000.

Moreover, refinancing deals would have to result in the following conditions:

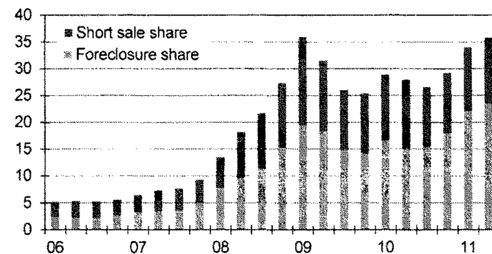
- The loan could be no more than 10% above the home's market value (to limit the probability of redefault).
- The "front-end" debt-to-income ratio (counting only housing costs) could not exceed 31%, and the "back-end" DTI ratio (counting all obligations) could not exceed 50%.

Approximately 600,000 current homeowners meet these criteria. Assuming a redefault rate of 25%, this would result in approximately 450,000 sustainable modifications.[xviii]

This is just about the number of modifications, in addition to those that would take place regardless, needed to forestall the anticipated house price declines.[xix] Without such a plan, the distress share of home sales is expected to rise from more than a third to a peak of 40% early in 2012 (see Chart 9). House prices will decline as the distress sales share rises.

But with a well-designed modification program implemented early next year, the share of distress sales will not increase appreciably.

Chart 9: Share of Distress Sales Is High and Rising
Share of home sales



Sources: Zillow, Realtors, Moody's Analytics

Such an effort would be costly. A principal reduction program of the magnitude considered here would be an estimated $18 billion. While there is little political appetite to have taxpayers foot this bill, this could be a good use of any funds that come out of the current settlement agreement between state attorneys general and the nation's largest mortgage services over their robo-signing missteps.

Conclusions

The housing crash and foreclosure crisis are not over. Home sales and construction are stable but depressed, and prices remain weak. With millions of foreclosures and short sales set to hit the housing market over the next 12 to 18 months, prices are set to fall further.

While house prices are declining, the recovery will have difficulty gaining traction. For most Americans, the home is still the most important asset, and consumers will be reluctant to spend while their wealth erodes. Many small-business owners use their homes as collateral to grow, and local governments rely on property taxes tied to house prices.

There are some reasons to be optimistic that the crash is winding down. House prices have fallen far enough that single-family housing is affordable and increasingly attractive compared with renting. Investors are putting up cash to purchase distressed properties. Overbuilding remains a problem, but a steadily smaller one, given the record-low construction and improvement in household formations.

But this optimism will be easily overwhelmed if house price declines reignite a vicious cycle, putting more homeowners under water, accelerating foreclosures and distress sales

and driving prices even lower. Only an unprecedented monetary and fiscal policy response short-circuited that cycle during the recession.

Given the balance of risks, policymakers should consider providing additional temporary help to the housing and mortgage markets. Reinvigorating HARP would provide a substantial boost with no meaningful cost to taxpayers. The economic benefit is clear. If more mortgages were refinanced, fewer borrowers would default, homeowners would have more money in their checkbooks, and the fragile economic recovery would receive a quick, sizable cash infusion. HARP will not fix all the ills that plague the housing and mortgage markets, but it has the potential to meaningfully assist homeowners at little additional cost to taxpayers. A well-structured and timely national principal reduction program would be a much larger and costlier step but would bring the housing downturn to a quick and definite end.

None of these policy steps are particularly satisfying, but they are worth carefully considering given that an ongoing housing downturn remains among the most serious threats to the economic recovery.

[i] Policymakers could take a number of other steps to shore up the housing and mortgage markets such as extending the current higher conforming loan limits that are set to decline in a few weeks, but the discussion in this testimony is limited to policy steps to support mortgage loan refinancings and modifications.
[ii] A well-functioning housing market is defined to be one consistent with an economy operating at full employment and growing at its potential rate.
[iii] This volume of new construction is supported by the annual formation of 1.25 million households, the obsolescence of 300,000 housing units, and the purchase of 200,000 vacation homes.
[iv] House prices should grow somewhere between the annual rate of growth in household income (4%) and overall annual price inflation (2%). House prices are ultimately determined by their replacement cost, which is equal to the sum of the cost of land and the cost of construction. The cost of land is determined by the opportunity cost of that land, or GDP per developable acre. The growth in GDP per acre is equal to the growth in household income (assuming that the profit share of GDP remains constant). Construction costs will grow at the rate of overall inflation in the long run, as material and labor costs can vary substantially in the short run. Since the proportion of house prices that are accounted for by land costs varies considerably from place to place (a very high percentage in San Francisco, for example, and a much lower one in Des Moines), the growth in house prices will vary considerably. For the past quarter-century or so (the recent boom and bust aside), house prices have grown at a rate closer to household income. As financial and other incentives for homeownership increased, households spent as much on housing as their incomes would allow. These incentives have likely peaked and may well decline; therefore, households will devote less of their income to housing, and prices are likely to grow more closely to the inflation rate.
[v] See "The Wealth Effect," Mustafa Akcay. Regional Financial Review, November 26, 2008.
[vi] CoreLogic estimates there are closer to 11 million underwater homeowners. The Moody's Analytics data are based on actual mortgage debt outstanding from Equifax credit files, while CoreLogic's estimate is based on debt outstanding at origination. The Moody's estimate of negative equity is nearly the same as CoreLogic's in California, much lower in Florida, and higher most everywhere else. CoreLogic may have some difficulty measuring debt outstanding in rural or exurban areas where homeowners generally have little equity even in good times (since house prices never rise much) and go into small negative-equity positions in difficult times. The Moody's estimate is much higher in Texas, for example. CoreLogic data are also unavailable for a half-dozen states.
[vii] The Census Bureau's Housing Vacancy Survey is based on a sample that, given the Census 2010 data, appears to be significantly biased.
[viii] See "Restringing HARP: The Case For More Refinancing Now," Mark Zandi and Cris DeRitis. Moody's Analytics Special Report, October 7, 2010.
http://www.economy.com/mark-zandi/documents/HARP_100710.pdf
[ix] The HOME Act, introduced by U.S. Representative Dennis Cardoza in September, does precisely this. See

http://cardoza.house.gov/index.cfm?sectionid=87§iontree=6,87&itemid=653.
Senator Barbara Boxer has introduced similar legislation:
http://www.boxer.senate.gov/en/press/releases/012611.cfm.

[x] The FHFA press release can be found at
http://www.fhfa.gov/webfiles/22607/HARPSTMT9911.pdf

[xi] See "Selling Home Affordable Refinance—New Refinance Options for Existing Fannie Mae Loans." Fannie Mae Announcement 09-04, March 4, 2009
https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2009/0904.pdf

[xii] The calculation of 4 million potential refis begins with the 18 million Fannie, Freddie and FHA loans that have coupons of more than 5.5%. Subtract 3.25 million that are seriously delinquent or are in foreclosure; 3.5 million with mortgage balances of less than $75,000 and thus a reduced incentive to refinance; 3 million with LTVs above 125%; and 4.25 million with short tenures and other financial reasons they are unwilling or unable to refinance.

[xiii] This result is similar to that reached by the CBO in estimating the impact of a mass refinancing program. See: http://www.cbo.gov/ftpdocs/124xx/doc12405/09-07-2011-Large-Scale_Refinancing_Program.pdf. The CBO estimated that were would be 2.9 million additional refis as a result of the plan, above those that would have occurred without the plan. The 4 million refis that we estimate would occur under our proposed changes to HARP include all refis, not just those resulting from the proposed changes.

[xiv] This assumes the proposed changes to HARP are implemented by early next year. The assumed spendout rate is consistent with that of the spendout of the 2001 tax rebates and the refinancing wave of early in the last decade. See Johnson, et. Al "Household Expenditure and the Income Tax Rebates of 2001," American Economic Review, vol. 96, no 5. pp. 1589-1610. It is likely the spendout would be greater given that homeowners will view their lower mortgage payments more as a permanent increase in their real incomes.

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

[xvi] This excludes the $3.5 billion in interest income that would be lost by Fannie and Freddie.

[xvii] To date, there have been a total of about 750,000 permanent HAMP modifications. When the HAMP program was unveiled in early 2009, President Obama predicted between 2 million and 3 million HAMP modifications.

[xviii] The redefault rate could be even lower given that this is comparable to the redefault rate on HAMP modifications.

[xix] Hope Now reports that mortgage loan modification efforts are running close to 1.5 million per year. This includes HAMP and, increasingly and more importantly, private modifications by mortgage servicers and banks.

PREPARED STATEMENT OF ANTHONY B. SANDERS

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SEPTEMBER 14, 2011

NEW IDEAS FOR REFINANCING AND RESTRUCTURING MORTGAGE LOANS
SEPTEMBER 14, 2011

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United States Senate
Committee on Banking, Housing and Urban Affairs
Subcommittee on Housing, Transportation and Community Development

Chairman Menendez and Members of The Subcommittee, thank you for the opportunity to speak to you today.

According to the recent data:

- owner equity in household real estate fell around $7.4 trillion from the peak of housing market to today (see Figure 1);
- households have been reducing their debt burden (see Figure 2);
- headline unemployment remains at 9.1% while another measure of unemployment places it at over 20% (see Figure 3);
- Real Gross Domestic Product (GDP) has grown at less than 2% growth rate for the first half of 2011; and
- Real Personal Consumption Expenditures fell in the second quarter of 2011 (see Figure 4).

A possible way to help jump start the economy and reduce mortgage defaults is to streamline mortgage refinancing. When a borrower refinances their mortgage, they may save $150 - $400 per month or $1,800 - $4,800 annually in mortgage interest.[1] Adding that amount to borrowers' disposable income to spend in the economy (or reduce delinquency and default) is very tempting.

Why haven't borrowers refinanced at these historically lower interest rates when it is in their own best interest? The reasons for lower than expected refinancing include:

- degraded credit after the housing market collapsed,
- negative equity, and
- servicing industry conflicts.

To be sure, streamlining the mortgage refinancing process could help American households, stimulate the economy and reduce defaults.

Senators Boxer (D-CA) and Isakson (R-GA) have proposed a bill (S.170) that reduces frictions to refinancing. Alan Boyce, Glenn Hubbard and Chris Mayer have independently proposed a streamlined

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[1] Of course, a refinancing can result in bigger or smaller interest saving.

mortgage refinancing proposal[2] that is similar in spirit to Boxer and Isakson while the Congressional Budget Office (CBO) has produced a study of a stylized streamlined mortgage refinancing.[3] The question is whether these streamlined mortgage refinancing proposals will be effective in jump starting the economy and/or significantly reducing mortgage defaults. Both the Boxer-Isakson bill and Boyce et al proposal feature 1) no credit requirements and 2) no loan-to-value (LTV) requirements in order to refinance.

THE CBO'S ANALYSIS OF STREAMLINED MORTGAGE REFINANCING

The CBO, using a stylized program, estimated that 2.9 million mortgages would be refinanced and there would be 111,000 fewer defaults on those loans.4 But 2.9 million mortgages being refinanced at around four percent would generate about $7.4 billion for the economy in the first year.[5] Of course, depending on assumptions, this number could be either higher or lower. Also, the higher LTV mortgages are located in Florida, Arizona and California, so the stimulus effect is concentrated in those states.[6]

The simulative benefits of $7.4 billion in one year (after the mortgage refinancing has taken place) are relatively small. Personal Consumption Expenditures in the U.S. were $9.43 trillion for July 2011 and amounts to less than one-tenth of one percent in additional personal consumption expenditures (and that assumes that every borrower that refinanced their mortgage spent the additional funds rather than saving it).[7]

So, unless the streamlined refinancing recommendation generates more refinancing and/or greater savings per refinancing, streamlining will not generate much of a positive "kick" to consumer expenditures.

WHO WINS AND WHO LOSES?

According to the CBO report:

> *Relative to the status quo, the specific program analyzed here is estimated to cause an additional 2.9 million mortgages to be refinanced, resulting in 111,000 fewer defaults on those loans and estimated savings for the GSEs and FHA of $3.9 billion on their credit guarantee exposure, measured on a fair-value basis. Offsetting those savings, federal investors in MBSs, including the Federal Reserve, the GSEs, and the Treasury, would experience an estimated fair-value loss of $4.5 billion. Therefore, on a fair-value basis, the specific program analyzed here would have an estimated cost to the federal government of $0.6 billion.*

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[2] Alan Boyce, Glenn Hubbard, and Chris Mayer, "Streamlined Refinancings for up to 30 Million Borrowers," September 1, 2011, http://www4.gsb.columbia.edu/null/download?&exclusive=filemgr.download&file_id=739308.
[3] Mitchell Remy, Deborah Lucas, and Damien Moore, "An Evaluation of Large-Scale Mortgage Refinancing Programs," Working Paper 2011-4, Congressional Budget Office Working Paper Series, September 2011, http://www.cbo.gov/ftpdocs/124xx/doc12405/09-07-2011-Large-Scale_Refinancing_Program.pdf.
[4] See Boyce, Hubbard and Mayer for optimistic assumptions.
[5] 2.9 million mortgages x $200 savings per month x 12 months = $7 billion
[6] Thanks to Andrew Davidson, Eknath Belbase and Dan Szakallas
[7] Rajashri Chakrabarti, Donghoon Lee, Wilbert van der Klaauw, and Basit Zafar, "Household Debt and Saving During the 2007 Recession," NBER Working Paper, No. 16999, April 2011.

I am not convinced of the estimated savings for the GSEs and FHA of $3.9 billion due to lower default rates since the primary drivers of mortgage default are unemployment, divorce and negative equity.[8] I remain skeptical about the merits of lower interest payments in preventing default. And since principal reductions are not included, I have my doubts as to the measure of $3.9 billion for GSE and FHA credit guarantee exposure. I would score this benefit as zero.[9]

But I do believe that there will be a loss of $4.5 billion to Federal investors in MBS (including Fannie Mae and Freddie Mac).[10] And I agree with the CBO that non-federal investors would likely experience a loss of $13 to $15 billion; most of that wealth would be transferred to borrowers in the form of lower mortgage rates.

So, in a sense, the streamlining of mortgage refinancing represents a $7.4 billion *per year* wealth transfer to borrowers.[11] So, non-Federal MBS investors are the big losers while the borrowers are the winners.

SAVINGS PER DOLLAR LOSS TO NON-FEDERAL MBS INVESTORS

Using the CBO's assumptions, 111,000 loans saved from default at a loss to non-Federal MBS investors of $14 billion amounts to $126,126 per loan saved. If the loss to non-Federal MBS investors is $15 billion, the loss per loan saved jumps to $135,135. If lowering mortgage rates has less of an impact than the CBO has assumed, the loss to non-Federal MBS investors could be extremely large. For the sake of discussion, assume that only 50,000 loans are saved from default and non-Federal MBS investors suffer a loss of $15 billion. That would raise the loss to non-Federal MBS investors to $300,000 per loan saved.

MORTGAGE INVESTOR RISK

Mortgage investors take the risk that frictions will increase or decrease, but they did not purchase MBS understanding that the government would unilaterally alter contracts.

It is important to understand that a change in expectations in refinancing is a cost (although the CBO was careful to note that their analysis was not a cost analysis). But while this is a wealth transfer from investors to borrowers, there has also been a wealth transfer from borrowers to investors as borrowers seem to be unable to fully exercise the prepayment option.

If the changes are limited to easing some underwriting requirements or limiting Loan Level Price Adjustments (LLPAs), then those are risks that investors have assumed. If the GSEs send every borrower who has a six percent or higher interest rate loan a preapproved application to lower their rate to four percent then that would be a violation of existing obligations to the investor.

My recommendation is that easing underwriting requirements and/or limiting LLPAs would be appropriate, if FHFA thinks that it will not harm taxpayers.

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[8] Andrew Davidson, Anthony B. Sanders, Anne Ching and Lan-Ling Wolff, *Securitization: Structuring and Investment Analysis*, Wiley Finance, 2004.
[9] Boyce, Hubbard and Mayer use a different set of assumptions that are more optimistic.
[10] See Satya Thallam and Anthony B. Sanders, "Brother can you spare a refi? The costs and benefits of the Administration's massive mortgage scheme," The Mercatus Center, 2011 for an alternative and large refinancing plan.
[11] See CBO Report, pg. 3

ONE YEAR INCREASE IN CONFORMING LOAN LIMIT

Another way to help stimulate the housing market is to raise the conforming loan limits for 1 year. As I opined in a previous testimony before the House Financial Services Committee, I felt it was appropriate to reduce the conforming loan limit to allow the private sector back into the market; however, I stated that if the housing market stalled, then alternative strategies should be considered regarding the conforming loan limit.

Raising conforming loan limits, which are almost always above the median house value in any county, is a subsidy to more expensive housing markets. As long as the conforming loan limit returns to current limits after one year and continues to decline after that point, I would be agreeable to a temporary increase in the conforming loan limit.

THE SHARED APPRECIATION MORTGAGE

Senator Menendez (D-NJ) has proposed a shared appreciation solution to try to overcome the negative equity problem.[12] The shared appreciation mortgage (or SAM) has been used in the United States for decades (although in low volumes) and has been tried in the United Kingdom to permit borrowers who have paid down their principal to sell a 50 percent share in the equity in return for, say, 50 percent of future gains in home price. The Menendez Proposal has a similar intention – the borrower receives a write down of principal in exchange for giving away a percentage of any appreciation in property value in the future.

The Bank of Scotland SAM experience is worth examining.[13] It was very popular with borrowers, but secondary market participants were nervous about a bond where the payoff was tied to home prices and no more SAMs were originated by Bank of Scotland. But a variation of the Bank of Scotland SAM emerged in the United States in the form of the Reverse Mortgage from Financial Freedom.

As an example, a borrower that is 40 percent upside down on their home can obtain a write down on principal in exchange for the borrower paying the lender a percentage of any appreciation on the house (and it could include an additional mortgage payment or coupon for the write down) to be settled at some future date or upon sale or refinance.

The problems with the SAM are twofold. First, capital markets have shown little interest in it as a product for investment. Second, there are moral hazard problems (the incentive to maintain the property once someone receives the capital gain). The Menendez proposal has solved one of the lingering problems with appraisals by requiring several independent appraisals.

I agree that a trial program for SAMs would be reasonable. The question I have is – who will insure the risk: the Federal government or private insurance companies? I would prefer the private market issue and insure these mortgages.

Thank you for the opportunity to testify.

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[12] "Anthony Sanders: A Voluntary Private Market Solution," Knowledge@W.P. Carey, December 17, 2008, http://knowledge.wpcarey.asu.edu/article.cfm?articleid=1727.

[13] Anthony Sanders and C. Carlos Slawson, "Shared Appreciation Mortgages: The UK Experience," *Journal of Housing Economics*, Vol. 14, pp. 178-193, 2005 and Anthony Sanders and F. Page, "On the Pricing of Shared-Appreciation Mortgages," *Journal of Housing Economics*, Vol. 5, pp. 49-57, 1986.

FIGURE 1: Owner's Equity in Household Real Estate

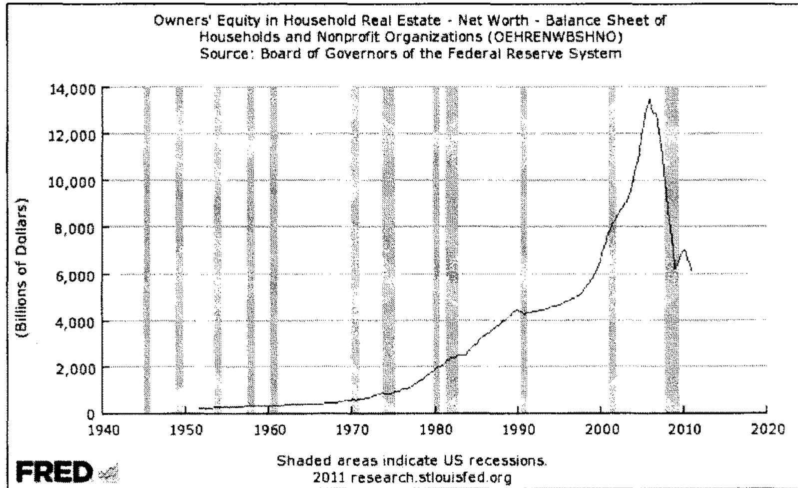


FIGURE 2: Household Debt Services as a Percentage of Disposable Income

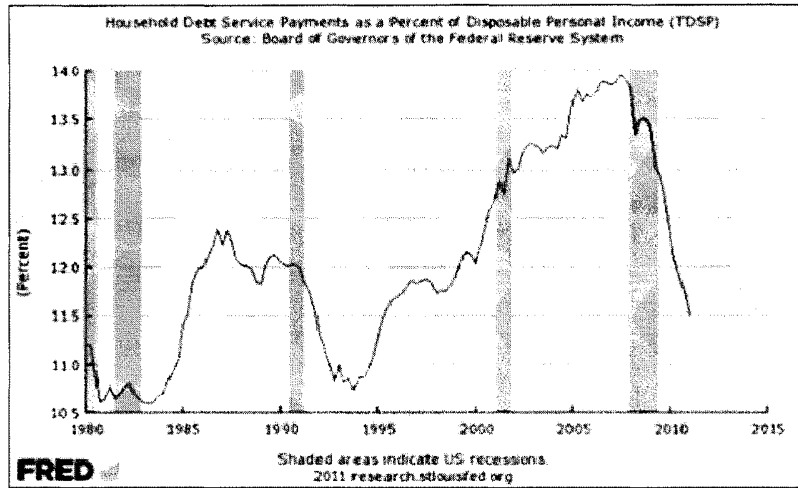


FIGURE 3: Case-Shiller Home Prices Versus Unemployment

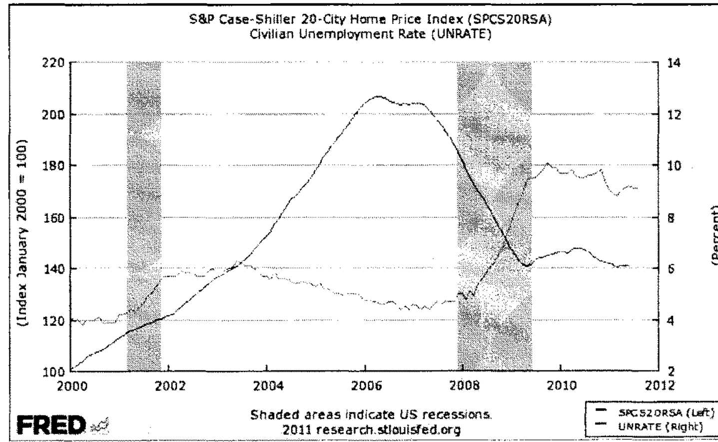


FIGURE 4: Real Personal Consumption Expenditure Growth

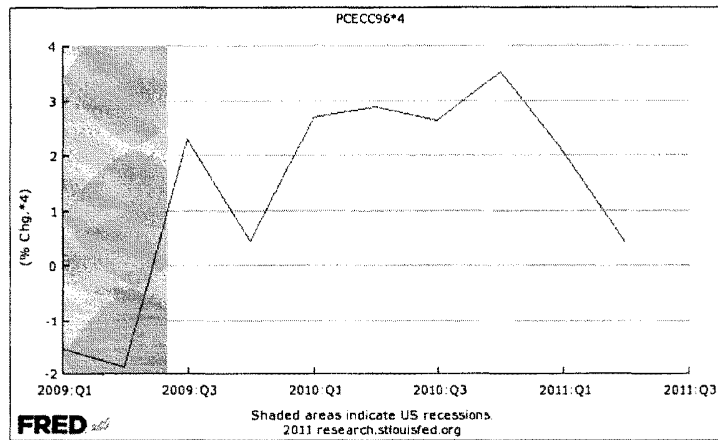


FIGURE 5: MBA Purchase Index for 30 year Fixed-rate Mortgages

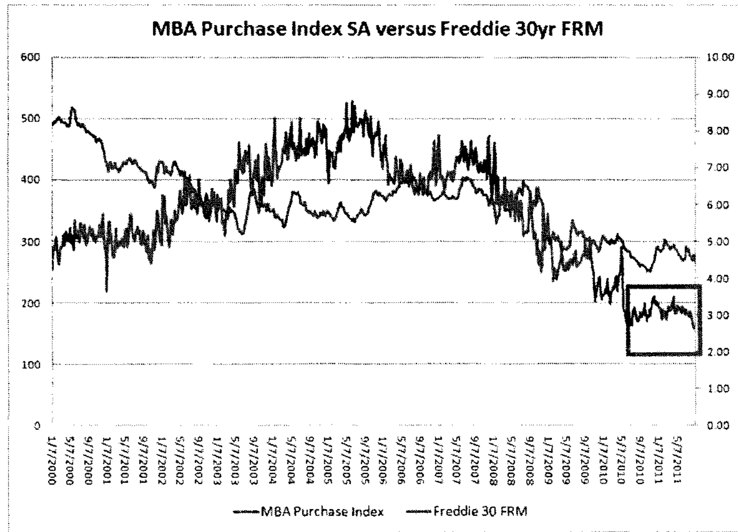


FIGURE 6: MBA Refinance Index

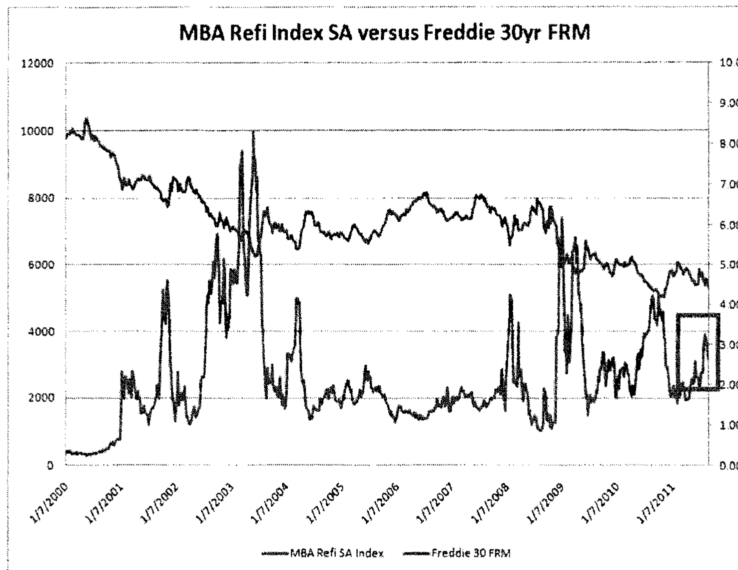
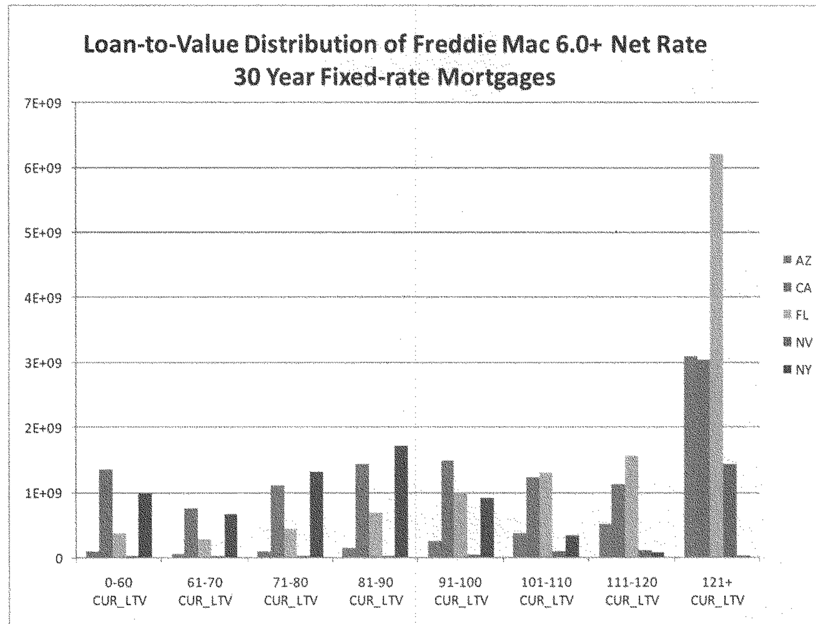


FIGURE 7: High Loan-to-Value Ratios are Concentrated in Four States



Anthony B. Sanders
Distinguished Professor of Real Estate Finance, George Mason University
Senior Scholar, Financial Markets Working Group, Mercatus Center at George Mason University

Anthony B. Sanders is a Senior Scholar at the Mercatus Center at George Mason University. He is also Professor of Finance in the School of Management at George Mason University where he holds the title of Distinguished Professor of Real Estate Finance. He has previously taught at University of Chicago (Graduate School of Business), University of Texas at Austin (McCombs School of Business) and The Ohio State University (Fisher College of Business). In addition, he served as Director and Head of Asset-backed and Mortgage-backed Securities Research at Deutsche Bank in New York City.

His research and teaching focuses on financial institutions and capital markets with particular emphasis on real estate finance and investment. He has published articles in *Journal of Finance*, *Journal of Financial and Quantitative Analysis*, *Journal of Business*, *Journal of Financial Services Research*, *Journal of Housing Economics* and other journals. Professor Sanders has received 6 teaching awards and 3 research awards. He serves as Associate Editor for several leading journals. Recently, he has given presentations to the European Central Bank in Frankfurt, Exane BNP Paribas in Paris and Geneva and the Bank of Japan on the subject of the housing bubble and commercial real estate in the U.S. and the mortgage market. He has given other presentations in Chile, Japan, China, Poland, England and Mexico in recent years. Professor Sanders has testified in the U.S. Senate and U.S. House of Representatives on the U.S. real estate asset and debt markets. Also, he was an invited speaker to the FTC on the subject of predatory lending.

Dr. Sanders earned his PhD and MA from the University of Georgia.

PREPARED STATEMENT OF CHRISTOPHER J. MAYER

Paul Milstein Professor of Real Estate, Columbia Business School

September 14, 2011

TESTIMONY OF DR. CHRISTOPHER J. MAYER
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

HEARING: "NEW IDEAS FOR REFINANCING AND RESTRUCTURING MORTGAGE LOANS"
SEPTEMBER 14, 2011

Good afternoon Chairman Menendez, Ranking Member DeMint, and Members of the Subcommittee. Thank you for inviting me to speak today. My name is Christopher J. Mayer. I am the Paul Milstein Professor of Real Estate at Columbia Business School. I have spent the last 18 years studying housing markets and credit while working at the Federal Reserve Bank of Boston and serving on the faculties of Columbia Business School, the University of Michigan Business School, and the Wharton School of the University of Pennsylvania. I also serve as Visiting Scholar at the Federal Reserve Bank of New York.

Frictions in the mortgage market have restricted the ability of tens of millions of borrowers from refinancing their mortgages, hampering monetary policy, slowing the economic recovery, and leading to excessive numbers of foreclosures. Consumer spending, typically at least 70 percent of GDP, has been slowed as underwater and often over-levered homeowners lack financial ability and confidence.

Existing mortgage delinquencies and defaults are at unacceptable levels which, combined with stagnant labor markets, is leading to another round of falling home prices. More than 4 million mortgages are at least 90 days or more delinquent or in some stage of foreclosure (10.5 months of inventory).[1] And another 3.4 million mortgages will roll from current to 90-days delinquent in the next year at current rates.[2] Existing efforts to stem new defaults and foreclosures have made only limited progress.

As a result of a weak economy, Federal Reserve policy, and global uncertainty, the 10-year US Treasury interest rates have hovered near 2 percent, as low as they have been since the Great Depression. Nonetheless, few borrowers have been able to take advantage of these low interest rates to reduce their mortgage payments. Unable to refinance their mortgages the way corporations have been able to refinance their debt, consumers are left with weak balance sheets and mortgage payments often above of the cost of renting,

[1] Sources: Lender Processing Services Mortgage Market Monitor (June, 2011, P. 3), Equifax Portfolio Credit Trends (July, 2011, P. 66).

[2] Source: Equifax Portfolio Credit Trends (July, 2011, author's calculations P. 64).

contributing to excessive delinquencies and foreclosures. These constraints on refinancing have a disproportionate impact on middle-class borrowers with origination balances under $200,000 and poorer credit and whose employment opportunities have been hit especially hard by the recession.

Historically, low long-term interest rates have led to much higher rates of refinancing. For example, in 2002 and 2003, monthly mortgage rates fell from 7.0 percent to 5.2 percent.[3] More than 85 percent of all mortgages outstanding in January 2002 with rates above 7 percent paid off their loan in the next 30 months.[4] As of June 2011, more than 75% of GSE[5] borrowers with a 30-year fixed-rate mortgage (FRM) have a rate of 5% or more, despite the fact that bond market-determined mortgage rates have been at or below 5.0% for nearly every month in the past two years and are currently below 4.25%.[6] Under normal credit conditions we might have expected the bulk of these eligible mortgages to have paid-off as borrowers refinanced or moved, as happened during the last refinancing wave from 2002 to 2003.[7] This suggests tens of millions of borrowers have not been able to take advantage of what should be an attractive refinancing proposition.[8]

Numerous frictions have contributed to the slow rate of refinancing, including the decision by the GSEs to charge significant upfront fees for mortgages made by moderate credit, 80-125 LTV borrowers. These fees meant millions of borrowers faced a much higher than market determined interest rate. As a strategy for minimizing risks to the GSEs and the taxpayer on new purchase mortgages, such fees may make sense. But this risk

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[3] Source: Freddie Mac Primary Mortgage Market Survey.

[4] Authors computations from LPS/McDash data on outstanding 30-year fixed rate mortgages guaranteed by Fannie Mae or Freddie Mac.

[5] GSEs are the government-sponsored entities Fannie Mae and Freddie Mac.

[6] Sources: Author's calculations from Lender Processing Services and Freddie Mac's Primary Mortgage Market Survey.

[7] According to data from HMDA, about 25 million mortgages were refinanced and 10 million more were originated for home purchase in 2002 to 2003, out of a stock of about 47 million mortgages. While some of these mortgages likely overlap, these numbers suggest that upwards of two-thirds of the stock of home mortgages were originated in the last trough of mortgage rates. By comparison in 2010 and the first five months of 2011, fewer than 10 million mortgages were originated according to Lender Processing Services, about one-third the rate of the previous refinancing boom.

[8] A Morgan Stanley analysis of actual versus predicted prepayment rates for securitized mortgage pools finds that overall prepayment was well below what would have been predicted from earlier periods. (See Appendix Table 1.)

minimization rationale breaks down for refinancings when the federal government already guarantees the underlying mortgage.

I believe that an appropriately structured refinancing program that minimizes closing costs, requires minimal underwriting, and that incentivizes servicers and originators to participate would mimic take-up rates at previous times when rates fell. Such a streamlined refinancing program could benefit 25 million or more borrowers with government-backed mortgages, leading to possible savings of $70 billion or more per year in lower mortgage payments, or more than $2,800 per year per borrower. This program is based on work with co-authors Alan Boyce and Glenn Hubbard and is described in detail on our website (http://www4.gsb.columbia.edu/realestate/research/housingcrisis/).[9] I have also attached a copy of the proposal for your convenience today.

In my testimony, I will describe the current barriers to refinancings, how our plan would overcome these barriers, and why this plan is in the interest of taxpayers, the GSEs, and other mortgage service providers. I also discuss possible critiques and implementation issues and how such issues can be addressed. Many elements of such a plan could be enacted by the Administration and the GSEs, though these efforts could be strengthened through legislation. In either case, we believe that our plan would have a positive impact of the Federal deficit.

Finally, I briefly discuss other proposals that might help with the foreclosure crisis, including ideas to address the overhang of non-performing mortgages and previously foreclosed homes that I have developed with Chip Seelig and the possibility of shared appreciation mortgages to help work out underwater borrowers.

The Refinancing Offer

Under our plan, every homeowner with a GSE mortgage can refinance his or her mortgage with a new mortgage at a current fixed rate of 4.20% or less, with the rate subject to change up or down with the price of Agency pass-through Mortgage-Backed Securities (MBS). For borrowers with an FHA or VA mortgage, rates would be higher, but these borrowers should be included in any large-scale refinancing program.[10] To qualify, the homeowner must be current on his or her mortgage or become so for at least three months.

[9] Alan Boyce is CEO of the Absalon Project; Glenn Hubbard is Dean and Russell Carson Professor of Finance and Economics at Columbia Business School.

[10] FHA and VA mortgages are also guaranteed by the federal government and thus can easily be included in any widespread refinancing program. However, some FHA or VA borrowers pay higher rates than GSE borrowers because their mortgages have greater risk. Under our program, these borrowers would pay the same higher insurance premium to the federal government, but the FHA or VA would facilitate the refinancing of their current mortgage to take advantage of lower bond rates.

This mitigates the current moral hazard problems where many borrowers feel pressured to miss payments in order to qualify for a mortgage modification and encourages borrowers to remain current on their loans.

Other than being current, we would impost NO other qualification or application, except for the intention to accept the new rate (that is, no appraisal, no income verification, no tax returns, etc.). Issuers of new mortgages would be indemnified against any other "reps and warranties" violations since the originators have not verified any borrower information other than being current on the outstanding mortgage. These new refinancings could be accomplished with minimal paperwork, other than what is needed legally to refinance in homeowner's jurisdiction. This program would only refinance existing first-lien mortgage debt and would not allow cash out or rolling multiple mortgages into a single new mortgage. Origination and closing costs would be minimized through the re-issue or substitution of title insurance policies and no need for an appraisal.

We have conducted a detailed pricing analysis of this plan, which I summarize here today. Under our plan, the GSEs would charge a guarantee fee of 40 basis points (0.4 percent) per year for all mortgages refinanced under this plan. This would be much larger than the current guarantee fee of 15 to 25 basis points, allowing the GSEs to earn a premium to cover the costs of implementing this plan. The GSEs would be made whole from any losses from the mortgages and mortgage-backed securities that the GSEs hold in their portfolio and any losses from giving up possible claims for "reps and warranties" violations. In addition to the guarantee fee, our plan would pay servicers 30 basis points per year to cover the costs of originating and servicing new mortgages. The new spread of 70 basis points between the wholesale mortgage rate that bondholders would pay for securities issued under this plan and the retail rate is a bit higher than it would be under normal times, mostly due to the higher guarantee fee payments. The plan should be profitable for new originators and servicers given the streamlined process and low origination costs under our plan.

Given the advantages existing servicers have in working with their own customers and in resolving issues like modifying title insurance and mortgage insurance policies, we believe that existing servicers should have a short period of time to offer this program to their own customers on an exclusive basis. After that time, any mortgage originator should be allowed to offer this program to any borrower who did not take up the program with their existing servicer. Mortgage insurers and title insurers should be required to modify their existing policies to cover the new mortgages no matter whether originated and serviced by the existing servicer or by a new originator or servicer. Second lien holders or home equity lenders should agree to re-subordinate their claims to a newly issued first mortgage. Mortgage insurers, title insurers, and second lien holders who do not participate

should be barred from doing future business with the GSEs and FHA/VA for a period of one year.[11]

Economic Impact of our Plan

We have made detailed computations based on our plan using a simulated mortgage rate of 4 percent for 30-year mortgages and 3.5 percent for 15-year mortgages with no points or closing costs. We assume that 85% of existing borrowers in pools with average outstanding mortgage rates of 1 percent or more above the offered rate accept the refinancing offer, while take-up rates are 70 percent for borrowers with savings of 0.5-1 percent and 10 percent for borrowers with savings under 0.5 percent. These simulations thus look more like what a normal refinancing wave would look like rather than assuming 100 percent participation. Based on these computations, we expect mortgage payments to fall by about $70 billion, benefitting about 25 million borrowers (about $2,800 average savings).[12] About $3.66 trillion of mortgages would be refinanced based on $4.5 trillion of outstanding mortgage-backed securities. This effect is a big part of how monetary policy would normally work in this setting. If we scale up the number of borrowers and savings based on missing $1.5 trillion of outstanding mortgages from our analysis, the estimated number of borrowers helped would be more than 30 million and savings could be up to $75 to $80 billion.[13]

This plan would function like a long-lasting tax cut for these 25 or 30 million American families. Empirical evidence suggests that consumers spend a larger portion of permanent increases in income than temporary increases. This increase is accomplished while the plan reduces the deficit modestly by improving the budget position of the GSEs. This program would disproportionately benefit the most disadvantaged borrowers who have been seriously harmed by the recession. These consumers have been unable to take

[11] If this plan is pursued with legislation, such participants might be required to participate with no conditions as long as it could be demonstrated that the participants were strictly better off by participating and not holding up the process.

[12] A small portion of these estimated savings come from amortizing existing mortgages over a longer period of time. That is, borrowers with 27 years left on their mortgage will now be spreading payments over 30 years for a new FRM. Given that many households face liquidity constraints, offering the option of an extended amortization period is likely an additional benefit.

[13] Since many of the mortgages missing from our sample are previously defaulted loans that are repurchased by the GSEs and would thus be ineligible for our program, we think that a much smaller percentage of the up to $1.5 trillion of missing mortgages would likely take advantage of our program. We are not counting the loans held in whole loan form in bank portfolios nor are we counting the performing loans in Private Label Securitizations (PLS) as neither group currently benefits from an agency guarantee. In the interests of fairness to these homeowners, a similar program with higher fees could be pursued.

advantage of refinancing opportunities (and most likely to increase consumption as a result of lower mortgage payments). More than one-half of all savings accrue to borrowers whose original mortgage was under $200,000. Since these borrowers tend to have lower incomes and pay lower income tax rates, they would keep a significant amount of the interest savings.

The housing market benefits from our program in many ways. Lower mortgage payments reduce future defaults, helping to stabilize house prices for all homeowners, whether or not they have a GSE/FHA/VA mortgage. The good news about refinancing may help improve consumer confidence, further benefiting the housing market. House prices may start to go up, leaving fewer borrowers underwater, starting a virtuous circle. Finally, reducing pressure on servicers and PMI companies may help the mortgage market start to recover to a more normal level, helping spreads on newly originated mortgages.

Budget Impact on Taxpayers and other Participants[14]

It is important that any plan benefits not only the GSEs and taxpayers, but also is attractive to market participants who must administer any plan. Frictions that make current mortgage origination unappealing are a big reason for the failure of the existing HARP program.

The plan would benefit both taxpayers and GSEs and should have a neutral impact on the federal deficit. Under our plan, the GSEs receive an increased guarantee fee that has an up-front value of $54-$72 billion. By contrast, our rough calculations suggest that losses on the existing portfolio of mortgage-backed securities could be as high as $41 billion. Even after these mark-to-market costs, the GSEs should earn appreciable profits, even above any additional costs of refinancings and losses from the right to "put back" legacy mortgages to originators in the event of a default.[15] These computations do not count what are estimated by the Congressional Budget Office as billions of dollars of additional savings from fewer mortgage defaults from borrowers who can more easily afford to make their new and much lower mortgage payments. The computations also do not count losses from the Federal Reserve and the US Treasury that own about $1 trillion of mortgage-backed securities, although most government-held securities are relatively low coupon mortgages with smaller than average losses.[16]

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[14] A more detailed analysis is available on our website, above.

[15] GSEs lose the right to "put back" legacy mortgages to servicers in the event of a future default due to a "reps and warranties" violation. However, because we limit the program to borrowers who are current on their mortgage, the potential market value of these "put back" rights is likely quite low. See also CBO p21-22.

[16] See the CBO report, "An Evaluation of Large-Scale Mortgage Refinancing Programs." In that report, the main cost identified to the federal government was the loss in book value to the Federal Reserve – absent that non-

Existing servicers (two-thirds of mortgages are serviced by largest banks) benefit by lower legal liabilities associated with possible "reps and warranties" violations and safer portfolios of second liens and home equity lines of credit. In return, we would require servicers to meet new service-quality standards. Offsetting these gains, as a group, banks own more than $1 trillion of existing mortgage-backed securities in their portfolio. These mortgage-backed securities would likely prepay faster resulting in a loss of higher returning assets. Nonetheless, we believe that banks typically hold portfolios with lower coupon bonds, which are held in Available For Sale accounting and would result in little or no mark-to-market losses. When capital-constrained banks have higher coupon bonds trading at a premium, they often liquidate the bonds to book profits and increase capital, replacing them with lower coupon bonds. Banks will also suffer some impairment to their Mortgage Servicing Rights, but this should be minimized by existing hedges, which have performed well in the recent bond market rally. We expect that banks will find participation in this streamlined refinancing to be profitable and result in increased customer satisfaction.

Other participants also benefit from borrowers having lower mortgage rates. Second liens and home equity lines or credit are safer when borrowers have lower first mortgage payments. Mortgage insurers generally benefit from our program by reducing the likelihood of a default that might trigger an insurance payment. However, mortgage insurers may lose the right to pursue some "reps and warranties" violations. If the value of these lost claims is viewed as sufficiently large, the program could allow a small payment to mortgage insurers to cover the costs of such lost claims.

Nearly all the direct financial gains to mortgage borrowers from this plan come at the expense of investors who understood and accepted the callable nature of mortgage interest rate risk. About two-thirds of GSE bonds are held by the private sector or foreign owners. Nonetheless, bondholders still benefit from the improved economic outlook associated with this refinancing program. Some bondholders, such as Pimco, have publically supported this plan for this reason. Given historical experience, GSE bondholders purchased the bonds at prices that anticipated these bonds being refinanced when mortgage rates fell. Thus, most Agency bondholders have received an unanticipated windfall from the extremely slow refinancing rates, effectively benefitting from unanticipated policies and inefficiencies in the mortgage market at the expense of existing

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budget impact, CBO estimates a net gain to taxpayers of $1.8 billion (p 22: ($0.6) + $2.4).[16] The Federal Reserve does not mark to market, so there will be no accounting impact on its balance sheet. The CBO also notes that "...the conclusion that the program has a net fair-value cost to the government overall is robust to a wide set of alternative assumptions." (P. 20)

homeowners. This shift has occurred for almost three years, benefiting the holders of GSE bonds. Bondholders have also benefitted enormously from government actions during the crisis. In 2008, the government guaranteed GSE bonds against losses. Later the Federal Reserve bought $1.25 trillion of Agency MBS and the Treasury bought $225 billion and still held about $1.15 trillion of Agency MBS as of December 2010. Absent these purchases, Agency MBS prices would be significantly lower, and the attendant losses from a streamlined refinancing wave would also be lower.

Impediments and Questions About Widespread Refinancing

In our more detailed proposal, we address a number of other questions. While some critics have questioned whether such a program would lead to higher future mortgage costs, we believe that such an intervention would be consistent with what bondholders expected when they bought bonds in the first place—that is, bond prices reflected the expectation that if mortgage rates fell, most borrowers would refinance. We also think that when analysts look back on the crisis, they are more likely to believe that bondholders on the whole benefitted from government actions during the crisis rather than having been net losers.

Another concern might come from a recent CBO report suggesting that lowering mortgage rates and reducing barriers to refinancing would result in only 2.9 million new refinancings, amounting to $7.4 billion per year. Yet the CBO working paper's estimates are at great variance to private estimates from Goldman Sachs, JP Morgan, Moody's Analytics, Morgan Stanley, and our own estimates suggesting an economic stimulus of up to $25 to $70 billion or more and helping 18 to 30 million borrowers (See our response to the CBO posted on our website for more details).

Others have expressed concern that a low mortgage rate program might impair labor mobility in the future, especially if mortgage rates rise. We believe that securities could be structured to allow borrowers to repurchase their mortgages out of pools in the event that mortgage rates rise at a discount, similar to what is done in Denmark.

Others have remarked that over 125 LTV loans would not be able to participate. Our more detailed analysis discusses how this program could also apply to these mortgages, with some simple rule changes by the IRS that would not interfere with the original intent of the limitation.

Finally, some have noted that this program would only apply to borrowers whose loans are currently guaranteed by the Federal government through its conservatorship of the GSEs and the FHA. This is a legitimate policy concern, but addressing it would require the assumption of additional liabilities by the taxpayer, and we have not included that idea in our proposal.

Other Ideas for Managing Non Performing Mortgages and Previously Foreclosed Homes

Even as we address the problems of the majority of homeowners who are current on their mortgage and struggling to make it, it is also important to address the problems of borrowers who have been unable to make their mortgage payments, the glut of previously foreclosed homes, and the challenges associated with underwater borrowers who may be stuck in their homes for years to come. I appreciate the efforts the Chairman and the members of this Committee continue to make to explore the full range of options needed. Various proposals have been put forth including interesting and important ideas to address non-performing mortgages and REO inventory, to expand the institutional rental market, and to provide principal reductions in some cases, but ensure that any ensuing appreciation is fairly shared by homeowners and taxpayers. Each of these areas is important, and I am eager to help the members of this Committee and its staff in any way I can to develop these ideas.

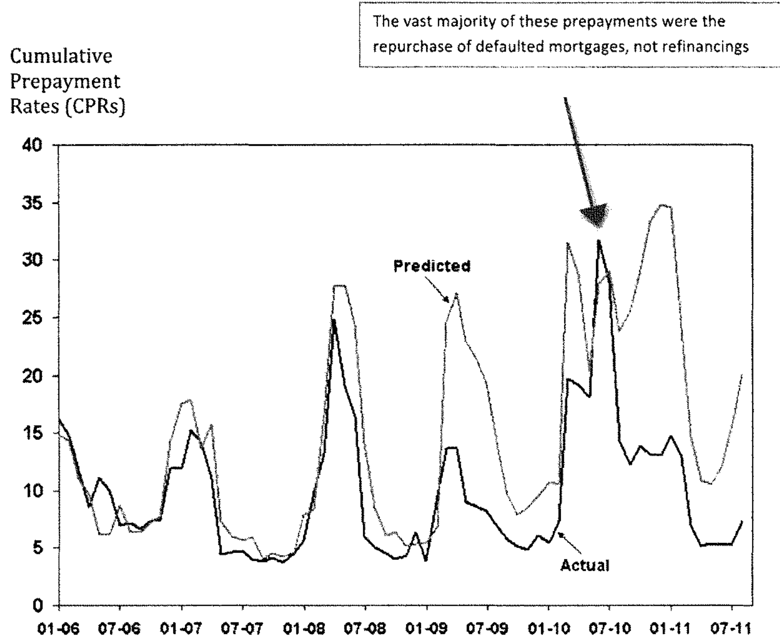
Conclusion

This proposal will make a tremendous difference to families, to the real estate market, and to our economy. Clearly this Committee and our national leadership in the Administration will still, however, have many real estate challenges even if this is implemented. This proposal does not solve the problem of people who cannot afford their existing homes even at lower interest rates. It does not answer the questions of how to permanently restructure the GSEs. It makes both of these issues, however, far more tractable by putting tens of millions of homeowners in a more stable and sustainable position.

We are at a unique and potentially risky time as the nation struggles to recover from the worst recession since the great depression. Until we fix the housing market, it will be hard for the economy to recover. American household's contractual right to prepay their mortgages with no penalty is a significant, and currently missing, driver of how Federal Reserve monetary policy is transmitted to the economy. I appreciate the opportunity to address you today and look forward to answering any questions that you might have.

Appendix Table 1: Comparison of actual and predicted prepayment rates

As is apparent in this chart, mortgage repurchases are much less sensitive to mortgage rate changes after the financial crisis hit and the GSEs were taken over by the government starting in the fall of 2008.



Source: Morgan Stanley estimates of predicted cumulative prepayment rates (CPRs) versus actual prepayment rates, updated to August 2011. Even the spike in prepayments in the summer of 2010 was driven by high defaults and buyouts of defaulted mortgages from pools rather than prepayments, suggesting appreciable barriers to refinancing that have appeared starting in the second half of 2008. See "GSEs need to 'Buy Out" loans in MBS – February 9, 2010 and "'CARP': A Broad ReFi Program – July 23, 2010 by Harley Bassman/Bank of America Securities-Merrill Lynch (www.convexitymaven.com).

Draft 11: 9/1/2011

Streamlined Refinancings for up to 30 Million Borrowers[1]

By Alan Boyce, Glenn Hubbard, and Chris Mayer[2]

Executive Summary

Frictions in the mortgage market have restricted the ability of tens of millions of borrowers from refinancing their mortgages, hampering monetary policy, slowing the economic recovery, and leading to excessive numbers of foreclosures. We propose a streamlined refinancing program that may benefit up to 30 million borrowers with government-backed mortgages, leading to possible savings of $70 billion per year in lower mortgage payments. Below we describe the current barriers to refinancings, how our plan would overcome these barriers, and why this plan is in the interest of taxpayers, the GSEs, and other mortgage service providers. We also discuss possible critiques and implementation issues and how such issues can be addressed.

1) The problem

a) As of June 2011, more than 75% of GSE[3] borrowers with a 30-year fixed-rate mortgage (FRM) have a rate of 5% or more, despite the fact that market-determined mortgage rates have been at or below 5.0% for nearly every month in the past two years and are currently around 4.25%.[4] Under normal credit conditions we might have expected three times this many eligible

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[1] Similar plans are proposed in the House of Representatives by Representative Dennis Cardoza and in the Senate by Senators Barbara Boxer and Johnny Isakson.

[2] Alan Boyce is CEO of the Absalon Project; Glenn Hubbard is Dean and Russell Carson Professor of Finance and Economics at Columbia Business School; Chris Mayer is Paul Milstein Professor of Real Estate, Finance and Economics at Columbia Business School and Visiting Scholar at the Federal Reserve Bank of New York. The authors would like to thank Daniel Hubbard, Laura Vincent, and James Witkin for excellent research assistance and Achim Duebel, David Scharfstein, Jeremy Stein, Joseph Tracy, Mark Zandi, and Jeff Murphy and his team at SNR Denton for many helpful comments. All opinions are those of the authors and do not represent the views of the Federal Reserve Bank of New York. Other recent reports with a similar themes include Mark Zandi and Chris DeRitis of Moody's Analytics-- "Restringing HARP: The Case for More Refinancing Now," October, 2010 and David Greenlaw of Morgan Stanley—"Slam Dunk Stimulus," July, 2010. See also, Hubbard and Mayer op-ed pieces in the *Wall Street Journal* in 2008 and the *New York Times* in 2010 calling for widespread refinancing programs and Absalon Project reports encouraging enhanced refinancing from in 2010 and 2011. BlackBox Logic, Equifax, Knowledge Decision Sciences, and Zillow provided crucial data for our analysis.

[3] GSEs are the government-sponsored entities Fannie Mae and Freddie Mac.

[4] Sources: Author's calculations from Lender Processing Services and Freddie Mac's Primary Mortgage Market Survey.

mortgages to have been prepaid, as happened during the last refinancing wave from 2002 to 2003.[5] This suggests tens of millions of borrowers have not taken advantage of a seemingly attractive refinancing proposition.

b) We believe that inefficiencies in the origination and servicing process, combined with GSE surcharges (so-called loan level pricing adjustments and adverse market delivery charges), falling home values, and conservative appraisals have made refinancing nearly impossible for most Americans.

c) In addition to blunting refinancing, these mortgage-market frictions are slowing the economic recovery by limiting the benefits of low interest rates for household spending. Unable to refinance their mortgages the way corporations have been able to refinance their debt, consumers are left with weak balance sheets and mortgage payments often above of the cost of renting, contributing to excessive delinquencies and foreclosures. These constraints on refinancing have a disproportionate impact on middle-class borrowers with origination balances under $200,000 and poorer credit and whose employment opportunities have been hit especially hard by the recession.

2) The Offer

a) Every homeowner with a GSE mortgage can refinance his or her mortgage with a new mortgage at a current fixed rate of 4% or less, with the rate subject to change up or down with the price of Agency pass-through Mortgage-Backed Securities (MBS). For borrowers with an FHA or VA mortgage, rates would be higher, but these borrowers should be included in any large-scale refinancing program.[6]

b) The homeowner must be current on his or her mortgage or become so for at least three months.

c) NO other qualification or application is required, other than intention to accept the new rate (that is, no appraisal, no income verification, no tax returns, etc.).[7]

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[5] According to data from HMDA, about 25 million mortgages were refinanced and 10 million more were originated for home purchase in 2002 to 2003, out of a stock of about 47 million mortgages. While some of these mortgages likely overlap, these numbers suggest that upwards of two-thirds of the stock of home mortgages were originated in the last trough of mortgage rates. By comparison in 2010 and the first five months of 2011, fewer than 10 million mortgages were originated according to Lender Processing Services, about one-third the rate of the previous refinancing boom.

[6] FHA and VA mortgages are also guaranteed by the federal government and thus can easily be included in any widespread refinancing program. However, some FHA or VA borrowers pay higher rates than GSE borrowers because their mortgages have greater risk. Under our program, these borrowers would pay the same higher insurance premium to the federal government, but the FHA or VA would facilitate the refinancing of their current mortgage to take advantage of lower bond rates.

[7] Issuers of new mortgages would be indemnified against any other "reps and warranties" violations since the originators have not verified any borrower information other than being current on the outstanding mortgage.

d) Minimal paperwork, other than what is needed legally to refinance in homeowner's jurisdiction. The Bureau of Consumer Financial Protection may provide a one-page substitute for TILA, RESPA, and HMDA filings to further reduce paperwork and costs.
e) Homeowners can choose between a 15- or 30-year amortization schedules for newly issued mortgages.
f) Homeowners may only refinance existing first-lien mortgage debt and cannot cash out or roll multiple mortgages into the new mortgages.
g) GSEs would be required to issue new MBS in large, highly standardized, transparent, and homogeneous pools, as current Ginnie Mae II Jumbo securities are now issued.
h) Existing servicers would be relieved of their liability for past "Reps and Warranties" violations as long as the mortgage is current today and is at least a year old.
i) Existing second-lien holders would be asked to resubordinate to the newly refinanced first mortgage.[8]
j) Existing mortgage insurance contracts should be rolled to the new first mortgage.[9]
k) New title insurance policies must be done in a streamlined process and at low cost, likely a few hundred dollars at most.[10]

3) **An Example of How the Mortgage Math Works**[11]
a) The proposal will break help break through the frictions that are dampening refinancing activity and be profitable for all participants in the mortgage market.
b) Newly issued 30 year GSE MBS trade between 3.2 and 3.4 percent yields in the bond market

[8] Second-lien holders strictly benefit from borrowers receiving lower payments on the new mortgage. Second-lien holders who refuse to re-subordinate their second liens on a systematic basis would lose the right to do business with GSEs in the future. This language mirrors a provision in the Boxer Bill.

[9] Mortgage insurers (MIs) benefit from borrowers receiving lower payments on the new mortgages because the default risk of these borrowers is lower, although the MIs also lose the right to make "Reps and Warranties" claims on these past mortgages. The loss of rights might require small compensation from GSEs as part of the package, maybe an additional 10 basis points. However, failure to participate in the plan and re-endorse policies should result in loss of ability to insure new GSE mortgages for all future mortgage insurance business.

[10] Title insurers strongly benefit from this program through much higher volume of new business. Failure to participate in creating these new policies, which would not involve any additional guarantees beyond those made in the original title insurance policy, should result in loss of ability to provide title insurance for all future GSE mortgages.

[11] This example is for GSE mortgages. FHA/VA borrowers would receive a similar benefit, but may pay higher rates as these borrowers have a higher existing risk premium. We have more detailed computations that are available on request that can show the profits and losses for all parties involved, including why we believe that originators can profitably cover all costs of new originations.

c) GSEs currently receive a guarantee fee of 12.5 to 25 basis points on most legacy mortgages. We propose a new guarantee fee of 40 basis points to compensate the GSEs for their costs of implementing this plan, for any possible revenue lost by giving up some "reps and warranties rights," and for the loss in value of their retained portfolio. Assuming that the GSEs currently charge guarantee fees of 15bp, they will get 25 basis points of additional revenue.[12] This fee would have a present value of between 1.5 and 2.0 percent of the mortgage amount (the bond market values interest-only payments at a multiple of 6-to-8 times).
d) Servicers would receive the right to originate/service newly issued mortgages to their existing borrowers at a fixed spread to be determined by the GSEs, likely 25-30 basis points.[13] Servicers must agree to independently verified, minimum quality standards in order to obtain the right to originate mortgages under this plan.[14] Servicers who do not agree to these terms will be immediately replaced under the direction of the GSEs.
e) In this example, newly originated refinancings would be originated at 3.8 to 4.1 percent, with no points or costs to consumers.[15]
f) Servicers of newly issued mortgages under this plan would not be responsible for "reps and warranties" violations of past servicers/originators.

4) Large economic benefit for consumers, the housing market, and the economy

a) According to Appendix Table 1, only about 18 percent of GSE mortgages and 30 percent of FHA/VA mortgages were originated in the last 18 months when there have been two periods of exceptionally low mortgage rates, well below what would have been expected based on previous refinancing waves with low mortgage rates.
b) About 63 percent of GSE 30-year fixed-rate mortgages have a rate above 5.5 percent, despite large potential savings for these borrowers from refinancing.
c) For our computations, we turn to an analysis of about $4.5 trillion of mortgage pools, including almost all Fannie Mae, Freddie Mac, FHA and VA

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[12] Our calculations suggest that the GSEs would break even on their losses from their retained mortgage portfolio if they were to have an additional spread of only 15 basis points, so a total GSE spread of 30 basis points instead of 40 basis points would work. Making this "break-even" for the GSEs would reduce the estimated rates to consumers in this proposal by about 0.1 percent.

[13] Note that origination/servicing on newly originated mortgages today earns a spread of about 35 basis points. With low origination costs and economies of scale, originating and servicing these mortgages would be highly profitable at these spreads.

[14] Servicers who fail to maintain these quality standards would lose their servicing rights to all mortgages originated under this plan.

[15] One exception might be consumers who live in locations where local governments charge a percentage of the mortgage amount to refinance a property. In this case, consumers might pay slightly higher rates.

mortgage pools as obtained from Knowledge Decision Sciences, representing about 75 percent of the existing universe of potential borrowers.[16] A spreadsheet detailing our computations is available on our website at: http://www4.gsb.columbia.edu/realestate/research/housingcrisis/.

d) For our computations, we use a simulated mortgage rate of 4 percent for 30-year mortgages and 3.5 percent for 15-year mortgages with no points or closing costs. We assume that 85% of existing borrowers in pools with average outstanding mortgage rates of 1 percent or more above the offered rate accept the refinancing offer, while take-up rates are 70 percent for borrowers with savings of 0.5-1 percent and 10 percent for borrowers with savings under 0.5 percent. These simulations thus look more like what a normal refinancing wave would look like rather than assuming 100 percent participation.

e) Based on these computations, we expect mortgage payments to fall by about $70 billion, benefitting about 25 million borrowers (about $2,800 average savings).[17] About $3.66 trillion of mortgages would be refinanced. This effect is a big part of how monetary policy would normally work in this setting. If we scale up the number of borrowers and savings based on missing $1.5 trillion of outstanding mortgages from our analysis, the estimated number of borrowers helped would be more than 30 million and savings could be up to $75 to $80 trillion.[18]

f) This plan would function like a long-lasting tax cut for these 25 or 30 million American families. Empirical evidence suggests that consumers spend a larger portion of permanent increases in income than temporary increases. This increase is accomplished while the plan reduces the deficit modestly by improving the budget position of the GSEs (see below).

g) This program would disproportionately benefit the most disadvantaged borrowers who have been seriously harmed by the recession. These consumers have been unable to take advantage of refinancing opportunities (and most likely to increase consumption as a result of lower mortgage payments). About 48 percent of all outstanding balances of GSE loans today

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[16] These securities do not include mortgages in pools not in our data or held by the GSEs or Ginnie Mae either because they have not been securitized or they were repurchased from securitizations due to actual or likely default. The data cover 3.88 trillion of outstanding 30-year FRMs and 0.62 trillion of 15-year FRMs and were obtained from Knowledge Decision Sciences.

[17] A small portion of these savings come from amortizing existing mortgages over a longer period of time. That is, borrowers with 27 years left on their mortgage will now be spreading payments over 30 years for a new FRM. Given that many households face liquidity constraints, offering the option of an extended amortization period is likely an additional benefit.

[18] Since many of the mortgages missing from our sample are previously defaulted loans that are repurchased by the GSEs and would thus be ineligible for our program, we think that a much smaller percentage of the up to $1.5 trillion of missing mortgages would likely take advantage of our program. We are not counting the loans held in whole loan form in bank portfolios nor are we counting the performing loans in Private Label Securitizations (PLS) as neither group currently benefits from an agency guarantee. In the interests of fairness to these homeowners, a similar program with higher fees could be pursued.

went to borrowers whose origination mortgage was under $200,000. Because these borrowers have been less likely to refinance, they would obtain 54 percent of the total interest savings. Assuming mortgages are about three times income, this means most of the savings would accrue to borrowers whose household income at origination was under $70,000. (See Appendix Table 2).

h) The housing market benefits in many ways. Lower mortgage payments reduce future defaults, helping to stabilize house prices for all homeowners, whether or not they have a GSE/FHA/VA mortgage. The good news about refinancing may help improve consumer confidence, further benefiting the housing market. House prices may start to go up, leaving fewer borrowers underwater, starting a virtuous circle. Finally, reducing pressure on servicers and PMI companies may help the mortgage market start to recover to a more normal level, helping spreads on newly originated mortgages.

5) Profits for other participants

a) GSEs receive cash flow that has an up-front value of $54-$72 billion
   i) They earn 1.5-2.0 percent profit for originating new mortgages; with total refinancings of $3.6 trillion, this amount translates to a profit of $54 to $72 billion.
   ii) GSEs have about $580 billion of bonds on their balance sheet.[19] Assuming a weighted average market price of 107, the bonds have a mark-to-market premium of $40.6 billion. Even after these mark-to-market costs, the GSEs should earn appreciable profits, which can be used to cover costs of refinancings, possible future losses, and eventually returning some of the estimated $150 billion owned to taxpayers.
   iii) GSEs have lower costs of future defaults due to lower payments for current borrowers. Reduced defaults might be about $25 billion; we are working further on this estimate.
   iv) GSEs lose right to "put back" legacy mortgages to servicers in the event of a future default due to a "reps and warranties" violation. However, because we limit the program to borrowers who are current on their mortgage, the potential market value of these "put back" rights is likely quite low.

b) Existing servicers (two-thirds of mortgages are serviced by largest banks) benefit by lower legal liabilities and safer portfolios of second liens; must now meet new service-quality standards.
   i) Banks get rid of reps-and-warrants liability for the bulk of outstanding mortgages, helping to resolve legal uncertainty weighing down their share prices and legal reserves.

[19] See Appendix Table 2 for a list of the holders of GSE bonds and mortgages as of December, 2010.

ii) Lower payments on first mortgages make the existing portfolio of HELOCs and second liens less risky, helping to shore up bank balance sheets.
iii) In return, banks must agree to re-subordinate existing second liens to newly refinanced mortgages at no cost to existing homeowners.
iv) The banks have about $1.07 trillion of agency MBS in their portfolio, so they will see some prepayments as well.[20]
  (1) Banks typically hold portfolios with lower coupon bonds that would have smaller-than-average mark-to-market losses. When capital-constrained banks have higher coupon bonds trading at a premium, they often liquidate the bonds to book profits and increase capital, replacing them with lower coupon bonds.
  (2) Most of Banks' mortgage loans are categorized as "held to maturity" assets and thus are marked at amortized cost. Their holdings in Agency MBS typically are categorized as "available for sale," so the change in mark-to-market values is not reported on the income statement but does change the equity capital account. Thus a large prepayment wave will not result in large mark-to-market losses.
v) Servicers must conform to new independently verified customer service guarantees or lose the mortgage servicing relationship to a competitor.
vi) Existing servicers should have a short period of time (60 or 90 days) to offer this program to their existing borrowers on an exclusive basis. Afterwards, any servicer should be able to approach GSE borrowers to offer this program.

c) Taxpayers benefit: they will receive higher payments from Fannie and Freddie and lower future losses from mortgage defaults; lower mortgage interest deductions may also reduce the deficit.
  i) GSEs must pay back taxpayers for their losses to the extent possible, so profits from managing this program translate to a lower deficit
  ii) Lower homeowner mortgage payments reduce deductions from mortgage interest, raising net tax collections and further lowering the deficit.

d) Bondholders are paying the bulk of the cost of this program
  i) Bondholders benefit from the improved economic outlook associated with this refinancing program.
  ii) Nearly all the gains to mortgage borrowers from this plan come at the expense of investors who understood and accepted the callable nature of mortgage interest rate risk. Appendix Table 3 lists the major groups of bondholders for GSE MBS as of December, 2010. About two-thirds of GSE bonds are held by the private sector or foreign owners.
  iii) Given historical experience, GSE bondholders purchased the bonds at prices that anticipated these bonds being refinanced when mortgage rates fell. Thus, most Agency bondholders have received an unanticipated

[20] See Appendix Table 3 for a list of the holders of GSE bonds and mortgages as of December, 2010.

windfall from the extremely slow refinancing rates, effectively benefitting from unanticipated inefficiencies in the mortgage market at the expense of existing homeowners. This shift has occurred for almost three years, benefiting the holders of GSE bonds.

iv) Some GSE bonds are held overseas, where there are no costs to the US economy from increased prepayments.

v) Agency bondholders have also benefitted enormously from government actions during the crisis. In 2008, the government guaranteed GSE bonds against losses. Later the Federal Reserve bought $1.25 trillion of Agency MBS and the Treasury bought $225 billion and still held about $1.15 trillion of Agency MBS as of December 2010. Absent these purchases, Agency MBS prices would be significantly lower, and the attendant losses from a streamlined refinancing wave would also be lower.

vi) The Federal Government through the Federal Reserve and US Treasury and thus will suffer some economic loss from their portfolio from the prepayment of high-coupon Agency MBS. But, the Federal Reserve does not mark-to-market and bought the GSE MBS for the express purpose of lowering mortgage rates and stimulating the housing market, which is what this plan accomplishes.

e) Private Mortgage Insurers

i) The Agencies should ask Mortgage Insurers (MIs) to re-endorse existing policies for the newly refinanced mortgages.

ii) With lower mortgage rates, default rates would be lower, so MIs would get large benefits from this plan.

iii) Mortgage Insurers lose the possibility of pursuing reps and warranties violations on mortgages and may require some additional compensation, which might cost no more than 10 basis points, if needed at all.

f) Title Insurers

i) New title insurance policies under this program should require minimal additional work, but simply insuring against any adverse claims prior to the origination of the previous mortgage.

ii) A modified title insurance policy should be available for several hundred dollars at the most. With 20 million new mortgages, this policy would generate substantial new revenue for title insurers for little new effort.

6) Other important questions and responses:

a) Wouldn't a mass refinancing program interfere with markets in a way that might cause a loss in confidence by investors and future mortgage rates to rise?

i) As we note above, the government and the Fed have already undertaken unprecedented interventions, but most of these have positively impacted Agency bondholders, not so much homeowners. These interventions did not have the intended consequence of assisting homeowners in exercising their contractual right to refinance when interest rates fell.

ii) Historically, most bond prices already anticipated widespread refinancing when mortgage rates fell, just like occurred in 2002-2004,

when the majority of outstanding mortgages refinanced to take advantage of mortgage rates that fell below 5 percent.

iii) Nonetheless, if this issue were a continuing concern, the Agencies could add an additional covenant in future MBS guaranteeing that the Agencies would never again pursue a mass refinancing program (or limiting the scope of such a program). Such a provision would be a legally binding contract and require compensation for bondholders in any future mass refinancing program.

iv) This streamlined refinancing proposal is meant to reduce or eliminate frictions that have limited households' ability to exercise their contractual right to refinance when interest rates fell.

b) Restrictions on securitizing new mortgages with an LTV over 125 percent can change the type of securitization required, but such mortgages can be included in our program.

i) High LTV mortgages (greater than 125% LTV) cannot be placed into REMICs based on current IRS tax rules. One of the requirements for an agency MBS is that it be REMIC eligible. Thus, 125+ LTV loans are ineligible to be securitized into TBA MBS. However, these mortgages can still be securitized through non-TBA deliverable, single-class pass-thru securities and will trade at a lower price in the market. While these single-class securities cannot be tranched like REMICs can, the GSEs have issued such securities in the past and could do so again under this program. We believe that automated appraisals can be used to determine LTVs for the decision of which mortgages to place in normal or high LTV pools.

ii) Securities backed by high LTV mortgages present trade-offs to investors. On one hand, high LTV, low FICO, low loan balance mortgage loans are much less likely to efficiently exercise their option to prepay, which significantly increases their value. On the other hand, if such MBS contain >125 LTV loans, they will be ineligible for use in REMIC structures. We believe that such high LTV, low loan balance MBS will improve the TBA market and be material to this program, especially given that mortgages above 125% LTV are a minority of all outstanding mortgages

iii) TBA rules are negotiated rather than legislated or subject to SEC regulation. We believe that SIFMA retains broad discretion to allow the placement of high LTV mortgages into bonds. The intent of the TBA deliverability requirement is to preserve and improve liquidity. There is no requirement that such bonds be relatively homogeneous, as the expectation is that TBA means "cheapest to deliver." Historically, TBA good delivery requirements are negotiated, with SIFMA acting as the honest broker to ensure an orderly operation the MBS market.

iv) Current trading data and option adjusted spread models (OAS) show that high LTV/low credit score/low loan balance mortgage pools trade at premiums to TBA eligible pools. While seemingly counterintuitive, pools with relatively risky borrowers are attractive to many investors because of their relatively slow prepayment speeds.

c) Wouldn't a mass refinancing program lock homeowners into their homes, impairing labor market mobility, home sales, and future economic growth?
   i) Any time interest rates rise, homeowners have a reduced incentive to move. Of course, the larger issue is that underwater borrowers already have reduced ability to move which is reducing labor mobility and increasing unemployment.
   ii) Under this plan, the United States should mimic the Danish mortgage system and give mortgage borrowers the right to purchase their mortgages out of these pools at market prices. Under such a plan, performing borrowers, through their servicer, broker, banker, or other financial intermediary, could purchase bonds at market prices. The bonds would be presented to the trustee which would accept its' liability and thus allow borrowers to pay off their mortgages. Because these bonds would trade at a discount to par value when rates rise, borrowers would earn a "profit" by paying off their mortgage below par. In fact, if rates rose, borrowers might be able to use such profits to help offset the impact of lower house prices, effectively stabilizing the mortgage market and the economy.[21]

d) Aren't the originators getting "too much" by eliminating reps and warranties liability on future mortgages?
   i) Reps and warrants claims on mortgages that are current on their payments are likely to be worth relatively little.
   ii) Servicers believe that the current exercise of reps and warranties is far in excess of the intent of the original contract clause. In fact, they believe loans are being putback for small clerical errors.
   iii) If this issue is a continuing concern, the Agencies could demand that issuers carry over any some limited liability to the newly issued mortgages. Previous orginators would still benefit in that consumers with lower payments are less likely to default, thus reducing potential liability.

e) The program is "unfair," in that it does not cover all borrowers
   i) It is not possible to help borrowers whose loans are not currently guaranteed by the GSEs, FHA orVA without appreciable taxpayer funds or increased risk in lending.
   ii) To help remaining borrowers, the government should work to further reduce retail mortgage rates and develop a privately funded mortgage market.
   iii) This program could be extended to include borrowers whose loans fit the GSE conventional loan guidelines at the time of origination, but for some reason were not pooled with a GSE guarantee. This would need to be done at higher cost to the borrower, as the GSEs would be taking on incremental risk.

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[21] For more detail, see the following presentation: http://absalonproject.com/wp-content/uploads/2011/08Time-to-Fix-the-US-Mortgage-Market-8-22-11.pdf.pdf

iv) In addition, the government should endeavor to cover some HARP borrowers who agreed not to refinance again as part of their HARP mortgage. Such restrictions did not envision a low-cost mass refinancing program being undertaken at lower mortgage rates.

Appendix Table 1: Distribution of Mortgage Rates and Origination Year for Outstanding Government-Backed Mortgages as of June, 2011

(NOTE: McDash is missing about 10 million mortgages or 20 percent of outstanding mortgages, so these counts likely understate the number of potential beneficiaries)

	Percent of Borrowers with 30-yr FRM		
	GSE	**FHA**	**VA**
Below 4%	2.4%	0.4%	0.3%
4-5%	21.4%	23.1%	29.6%
5-5.49%	16.9%	28.2%	24.0%
5.5-5.99%	21.7%	17.9%	17.5%
6-7%	29.8%	22.3%	20.1%
above 7%	8.0%	8.2%	8.6%
Total number in McDash	15,555,981	5,488,159	1,125,248

	Percent of Borrowers with 30-yr FRM		
Date of origination	**GSE**	**FHA**	**VA**
2007 or earlier	57.7%	30.5%	38.9%
2008-2009	26.0%	40.9%	29.0%
2010-2011	16.4%	28.6%	32.1%

	Percent of Borrowers with 15-yr FRM		
	GSE	**FHA**	**VA**
Below 4%	6.9%	3.7%	1.8%
4-5%	38.6%	43.6%	31.6%
5-5.49%	21.0%	15.1%	20.9%
5.5-5.99%	17.7%	14.1%	24.3%
6-7%	13.3%	15.8%	16.5%
above 7%	2.6%	7.9%	5.0%
Total number in McDash	6,187,831	342,577	96,989

	Percent of Borrowers with 15-yr FRM		
Date of origination	**GSE**	**FHA**	**VA**

2007 or earlier	62.1%	37.8%	67.4%
2008-2009	14.7%	27.7%	10.6%
2010-2011	23.2%	34.5%	22.1%

Appendix Table 2: Distribution of Benefits Origination Balances as of June, 2011

Origination Balance	% Outstanding Balances	% Interest Savings
Under $100,000	14%	18%
$100,000-199,999	33%	36%
$200,000-299,999	27%	25%
$300,000-399,999	17%	15%
$400,000-499,999	6%	4%
$500,000-599,999	2%	1%
$600,000-699,999	1%	1%

Source: Lender Processing Services and authors' calculations

Notes: **% Outstanding Balances** represents the portion of total outstanding GSE mortgage balances broken down by the origination amount. So 47 percent of all outstanding GSE balances are for borrowers with an origination mortgage under $200,000. **% Interest Savings** represents the portion of the total interest savings that accrue to borrowers in each category. So 54 percent of all interest savings go to borrowers whose origination amount was less than $200,000. The reason that a disproportionate share of the interest savings go to borrowers with the lowest origination balances is that these borrowers also have the highest mortgage rates and were the least likely to refinance to take advantage of low rates.

Appendix Table 3: Ownership of GSE Bonds and Mortgages as of December, 2010

Owner	Dollars Outstanding	Percent
US Treasury/Federal Reserve	$1,148	21.5%
Commercial Banks	$1,071	20.1%
Foreign Investors	$770	14.4%
Mutual Funds/Private Pension Funds	$705	13.2%
Fannie Mae/Freddie Mac	$583	10.9%
Public Pension Funds/State & Local Govt	$280	5.2%
Savings Institutions/Credit Unions	$262	4.9%
Insurance Companies	$208	3.9%

Other	$301	5.6%
Total	$5,328	100%

Source: Inside Mortgage Finance, "The 2011 Mortgage Market Statistical Annual – Volume II," P. 293.

ADDENDUM

State		Senator	Party	Senator	Party	Population (2010)	Savings (millions)	Mortgages Eligible	Savings Per Refi	Refi count/ population	Refi value/ population	Housing Units with Mortgage (2009)	Share of 2009 mortages refi'd	AVG Credit Score
Alaska	AK	Begich, Mark	D	Murkowski, Lisa	R	710,231	$178	63,712	$2,792	9%	$250	104,790	0.61	674
Alabama	AL	Sessions, Jeff	R	Shelby, Richard C.	R	4,779,736	$863	421,326	$2,049	9%	$181	779,325	0.54	676
Arkansas	AR	Boozman, John	R	Pryor, Mark L.	D	2,915,918	$402	229,824	$1,748	8%	$138	435,512	0.53	668
Arizona	AZ	Kyl, Jon	R	McCain, John	R	6,392,017	$2,061	829,443	$2,485	13%	$322	1,076,371	0.77	659
California	CA	Boxer, Barbara	D	Feinstein, Dianne	D	37,253,956	$11,355	3,582,530	$3,169	10%	$305	5,226,588	0.69	672
Colorado	CO	Bennet, Michael F.	D	Udall, Mark	D	5,029,196	$1,936	767,789	$2,521	15%	$385	971,804	0.79	674
Connecticut	CT	Blumenthal, Richar	D	Lieberman, Joseph I.	ID	3,574,097	$958	343,879	$2,786	10%	$268	659,299	0.52	694
District of Columbia	DC					601,723	$246	68,131	$3,611	11%	$409	87,382	0.78	677
Delaware	DE	Carper, Thomas R.	D	Coons, Christopher A.	D	897,934	$327	121,362	$2,691	14%	$364	168,711	0.72	684
Florida	FL	Nelson, Bill	D	Rubio, Marco	R	18,801,310	$5,399	2,082,451	$2,592	11%	$287	3,093,098	0.67	673
Georgia	GA	Chambliss, Saxby	R	Isakson, Johnny	R	9,687,653	$2,618	1,146,692	$2,283	12%	$270	1,655,875	0.69	668
Hawaii	HI	Akaka, Daniel K.	D	Inouye, Daniel K.	D	1,360,301	$414	102,325	$4,042	8%	$304	177,529	0.58	688
Iowa	IA	Grassley, Chuck	R	Harkin, Tom	D	3,046,355	$442	264,130	$1,673	9%	$145	559,814	0.47	700
Idaho	ID	Crapo, Mike	R	Risch, James E.	R	1,567,582	$421	188,995	$2,225	12%	$268	278,102	0.68	688
Illinois	IL	Durbin, Richard J.	D	Kirk, Mark	R	12,830,632	$3,225	1,311,979	$2,458	10%	$251	2,251,649	0.58	684
Indiana	IN	Coats, Daniel	R	Lugar, Richard G.	R	6,483,802	$1,179	640,648	$1,841	10%	$182	1,223,347	0.52	676
Kansas	KS	Moran, Jerry	R	Roberts, Pat	R	2,853,118	$481	256,340	$1,875	9%	$168	486,683	0.53	682
Kentucky	KY	McConnell, Mitch	R	Paul, Rand	R	4,339,367	$625	331,362	$1,886	8%	$144	724,517	0.46	677
Louisiana	LA	Landrieu, Mary L.	D	Vitter, David	R	4,533,372	$683	326,816	$2,091	7%	$151	651,071	0.50	663
Massachusetts	MA	Brown, Scott P.	R	Kerry, John F.	D	6,547,629	$1,708	582,794	$2,932	9%	$261	1,155,696	0.50	703
Maryland	MD	Cardin, Benjamin L.	D	Mikulski, Barbara A.	D	5,773,552	$2,257	753,784	$2,995	13%	$391	1,102,684	0.68	688
Maine	ME	Collins, Susan M.	R	Snowe, Olympia J.	R	1,328,361	$246	102,705	$2,399	8%	$185	263,918	0.39	699
Michigan	MI	Levin, Carl	D	Stabenow, Debbie	D	9,883,640	$2,034	1,017,268	$2,000	10%	$206	1,882,846	0.54	679
Minnesota	MN	Franken, Al	D	Klobuchar, Amy	D	5,303,925	$1,574	713,992	$2,204	13%	$297	1,096,579	0.65	707
Missouri	MO	Blunt, Roy	R	McCaskill, Claire	D	5,988,927	$1,210	633,111	$1,911	11%	$202	1,078,256	0.59	683
Mississippi	MS	Cochran, Thad	R	Wicker, Roger F.	R	2,967,297	$292	143,275	$2,039	5%	$98	427,313	0.34	668
Montana	MT	Baucus, Max	D	Tester, Jon	D	989,415	$220	104,504	$2,102	11%	$222	150,921	0.69	701
North Carolina	NC	Burr, Richard	R	Hagan, Kay R.	D	9,535,483	$2,141	996,713	$2,148	10%	$225	1,661,351	0.60	667
North Dakota	ND	Conrad, Kent	D	Hoeven, John	R	672,591	$69	44,495	$1,545	7%	$102	101,911	0.44	706
Nebraska	NE	Johanns, Mike	R	Nelson, Ben	D	1,826,341	$296	173,493	$1,706	9%	$162	310,747	0.56	712
New Hampshire	NH	Ayotte, Kelly	R	Shaheen, Jeanne	D	1,316,470	$370	141,759	$2,607	11%	$281	257,807	0.55	703
New Jersey	NJ	Lautenberg, Frank R	D	Menendez, Robert	D	8,791,894	$2,987	951,698	$3,138	11%	$340	1,488,050	0.64	693
New Mexico	NM	Bingaman, Jeff	D	Udall, Tom	D	2,059,179	$513	217,962	$2,354	11%	$249	310,823	0.70	663
Nevada	NV	Heller, Dean	R	Reid, Harry	D	2,700,551	$955	347,089	$2,750	13%	$353	440,311	0.79	655
New York	NY	Gillibrand, Kirsten E	D	Schumer, Charles E.	D	19,378,102	$4,186	1,344,655	$3,113	7%	$216	2,579,280	0.52	686
Ohio	OH	Brown, Sherrod	D	Portman, Rob	R	11,536,504	$1,990	1,035,361	$1,922	9%	$173	2,108,697	0.49	685
Oklahoma	OK	Coburn, Tom	R	Inhofe, James M.	R	3,751,351	$620	329,659	$1,880	9%	$165	572,509	0.58	666
Oregon	OR	Merkley, Jeff	D	Wyden, Ron	D	3,831,074	$1,267	482,977	$2,624	13%	$331	655,589	0.74	686
Pennsylvania	PA	Casey, Robert P., Jr.	D	Toomey, Patrick J.	R	12,702,379	$2,412	1,103,232	$2,187	9%	$190	2,205,428	0.50	696
Rhode Island	RI	Reed, Jack	D	Whitehouse, Sheldon	D	1,052,567	$239	87,815	$2,722	8%	$227	186,002	0.47	692
South Carolina	SC	DeMint, Jim	R	Graham, Lindsey	R	4,625,364	$1,004	457,955	$2,192	10%	$217	769,352	0.60	665
South Dakota	SD	Johnson, Tim	D	Thune, John	R	814,180	$108	66,139	$1,629	8%	$132	126,093	0.52	710
Tennessee	TN	Alexander, Lamar	R	Corker, Bob	R	6,346,105	$1,249	614,035	$2,033	10%	$197	1,085,291	0.57	679
Texas	TX	Cornyn, John	R	Hutchison, Kay Bailey	R	25,145,561	$5,056	2,362,989	$2,140	9%	$201	3,428,275	0.69	651
Utah	UT	Hatch, Orrin G.	R	Lee, Mike	R	2,763,885	$825	337,577	$2,443	12%	$298	455,691	0.74	683

Virginia	VA	Warner, Mark R.	D	Webb, Jim	D	8,001,024	$2,760	991,916	$2,782	12%	$345	1,475,470	0.67	689
Vermont	VT	Leahy, Patrick J.	D	Sanders, Bernard	I	625,741	$126	53,124	$2,370	8%	$201	121,554	0.44	706
Washington	WA	Cantwell, Maria	D	Murray, Patty	D	6,724,540	$2,456	882,999	$2,781	13%	$365	1,195,537	0.74	691
Wisconsin	WI	Johnson, Ron	R	Kohl, Herb	D	5,686,986	$910	439,924	$2,068	8%	$160	1,074,592	0.41	699
West Virginia	WV	Manchin, Joe, III	D	Rockefeller, John D., I\	D	1,852,994	$170	84,855	$1,998	5%	$92	274,517	0.31	679
Wyoming	WY	Barrasso, John	R	Enzi, Michael B.	R	563,626	$116	50,559	$2,289	9%	$205	93,297	0.54	690
							$76,176	30,730,147				50,747,854.00		