S. HRG. 112–677

EXPANDING REFINANCING OPPORTUNITIES TO IMPROVE THE HOUSING MARKET

HEARING

BEFORE THE

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

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

EXAMINING REFINANCING OPPORTUNITIES TO IMPROVE THE HOUSING MARKET

MAY 8, 2012

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

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

U.S. GOVERNMENT PRINTING OFFICE

77–843 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

TIM JOHNSON, South Dakota, *Chairman*

JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
ROBERT MENENDEZ, New Jersey
DANIEL K. AKAKA, Hawaii
SHERROD BROWN, Ohio
JON TESTER, Montana
HERB KOHL, Wisconsin
MARK R. WARNER, Virginia
JEFF MERKLEY, Oregon
MICHAEL F. BENNET, Colorado
KAY HAGAN, North Carolina

RICHARD C. SHELBY, Alabama
MIKE CRAPO, Idaho
BOB CORKER, Tennessee
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
MIKE JOHANNS, Nebraska
PATRICK J. TOOMEY, Pennsylvania
MARK KIRK, Illinois
JERRY MORAN, Kansas
ROGER F. WICKER, Mississippi

DWIGHT FETTIG, *Staff Director*
WILLIAM D. DUHNKE, *Republican Staff Director*

CHARLES YI, *Chief Counsel*
ERIN BARRY FUHER, *Professional Staff Member*
BETH COOPER, *Professional Staff Member*
WILLIAM FIELDS, *Legislative Assistant*

ANDREW OLMEM, *Republican Chief Counsel*
CHAD DAVIS, *Republican Professional Staff Member*
DANA WADE, *Republican Professional Staff Member*

DAWN RATLIFF, *Chief Clerk*
RIKER VERMILYE, *Hearing Clerk*
SHELVIN SIMMONS, *IT Director*
JIM CROWELL, *Editor*

C O N T E N T S

TUESDAY, MAY 8, 2012

WITNESS

EXPANDING REFINANCING OPPORTUNITIES TO IMPROVE THE HOUSING MARKET

TUESDAY, MAY 8, 2012

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

The Committee met at 10:05 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. This Committee will come to order.

Our housing market faces dual problems: the continued lag in the housing recovery which is creating impediments to fixing the second problem: the need for large-scale, long-term housing finance reform. While the Committee continues to be concerned about the long-term structure of the housing finance system, today's hearing takes a closer look at one of the strategies to improve the struggling housing market.

During our hearings on the state of the housing market, several witnesses, including Secretary Donovan, discussed the need to expand refinancing opportunities for borrowers who were paying their mortgage. I would like to thank the Secretary for coming back to discuss this topic in greater detail.

In January, the Federal Reserve released a white paper entitled "The U.S. Housing Market: Current Conditions and Policy Considerations." In this paper, the Fed stated that "continued weakness in the housing market poses a significant barrier to a more vigorous economic recovery." One of the barriers identified in the white paper includes obstacles to refinancing at today's low interest rates.

The Administration's Housing Plan also identifies removing barriers and expanding refinancing opportunities as part of the solution. While FHFA made some changes to the HARP program last year at the urging of Members of Congress and the Administration, I continue to hear from constituents and the housing industry that more could be done to encourage competition in the refinancing market and give homeowners more options.

During a hearing in the Housing and Transportation Subcommittee 2 weeks ago, Senator Menendez outlined legislation he and Senator Boxer are working on to expand refinancing opportunities for borrowers with GSE-held loans. I look forward to a further discussion of that legislation and any other proposals today.

As I stated during our state of the housing market hearings on this topic, I share the concern that ongoing challenges in the housing market are acting as a drag on economic recovery. As we have heard many times in this Committee, there is not a silver-bullet solution that will save the housing market, but several options implemented together could provide stability to the market. I hope that this Committee can work in a bipartisan fashion to find practical solutions to help overcome the barriers that are weighing down our housing recovery.

With that, I will turn to Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. Welcome again, Secretary Donovan. You have been up here a lot, and we appreciate it.

Today the Committee will consider ways to aid our troubled housing market by expanding refinancing opportunities. And while this topic is timely, I think it is disappointing that 4 years after the bursting of the housing bubble, the Committee has still not produced comprehensive housing legislation. And as a result, little has been done to address the serious problems in our housing market.

FHA, for example, still needs to be reformed. Foreclosures remain, as the Chairman mentioned, at record levels. Millions of mortgages are underwater, and Fannie and Freddie continue to lose money at the expense of the American taxpayer. In fact, while the taxpayers have spent almost $190 billion bailing out the GSEs, the only work product we have received from the Administration is a brief discussion piece that lists three policy options but does not, Mr. Secretary, make any recommendations.

Meanwhile, millions of dollars have been spent on piecemeal programs like HAMP and the so-called Hardest Hit Fund. But as SIGTARP has repeatedly noted, none of these programs have achieved their expected results.

Admittedly, the problems facing our housing markets are very complex, as you have reminded us, and there are no easy solutions. Finding answers will require careful study and crafting legislation based on facts and rigorous analysis.

Unfortunately, rather than doing the hard work required to solve problems, some have chosen to create scapegoats. Blaming certain regulators for not undertaking massive principal reductions may make for a good 1-day new story, but it is not an effective means for solving the problems plaguing our housing market. Plus paying banks billions of taxpayer dollars to write down mortgages is just another back-door bailout of Wall Street.

Given how the Administration now praises TARP, maybe another Wall Street bailout is just what it wants. The American people, however, are tired of bailouts. It is time to take a more serious approach to fixing the housing market.

As I have stated before, my Republican colleagues and I are willing to work with the Committee to produce and to craft effective bipartisan legislation. The Committee is the best forum, I believe, right here, to facilitate careful deliberations and the needed compromises. In contrast, by bypassing the Committee and proceeding directly to the floor with any legislation will almost certainly result in partisan gridlock. Accordingly, the majority's decision about how it will proceed with any housing legislation will likely reveal whether such legislation is a serious effort to solve problems or just another effort to highlight differences at the expense of real compromise.

I believe the American people have already waited 4 years for housing reform legislation, and I welcome this hearing, Mr. Secretary. Only time will tell whether the American people will be made to wait even longer.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Shelby.

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

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you very much, Mr. Chairman, for holding the hearing, and I have to go shortly to the floor as part of the debate on the prevention of the increase in student loan interest rates. But I did want to first commend the Secretary for all of his efforts. You are here today principally on the Menendez-Boxer proposal. Let me personally commend Senator Menendez for his very, very thoughtful proposal.

We have been trying over the last several years to do many things to support and revitalize the housing market. I do not think there is one magic solution. It is many things.

In that context, I am very pleased that the Administration has finally taken interest in the REO-to-rental initiative, taking some of these properties on the books of banks and putting them back in the marketplace as rental properties.

I also understand that you will be discussing Project Rebuild. I was pleased to work with you in this regard. And I think it is important, with the tools available and as quickly as possible, to deploy them to keep people in their homes, minimize foreclosures, and to provide a floor essentially to the housing market, and then hopefully begin to see it appreciate in a thoughtful and measured way.

But, Mr. Secretary, thank you for all of your efforts and your commitment, and thank you, Mr. Chairman.

Chairman JOHNSON. Anybody else? Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman, for this important hearing. And, Mr. Secretary, thank you for joining us again. I appreciated it when you came before the Subcommittee just recently.

As I have said many times, we need to fix the housing market now to get the broader economy moving again and creating jobs. Fixing the housing market must involve using multiple strategies to attack the problem from different angles, and refinancing should be one of those strategies, particularly for borrowers who are making their payments but whose interest rates on their mortgages are above today's interest rates of 4 to 5 percent.

That is why within the next few days I will be introducing with Senator Boxer an important and widely supported bill called the

Responsible Homeowner Refinancing Act of 2012. It is supported by borrower groups such as the Americans for Financial Reform, the National Consumer Law Center, the National Council of La Raza, NCRC, by the National Association of Realtors, the National Association of Home Builders, many lenders like Quicken Loans, and some mortgage investors like Amherst Securities.

Our bill would help $17.5 million borrowers who have Fannie Mae and Freddie Mac loans but who are trapped paying interest rates above 5 percent because of barriers to refinancing. Our bill would make it easier for homeowners to refinance and lower their mortgage payments, which is a popular and commonsense way to help the housing market. Allowing a homeowner to refinance from a loan that is 6-percent interest to a loan that is 4-percent interest, for example, would save them hundreds of dollars a month, putting more money in their pockets, reducing defaults and foreclosures. And summaries of the bill are available for the press in the back of the room.

I would also like to thank Senator Franken for working with me on the put-back risk provision of the discussion draft which is similar to a provision he introduced in another bill. Our bill does not include, however, the Administration's proposal to refinance private loans through the FHA or the Administration's proposal to pay closing costs of borrowers who agree to shorter loan terms, which I understand Senators Feinstein and Merkley are working on, respectively.

Finally, some but not all of the refinancing provisions were addressed in FHFA's Home Affordable Refinance Program expansion, also called HARP 2. For example, HARP 2 removed loan-to-value caps for underwater homeowners but does not apply to borrowers under 80 percent loan-to-value ratio who theoretically should be able to refinance but in practice sometimes cannot. FHFA scaled back lender liability for representations and warranties which lenders cite as an obstacle to encouraging them to extend refinance loans for same-servicer refinances in HARP 2. But FHFA did not scale back representations and warranties liability for cases when a different servicer was refinancing the loan, which has led to a lack of competition among lenders that has resulted in much higher interest rates for borrowers. And we need to inject competition and market forces into this market where servicers have an unfair monopoly on refinancing certain borrowers who effectively have no choice but to use their original lenders.

There are some other obstacles that we had at the hearing, Mr. Chairman. It is more fully in my statement, and we will flesh it out with the Secretary.

Finally, one of the best aspects of the Boxer-Menendez Responsible Homeowner Refinancing Act is that, according to preliminary CBO estimates, it will stop bailouts and save taxpayers money because fewer homeowners will default if their mortgage payments are lowered and, therefore, we have been told that we do not even need to consider some of the points that we were going to add. So I think this is a slam-dunk for both homeowners and the taxpayers, and we look forward to working with the Chair as we move forward.

Chairman JOHNSON. Are there any other Members who wish to make an opening statement?

[No response.]

Chairman JOHNSON. Thank you all.

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

Now I would like to briefly introduce our witness, who is no stranger to this Committee. Secretary Shaun Donovan is the 15th Secretary of the Department of Housing and Urban Development. Secretary Donovan has served in this capacity since January 2009.

Secretary Donovan, you may proceed with your testimony.

STATEMENT OF SHAUN DONOVAN, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. DONOVAN. Thank you, Chairman Johnson, Ranking Member Shelby, Members of the Committee. Thank you for this opportunity to testify about the Administration's initiatives to help American homeowners refinance their mortgages and rebuild equity in their homes.

Mr. Chairman, this hearing comes at a moment in which our housing market appears to have turned a corner following the best winter of home sales since the crisis began. Indeed, with interest rates at historic lows, more than 14 million homeowners have refinanced their mortgages, putting nearly $27 billion a year in real savings into the hands of American families and into our economy. Because we have provided responsible families opportunities to stay in their homes, more than 5.9 million modifications have been started in the last 3 years, and the number of families falling into foreclosure is half of what it was in early 2009.

Because we have helped communities struggling with concentrated foreclosures, places with targeted neighborhood stabilization investments have seen vacancies fall and home prices rise. Most important of all, our economy has added private sector jobs for 26 straight months, totaling 4¼ million jobs. This represents important progress, but to create an economy built to last, we need to do more.

Indeed, as I discussed before this Committee in February, a range of barriers keeps struggling borrowers from getting the relief they need and our economy needs at this pivotal moment. In particular, Mr. Chairman, barriers to refinancing are preventing millions of responsible homeowners from taking advantage of interest rates that are at their lowest levels since the 30-year mortgage was created.

For instance, consider Judy from Tucson. Judy is in a mortgage with a 7-percent interest rate and cannot refinance, not because she has ever been late on a mortgage payment but because her home, like half of all homes in Arizona, is underwater. Not being able to refinance not only prevents homeowners like Judy who have done the right thing and who are current on their mortgages from saving thousands of dollars each year. It also prevents our economy from receiving the lift that low interest rates typically provide.

That is why the President called for us to take more aggressive steps last fall. Within 6 weeks, we had identified barriers that were holding people with loans backed by the GSEs from refinancing. And by the end of the year, servicers were ramping up their operations for HARP 2.0.

Just four of the largest servicers report that they are processing applications as we speak from 750,000 homeowners who stand to save an average of $2,500 per year—the equivalent of a good-size tax cut. Indeed, nationwide, refinancings were up over 100 percent in March compared to a year earlier. And in the hardest-hit States like Arizona and Nevada, where I traveled just last week, they have more than tripled, and we expect these numbers to continue to rise when we dramatically cut fees for FHA refinancing next month.

But, Mr. Chairman, that is still not enough, and so today I want to discuss four legislative proposals supported by the Administration to ensure every responsible borrower has the opportunity to refinance and rebuild equity.

The first would provide borrowers whose loans are not guaranteed by FHA or the GSEs access to simple, low-cost refinancing, so long as they are current on their mortgage, meet a minimum credit score, have a loan within FHA conforming loan limits, and are currently employed. The program includes features to minimize program costs, including establishing loan-to-value limits. Lenders interested in refinancing deeply underwater loans would need to write down the balance of the loan before they qualify, relieving the strain on the borrower and reducing risk to the taxpayer.

And while this program would be run by FHA, it would be financed from a completely separate account from FHA's MMI Fund. Further, by financing this proposal through a dedicated funding source, we will eliminate any expected cost to the taxpayer. And I am pleased that Senator Feinstein has joined with us to draft this critical legislation.

The second proposal, as developed by Senators Menendez and Boxer, would allow us to clear the remaining barriers to refinancing for borrowers with GSE-insured loans. While HARP 2.0 has already given many more borrowers an opportunity to refinance, there remain responsible borrowers who need our help, including those who have equity in their homes. To ensure these families are not left out, we support extending streamlined refinancing for all GSE borrowers, irrespective of their loan-to-value ratio. And to ensure more homeowners can refinance with a better deal, the proposal creates competition between lenders and removes other potential hurdles like unnecessary appraisals, which will help responsible borrowers who happen to live in slower markets. Clearing these barriers will go a long way toward further strengthening the GSEs' portfolios and saving taxpayers money.

Of course, while refinancing is critical to reducing costs to homeowners, we also need to ensure borrowers have an opportunity to rebuild equity in their homes. Savings in our homes is the single biggest source of how we send our kids to college. It is how most people get capital to start a small business and how people save for their retirements. That is why the first of our two equity-building proposals, which is being introduced today by Senator Merkley, would give all underwater homeowners who choose to participate in these programs the opportunity to apply the savings from refinancing to rebuild equity in their homes.

As an incentive, we are proposing that homeowners' closing costs—about $3,000 on average—be paid by the GSEs, and to be eligible, borrowers must agree to refinance into a loan with a term of no more than 20 years, providing a path for all borrowers to get their heads above water faster.

The second equity-building proposal I want to discuss is the Project Rebuild Act, introduced by Senator Reed, which would further stabilize places where prices have dropped the most and create 200,000 jobs. Mr. Chairman, we know that the second a foreclosure sign goes up on your block, your home value drops by as much as $10,000. Well, homeowners that are in the hardest-hit places often live near a dozen or more homes with those signs. But as the Neighborhood Stabilization Program has proven, we can halt the slide in home values in these hard-hit places. Indeed, according to data hot off the presses, three-quarters of neighborhoods that received targeted investments through the first two rounds of NSP showed increased home prices, largely as a result of improved vacancy rates. That is the kind of success Project Rebuild would build on, and it is widely believed Project Rebuild is not only an investment in jobs to rebuild vacant or abandoned homes, but also in the neighbors who live next door.

And that, Mr. Chairman, is ultimately who these proposals are about—the millions of families who are playing by the rules and doing their fair share—in many cases, more than their fair share. These families have not walked away from their obligations. We cannot walk away from ours. Ensuring we do not starts with making sure every responsible family in America, regardless of what kind of loan they have, has the opportunity to refinance and rebuild equity not only in their homes but in the American dream. That is what these proposals are about. That is what it is going to take to create an economy build to last. And it is why I look forward to working with this Committee and with Congress to enact them.

Thank you.

Chairman JOHNSON. Thank you for your testimony.

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

Mr. Secretary, pertaining to HARP 2.0, FHFA made some changes to the HARP program last fall, including expanding the loans that are eligible for refinancing and encouraging refinancing into shorter-term mortgages. Did those changes go far enough? If not, what barriers still remain for borrowers?

Mr. DONOVAN. Mr. Chairman, we believe that those changes are critical and have made an important difference, as I said, about 750,000 applications just from four of the largest lenders that are being processed right now. But there are three key remaining barriers that we see.

One is that we have many families who are above water on their first liens—in other words, the LTVs are 80 percent or below—but because they have second liens, because they have other debt, or for other reasons, they are being stopped from refinancing. So extending HARP 2.0 to include above-water borrowers, those with equity in their homes, we think is a critical piece.

Second, while there were a number of important steps to increase competition among borrowers, right now that is one of the key barriers we have, is that servicers who do not currently have that loan or service that loan are being discouraged from competing to refinance those loans. There are a number of changes that we can make there, underwriting changes and others, that would help create more competition and lower the costs of refinancing.

And then the third is that because there are certain markets where automated appraisals are hard to do, there are about 20 percent of borrowers, even those that would otherwise be eligible for HARP 2.0, that have increased costs because they have to do a manual appraisal. We want to extend those automated appraisals to the remaining roughly 20 percent of GSE borrowers who are locked out because they just happen to be in a market where there are fewer sales to be able to construct those AVMs.

Again, given that the risk is already there on the GSEs' balance sheet, we think these are prudent steps that both help families, help the economy more broadly, but also help the taxpayer by lowering the risk of redefault for those loans.

Chairman JOHNSON. What are the most important steps that can be taken by Federal agencies and regulators to facilitate refinancing under current administrative authority?

Mr. DONOVAN. I think we have taken most of those steps. We believe that many of the steps that I have just described could actually be taken under existing authority, and we would urge that FHFA implement a number of them, even without the legislation being passed. But we do think there are some critical pieces where the legislative authority is required because of legal uncertainty, and so the legislation remains critical to pass as quickly as possible.

Chairman JOHNSON. I have heard from constituents and many groups across the mortgage industry that the put-back risk, the risk that the GSEs would return the loan to a bank's balance sheet for cost servicer refinancing, is stifling competition between lenders and creating barriers for community banks. What impact is this having on consumers? And how can this be addressed to encourage competition in the mortgage market?

Mr. DONOVAN. This is a very important piece. Essentially what is happening is that the original servicer who may have made that loan, if there were mistakes made in originating that loan, a new servicer is concerned about taking on what we call those reps and warranties, even though they were not responsible for the original loan when it was made. And so what we have done through HARP 2.0 is remove many of those barriers; however, there continue to be differences between the way Fannie and Freddie are implementing that and also differences between how above-water loans and underwater loans are treated. And, frankly, we think it does not make a lot of common sense that a homeowner who actually has more equity in their home and is, if anything, a lower-risk borrower would have to pay more or be locked out of refinancing relative to those borrowers who may be underwater in their loans.

So we think this is both a matter of good—there is a good economic case for doing this, but also it is a question of fairness to be able to make sure that these refinancing opportunities are available across the board.

Chairman JOHNSON. You previously stated that the best way to protect the taxpayer is to ensure that loans currently on FHA's books continue to perform. How would expanding refinancing opportunities accomplish this?

Mr. DONOVAN. Well, this is a critical point, and this is something that economists across a broad spectrum—I know you had testimony from Chris Mayer, Laurie Goodman, and many others here recently to this Committee about the importance of refinancing overall. The Fed has spoken very clearly about the ways that reductions in payments that average $2,500 to $3,000 a year boost consumer spending and are a net plus to the economy in terms of the ripple effects that that spending has.

So I think the broad case has been made very clearly this is good for the economy. What I would add to that is that for every additional point of increase that we see in home prices, as the economy improves, as the number of foreclosures is reduced, we see a substantial benefit to FHA and to the GSEs because not just defaults go down but, as home values rise, the recoveries that we make on any foreclosures that do go forward are significantly lower. The estimates just to the benefits for the GSEs, I think Chris Mayer, when he was here, estimated a more than $20 billion benefit to the GSEs from lower default rates. Depending on the take-up, those may be at the high end of the range, but clearly there are very significant benefits that come not just to the economy more broadly but directly to FHA and the GSEs as the housing market is improved overall.

Chairman JOHNSON. One last question. The Administration's Housing Plan would also expand FHA refinancing to non-GSE borrowers who are still paying their mortgages. During our previous hearing, you mentioned several ways to protect the taxpayers from the potential risk associated with these loans. As part of that protection, do you have more specific recommendations for standards these loans would need to meet?

Mr. DONOVAN. Absolutely. And I would start, Mr. Chairman, by reiterating that these are homeowners that are currently paying. They must be current on their loan and have made every payment for the past 6 months, missed no more than one payment in the last 12 months, and so they are already relatively low-risk loans, and by lowering their payments, they are even lower risk.

In addition, we have a number of criteria in terms of credit scores, employment, and others that we would put on top of that that would help to protect taxpayers. And then I think two other things that are absolutely critical: one would be to create a completely separate fund, different from the MMI Fund, with a dedicated revenue source to offset any expected costs, and then perhaps most importantly, a requirement that the deeply underwater loans, which all the data show would have the most risk of these loans because of the greater likelihood of default over time, those loans would have to be written down to a loan-to-value of 140 percent or lower in order to be refinanced.

So our numbers would show that those loans below 140 are likely, much more likely to be sustained over time, and that by writing down any loans at the higher LTV to 140 percent, we are mitigating a substantial portion of any redefault risk on those loans that are higher LTV.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Secretary Donovan, following your testimony before this Committee in February, I submitted a question for the record requesting additional data on the President's proposal to allow borrowers with private sector loans to refinance into FHA-backed loans. Yesterday I received a written response to this request stating, and I will quote, that "HUD does not have official estimates of default rates, participation rates, or other performance parameters."

Since the Administration admittedly did not have the key data, it seems to me, for evaluating the proposal, what is the basis for your support of this proposal? And without this data, how do you know if it presents any risk to taxpayers? That is our concern.

Mr. DONOVAN. Absolutely, Senator. I think one of the issues here, as I think we have talked about before, is that these are voluntary programs where take-up—we have a broad range of estimates of potential take-up. What I will say is that—and we would be happy to meet with you and share more detail, or anybody on the Committee, on the specifics. Our estimate is that there would be—with some of the restrictions that we have proposed, the upper end of potential cost is about $5 billion, and we have proposed an offset that would meet that. We would also, though, be willing to work with the Committee on refining, for example, the 140 loan-to-value criteria. The lower that is set, the lower the take-up would likely be, and certainly lower the cost. So that $5 billion is an estimate based on that 140 LTV, but many of these criteria—we are working with Senator Feinstein. We would be happy to work with the Committee on refining in terms of the potential eligibility and, therefore, the take-up and the cost.

Senator SHELBY. Do you share my overall concern about the solvency of FHA, which is under your jurisdiction?

Mr. DONOVAN. I certainly continue to focus very heavily, as we talked about at the last hearing, on a whole series of steps we can take to strengthen the fund. We recently announced substantial premium increases on a range of loans as well as published a new rule on lender indemnification that will be important in terms of protecting the fund. But I do think we are taking a broad series of steps that are necessary and important to protect the fund.

Senator SHELBY. The latest actuarial report states that FHA's capital ratio is only 0.24 percent. Mighty low. How quickly do you plan to increase FHA's capital? And when will it be above the statutorily required 2 percent? You know, I think we have talked about this before. Capital is probably the first step and the best way to ensure that FHA does not need a bailout from the taxpayers.

Do you think that a 2-percent capital requirement is adequate—because we are a long way from 2 percent—to protect the taxpayers from bailing out FHA in the future?

Mr. DONOVAN. The actuarial last year projected that the capital ratio would return to 2 percent by 2015. Since that time, we have both had close to $1 billion in recoveries through the mortgage servicing settlement and significantly increased premiums. So I do not have a prediction beyond what the actuarial said last year. We will obviously wait to see what the actuarial says this year in terms of the modeling. But we have taken a number of steps since then that would accelerate the return to the 2-percent ratio.

The other thing I would just point out, CBO did score the projected receipts for FHA and Ginnie Mae, close to $10 billion for next year, $1.8 billion higher than the Administration's estimates. So, clearly, the new loans that we are adding to our book are projected to substantially increase that capital.

Senator SHELBY. Mr. Secretary, if a private mortgage insurer held only 2-percent capital, do you believe that would be adequately capitalized?

Mr. DONOVAN. I think given the way that our reserves are projected and calculated, it is quite different from the way the private sector does that. And so I do not think it is an apples-to-apples comparison.

My sense—and we are evaluating this, given the lessons that we have learned through this crisis, and I am not going to say today that 2 percent is absolutely adequate. I think it is something worth discussing with the Committee and looking at whether it should be revised. But I do not think we should make the mistake of comparing the 2 percent for us because it requires, for example, 30 years of potential projected losses. Typically the reserves that banks are holding are against a much shorter window of losses. Those are all differences that I think it is important to look at when you are thinking about comparing the 2 percent to the way stress tests and others are done——

Senator SHELBY. But we do know capital is important, isn't it?

Mr. DONOVAN. Absolutely. Absolutely.

Senator SHELBY. One more question, if I can. Deborah Lucas at MIT, in conjunction with the Congressional Budget Office, released a paper in September of last year that models the effects of expanding a large-scale mortgage refinancing program. The paper discusses the negative economic impact that could result from losses taken by investors in mortgage-backed securities.

Are you familiar, first, with this paper?

Mr. DONOVAN. Yes.

Senator SHELBY. Do you dispute its findings?

Mr. DONOVAN. We clearly have modeled into the net benefits, and I think the Fed and other economists that have looked at this do calculate in the lost interest payments to investors as part of this. And even though there are, as you have said, losses that would be taken by investors, there are significant still net benefits overall to the economy from those savings.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for your service.

You mention in your testimony that lenders in the HARP program report that borrowers are saving as much as $2,500 per year, which, as you point out, is the equivalent of a big tax cut for those borrowers. But am I correct in saying that even that figure does not include the additional savings borrowers could get if we enacted the Menendez-Boxer draft bill and increased competition in the HARP refinance market by making it easier for lenders who are not currently servicing that loan to compete for the business?

Mr. DONOVAN. There is no question that you would both increase the savings to families that are already planning to refinance and you would make additional homeowners eligible or make it economic for them, if you will, to refinance. So it has both those benefits—increasing the amount of savings for folks who are already refinancing as well as expanding the pool of families that we would expect to refinance.

Senator MENENDEZ. And do you have any sense of how many additional individuals—how much additional borrowers could save, I should say?

Mr. DONOVAN. Just looking at the appraisals, we are talking about hundreds of dollars for those borrowers just on the refinancing costs. When you add to that some of the fees, for example, for above-water borrowers who may already be refinancing, you are looking at adding hundreds and in some cases even as much as $1,000 a year in potential savings.

What I will tell you is with the reductions that we have announced that go into effect on June 11th for FHA borrowers, the fees alone we expect to be about $1,000 a year in lower costs. So that is absolutely critical.

Senator MENENDEZ. Really significant. So if I have been patching the roof that is leaking in my home, I now will have the wherewithal to replace it, which is, of course, of value to preserve the property value, but also has a tremendous economic ripple effect in our country as well.

Am I correct, Mr. Secretary, that FHFA making further changes in HARP 2 as outlined in the Menendez-Boxer discussion draft would actually save the GSEs money because of reduced defaults once homeowners' mortgage payments are lowered?

Mr. DONOVAN. All of our modeling suggests that there would be significant savings to the GSEs in terms of lower default rates. I think Chris Mayer here, a professor at Columbia, testified about specific numbers that he expected that exceeded $20 billion. Our expectations of take-up are somewhat lower than his, but still, you are talking about substantial sums that could be saved from lower defaults.

Senator MENENDEZ. Yes. As a matter of fact, Professor Mayer at our Subcommittee hearing that I chaired a few weeks ago estimated that it would result in GSE profits of as much as $23.7 billion. So whether it is your lower range or that range, the reality is you are talking about significant saving of taxpayers' money and reducing the size of any fiscal challenge in the future.

The other question I have is: Do you believe that the HARP 2 policies, some implemented by the GSEs and some by the servicers themselves, are reducing competition among banks and ultimately decreasing the effectiveness of HARP 2 and robbing homeowners of savings through lower interest rates? I think we try to address that based upon all the things we heard in the hearing, and I am wondering how you view those.

Mr. DONOVAN. There is no question that while many of those barriers to greater competition were removed by HARP 2.0, your bill targets the critical remaining barriers. I will just give you one example of what is happening at this point.

Because servicers who currently service the loan and already have all of the data through the GSE systems to be able to refinance, they only have to do, for example, a verbal confirmation of employment in order to proceed to refinance.

Other services who would want to compete to refinance that loan still have to go through a fuller underwriting in those systems, including, for example, getting a full W–2 and all of the documentation around not only employment but income. Those are things that, given, again, the risk already exists on the GSE books, we think just do not make sense here. And because they have already been removed for the existing servicer, we ought to go the next step and make sure that there is competition. I think Laurie Goodman estimated that the potential was to save as much as $15,000 per borrower by increasing the competition there on the refinancing of these loans.

Senator MENENDEZ. And one final comment on your remark. In the panel that we had—I think we had about six witnesses representing a wide range of views—there was unanimity on the view that asking for all of that documentation when, in fact, already the risk is there was not necessary and actually added an obstacle toward refinancing. So it was interesting for me to hear you and some of the most conservative Members of the panel had that view as well. I appreciate your responses.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. And, Mr. Secretary, I thank you for your testimony today. It was indicative of the Secretary that I have grown to know and respect, and I appreciate the way you have come in to talk about these bills in the way you have. I might not agree with every comment, but I thank you for the testimony.

Mr. DONOVAN. Thank you.

Senator CORKER. Mr. Chairman, I attended the Subcommittee meeting that Senator Menendez had, and it was a good hearing. I thought we had some good witnesses. And for what it is worth, I think there are some redeeming qualities to the Menendez bill. There are also some things that I think certainly need to be changed.

Mr. Chairman, I am hearing rumors that some of these bills may go straight to the floor and not come through the Committee. I think you can see by the Committee attendance that people have come to think not much is going to happen here of consequence. We have not dealt with the technical corrections bill, which I think people on both sides of the aisle would like to see happen on Dodd-Frank. In a bipartisan way, I might add, we certainly have not deal with GSEs, and I am just pleading with you today to please not let a bill that candidly could, with some changes, receive some bipartisan support go to the floor and turn into something that is certainly not that. I hope that the Chairman will not let the rumors that we are hearing become reality by any of these bills going directly to the floor and not through the Committee.

But I do want to get back to the Secretary, and I know you spent a lot of time on the AG settlement. I think one of the things that is coming out right now—and I think we sort of saw this on the front end, but the servicers, the big banks that so many folks in this country have been most upset with, including, it seems, this Administration, the big banks have the ability to get 45 cents in credit toward this $26 billion settlement for every dollar that they cram down of private investors' money, which I think most Senators understand are people's 401(k)s and other types of investment vehicles. And I think all of us want to see the private sector back in the business, but this AG settlement has frosted most of the people that we talk with on the private side because, again, they have no control. They have invested in these securities. The servicers, which, candidly, did many of the not-so-good—well, most of the not-so-good things in this arena actually get credit by using somebody else's money. And I just wonder if you have had much pushback—I am sure you have—from the private sector side. They said actually they did not even have a seat at the table, and especially knowing of your background, that surprised me a bit.

Mr. DONOVAN. So, look, there are key issues here, as we said earlier, in terms of the complexity of how you get progress on these loans. And it was very important to us as we went through the settlement that we were clear that any of those writedowns that happen on private label securities loans needed to be net-present-value positive. What that means in English basically is that it is actually—they would be a benefit to the investors——

Senator CORKER. They tell us that the model is flawed, and I know they are telling you that, too.

Mr. DONOVAN. And this is one of the points that we have been in discussions with them about. We did actually go back based on those concerns and get the servicers to agree to use a standard model, the HAMP model for what we call 2MP and the broader HAMP model. I think that was, in their view, substantially better than—in the investors' view, substantially better than what we had had before, but we continue to hear some specific concerns about that model, and so we are working with them to improve it.

But, again, the fundamental idea here is I agree with you, the investors should not be taking the losses to the benefit of the servicers. But where there are net-present-value-positive principal reductions that can happen, those should go forward.

The other thing that has been key, as you know, is on second liens, and I agree that it is a fundamental problem that we have that second liens have stood in the way of more progress on these loans. We did require significant writedowns on the second liens and, in fact, extinguishment of the liens at 180 days. We are talking to the investors about whether there are further steps that we could take to go beyond that that would be satisfactory.

On the other hand, just as here with the refinancing issue, what I do not think we should do is allow second liens—when there were not really rules of the road, there were no rules written and there should have been—the investors I think will agree with that today—about how you handle those second liens. We have tried to create rules that would force the reductions of the second liens, and here in refinancing, we have lenders that hold those second liens, servicers, that are standing in the way of refinancings on the first liens that would be good for the homeowner and good for the economy.

And so one of the key provisions in the Menendez-Boxer bill would be to remove some of those final steps, final barriers that second liens are providing. So I think this is a real issue.

Senator CORKER. OK.

Mr. DONOVAN. The problem is, in a world where there were not rules, how do we create rules after the fact? They are never going to be perfect, and I think we can continue to revise those. What I do not think is acceptable is to say we are simply not going to try to make progress here, not help homeowners, and not make progress on those simply because the perfect is the enemy of the good, if you will.

Senator CORKER. And I understand that point of view. You know, on the second lien portion—and I look forward to looking at the details of the second lien part of the Menendez bill. But, look, the servicers in many cases are the second lien holders, right?

Mr. DONOVAN. Exactly right, and they——

Senator CORKER. So, I mean, candidly, shouldn't the second lien automatically be extinguished first, period, gone? I mean, why would we give any credit at all to a second lien when you are writing down any portion, even a penny, of the first lien? Do you agree with that?

Mr. DONOVAN. There are cases where what you are talking about is a first lien that may be delinquent and a second lien that is current. Right?

Senator CORKER. I understand. But you know why they are doing that.

Mr. DONOVAN. And, ideally speaking, lien priority would say that the second takes all of the loss on that. The problem is there is no law, there is no requirement that says that, right? And we cannot as the Government impose that unless there were legislation or something else.

Senator CORKER. So I would——

Mr. DONOVAN. The issue is—I agree that we are not in a perfect place. On the other hand, we cannot wait for a perfect thing to make progress.

Senator CORKER. I understand, and I appreciate your point of view. And I would just say to Senator Menendez through the witness—I do not know if I can talk directly to him—that——

Senator MENENDEZ. You can always talk to me, Senator.

Senator CORKER. Thank you. Thank you so much. I think this is something that we ought to look at. Really, what is happening, you know, the servicers, again, in many cases have the second lien, and the mortgage holder is paying a much higher interest rate on that second lien and staying current. And what we really have done as a Nation is allowed any home equity that used to exist—most of it is gone now. We used to use it as an ATM machine, and we have created a huge problem for people. And I hope that in the Menendez legislation, by the time it gets to the floor, that we will absolutely totally extinguish 100 percent of any second mortgage before we allow one penny of a first mortgage to go away. I mean, that is the way a second lien works, and I hope that we will clarify that because, again, this is to the benefit of the servicers, which, by the way, have helped create—I mean, having the second liens have the same priority as the first liens, the way these things have been dealt with, has created a problem.

Let me ask one last question. I know the Chairman used 9 minutes and I did not make an opening statement. Qualified mortgage, I know that has to be troubling you knowing of your background, the way the consumer agency is looking at the qualified mortgage and basically trying to determine whether there is going to be a safe harbor for people who are originating loans. If they check all the boxes, then they in essence have made a valid loan. They are looking at something called "rebuttable presumption" which allows them years down the road to come back on originators, and it seems to me that that is a huge problem down the road as it relates to getting credit to viable borrowers. Is that something that troubles you?

Mr. DONOVAN. So I will admit, Senator, I am not an expert in the specifics of the rebuttable presumption versus the sort of hard test for complete removal of any liability on a safe harbor.

My understanding—and I think this is true of a number of the lenders, the clearinghouse banks and others that are looking at this—as important as whether it is a rebuttable presumption or a safe harbor is how bright-line the test is under a rebuttable presumption.

So I think if we could get to a standard where there is a very clear bright line under rebuttable presumption, that I think would satisfy most of the concerns that I hear about whether there would continue to be liquidity available. It is not the same as a safe harbor, but I think it is as important if not more important an issue to be looking at as just the difference between a safe harbor versus rebuttable presumption.

Senator CORKER. Thank you. Thanks for being here.

Mr. DONOVAN. Thank you.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair, and thank you, Mr. Secretary, for your testimony and, more importantly, your work on these many strategies to try to help address the challenge of refinancing, and particularly families underwater. And I appreciated your comments about the rebuilding equity strategy, the Administration's advocacy for a way that families can choose between refinancing to lower their monthly costs or refinancing to get them out of the position of being underwater in an expedited manner, and the statistics and the analysis that shows that half the families are sticking with the same payment at the lower interest rate and shorter term would be out from underwater in 5 years is a fairly powerful observation to bring to this. And I am not pleased to be able to introduce the Rebuilding Equity Act in order to try to capture this concept and see if we can take this forward in the Senate.

I wanted to turn to the non-FHA, non-GSE challenge of families that are underwater. Under the FHA strategy, one of the challenges we have run into is the 115 percent loan-to-value restriction, and I am not sure if you are necessarily familiar with that or have some observations on it, the different ways that we can overcome that particular hurdle.

Mr. DONOVAN. Could you just be more specific? The 115 percent for——

Senator MERKLEY. Yes, that FHA has——

Mr. DONOVAN. ——the short refi program or——

Senator MERKLEY. Well, my understanding, if I have this right, is that they are not allowed to extend the Government guarantee for loans that are more than 115 percent underwater and thereby we either need—and I am not sure if it is a regulatory or statutory fix to address that. I did not know if that was a piece you were working on.

Mr. DONOVAN. To be clear, we have made a refinancing alternative available for borrowers where their combined loan-to-value is below 115 percent. But even for those, the first lien that is going to be FHA insured would need to be below 96.5 percent. So it is actually more restrictive even than you are describing, if I have the right issue.

What we are proposing to do under this broad-based refi proposal is to allow up to 140 percent loan-to-value with the clear view that any loan that is deeply underwater would have to be written down substantially to get within those parameters. And so that is really the key legislative change that would be required under the proposal, and to create a separate fund from the traditional MMI Fund in order to make sure that we protect the MMI Fund.

And so those are the two key pieces of the legislation that would be required.

Senator MERKLEY. I appreciate that, that separate fund. One of the questions is: How do you put the money into that fund or that trust? And certainly one strategy is an insurance fee for families that are refinancing, helping them participate. Another possibility that has been raised is a broad-based financial sector fee of some sort. But I have looked at the issue of, instead of utilizing that approach, utilizing a risk transfer fee as a voluntary opt-in for companies who hold mortgages that are underwater, recognizing that there is substantial risk of holding these underwater mortgages, that they pay a risk transfer fee. And in laying this out over 40 years, if you have basically a spread between—because of Federal Government guarantee funds between a 2-percent and, say, a 5-percent mortgage and you throw in the risk transfer fee, you end up with solvency under kind of reasonably conservative assumptions. But it is not zero risk because dramatic things can happen, and that is where the Federal Government guarantee through FHA becomes essential or an extension of a Federal Government guarantee to utilize for the Federal Home Loan Bank System, and this is—it has struck me that in the end a lot of these conversations hit the rocks on the notion that there is some risk. And I guess the point I want to make and ask you to respond to is: We took enormous risk as a Nation, if you will, in helping out major financial institutions and helping out the auto markets. It seems to me that it is reasonable that we take modest risk, starting with the spread sheets that say we will actually make money, but worst case, there may be some risk, but the upside of helping millions of families be out from underwater and have their financial feet is a huge upside risk. And I think we have to get the conversation away from saying that there is some zero risk way to approach this. I would just throw that out there for you to comment.

Mr. DONOVAN. Senator, I think you have made an essential point. First, let me just say, to be clear, we did propose initially a way to pay for this broader-based refinancing, but we are very open to looking at other ideas like the one that you propose or an additional G-fee on these loans. There are a number of potential ways that we would like to work with the Committee on potential ways to pay for it and that we have been talking to Senator Feinstein about. But I think you have hit on the key point, which is there is no question that by refinancing these loans into FHA loans that there is some additional risk that we add because of that transfer.

I think the fundamental questions are: First, how do we minimize that risk? And by both focusing on current loans that meet additional underwriting criteria and by lowering those costs, these are safe loans to begin with.

Second, that by fully paying for it, we are offsetting any expected losses that might come.

And then, third, and most importantly, none of that calculates in exactly what you are talking about, which is there is enormous potential upside if we can just move house prices a few percentage points through this broad-based refinancing. The benefits to the taxpayers through improvements in the performance of Fannie Mae and Freddie Mac, FHA, and the broader lift that the economy would have are all potentially enormous. And so the benefits of doing this we believe substantially outweigh any potential risks, and we have tried to find—we want to work with the Committee to find as many ways to offset those risks as possible.

Senator MERKLEY. Thank you, Mr. Secretary, and I appreciate the Administration's attention to the non-GSE underwater challenge, and I look forward to continuing to work with the Members of the Committee and the Administration on that issue. Thank you.

Mr. DONOVAN. Thank you.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and, Secretary Donovan, thanks for your testimony this morning.

Mr. DONOVAN. Thank you.

Senator HAGAN. I mentioned this to you before, but I have the utmost confidence in Joe Smith, who is the former Commissioner of State Banks in North Carolina. I think he is going to do a tremendous job as the monitor of the global mortgage servicer settlement area. And I saw this morning that at least one large financial institution has begun delivering on its commitment under the settlement by identifying 200,000 customers who may ultimately qualify for a principal reduction program.

Can you discuss where we are on the implementation of the settlement and perhaps discuss some of the progress that is being made?

Mr. DONOVAN. Absolutely, and thank you for your support of Joe Smith. I think he has been a terrific—in the early going of this, he has been a terrific addition to the team in terms of implementation.

Not only have—and I think you saw the report that the Bank of America has begun mailing about 200,000 letters to borrowers. Going beyond that, there have already been principal reductions that have been delivered to families as a result of the settlement. There were many families that were being evaluated for other types of modifications that then were able to get very quickly after March 1st principal reductions. It is not a huge number at this point. It is in the thousands. But there are thousands of families that have already benefited and hundreds of thousands more that are now getting these letters, and not just from Bank of America but they are being mailed from all of the five banks. So that is moving forward.

The other critical piece is implementation has begun around the servicing standards that were in the settlement, and specifically our first deadline for implementation of the most critical pieces of the servicing standards is coming up within the next month or so. And we would be happy to get you a detailed timeline of when those standards have to go into effect. But we are very encouraged by the pace with which implementation is moving on those servicing standards.

Senator HAGAN. Could you give me the basic parameters of how much a principal reduction a borrower might be eligible for?

Mr. DONOVAN. It really varies by location. What we are seeing is that in the most deeply underwater States—California, Nevada—those principal reductions are exceeding $100,000 per homeowner. In a State like North Carolina, we would expect to see it more in the range of $50,000 to $100,000 on average. But these are substantial changes for these families.

And just to be clear, the requirement in the settlement is that not just the principal reduction happens, but that there is demonstrated ability for that family to pay and to remain in that home for at least 90 days. And so what is critical here is not just the amount of the principal reduction but that it gets the family to a sustainable level that will keep them in their home long term.

Senator HAGAN. Thank you. Also, following up on a conversation that we started in February when you were last here in front of the Committee, we want to be supportive of what the Department and the FHA are doing to ensure the long-term viability of the Federal insurance program. To that end, we have spoken about how to strengthen the enforcement authorities available to the FHA.

Can you talk about some of the changes that the FHA would like to see in order to help it manage the risk posed by the noncompliance on the part of FHA-approved lenders?

Mr. DONOVAN. This is critical, and there are two major changes that we have been seeking in legislation. We are working actively with your colleagues in the House to be able to get this legislation through. We came very close last year as part of our budget, but did not quite get there.

One is to clarify our ability to hold our lenders accountable through indemnification. We have just issued a rule that expands and makes clear the standards that we have for indemnification. But there are certain types of loans and lenders that we do not have clear authority to do that on. That is a critical piece.

The second is we have a somewhat perverse provision in the way that we can enforce that allows us to go after lenders only for regional or local violations based on their track records compared to other lenders in those areas. We cannot actually disqualify an entire company nationally through our current standards, and that is something that simply does not make any sense and is something that we would like to have clarified. There are other smaller provisions, but those are the two—the other thing I would just add—and I think this is particularly relevant for North Carolina—is that we have smaller lenders that today cannot originate loans under their own name unless they have the full ability to issue Ginnie Mae securities and other steps. And we have heard a lot of concerns as well in the Dakotas and in other areas where we have a lot of smaller lenders that they want that ability. That is something that we think makes perfect sense, and that would be included in the legislation as well. So I think that is an important one. It is not directly connected to enforcement, but it is something that I think you would be interested in and is an important piece.

Senator HAGAN. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. We will go to a brief second round.

Is there a time frame within which any changes would need to happen? Are we losing the opportunity to improve the market if these changes are delayed?

Mr. DONOVAN. Mr. Chairman, this is such an important piece of this, and this is why—I think you perhaps heard the President mention the importance of this issue as one of his top legislative priorities. He is going to be in Nevada on Friday and will talk specifically about the importance of expanding refinancing.

There is a real urgency here because interest rates today are at the lowest level they have ever been for a 30-year mortgage. But as the economy continues to improve, I think all expectations are that this window of record low interest rates may not last a significant period of time. And, therefore, it is particularly urgent that we take advantage of this.

As I said earlier, low interest rates like this are typically one of the most beneficial things on a macroeconomic level to boost the economy, and yet we are simply not seeing today the full benefit of these record low interest rates that we should be seeing. And the quickest, most effective, and I think the most bipartisan way that we can increase the boost to the economy of these record low interest rates is to quickly get these proposals enacted, and that is something that I think hopefully we can all agree on and move with real speed in getting these done.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Mr. Secretary, you and Senator Corker got into a little dialog about first liens, first mortgages, second mortgages, and the impact on that, dealing with FHA, dealing with GSEs, Fannie Mae and Freddie Mac. There have been a lot of proposals by the Administration to deal with that—writedowns. The basic property laws, you have got a first lien, which is the first priority; you have got a second lien, which is second. If the value of the first lien goes down or you pay it down or it is negotiated down or whatever, then it would logically follow that the value of the second lien would go up. Is that correct, generally, generally speaking?

Mr. DONOVAN. Generally speaking, yes.

Senator SHELBY. Assuming the property values were there. If you had a $250,000 mortgage on a piece of property, first lien, and Fannie and Freddie or FHA, or whoever, a Government-sponsored enterprise or Government-run, had a first mortgage and you had a $50,000 second mortgage, and if you by negotiations or something lowered the $250,000 lien to, say, $180,000—I will just throw that out—wouldn't it follow that the value, assuming the property was worth so-and-so, the value of the second lien would be enhanced perhaps?

Mr. DONOVAN. If there is no requirement that you write it down or——

Senator SHELBY. What do you mean? Do you mean write down the second lien?

Mr. DONOVAN. Yes.

Senator SHELBY. Do you know of any requirement that——

Mr. DONOVAN. We have actually implemented that requirement in our HAMP program and in the settlement.

Senator SHELBY. Explain what you mean. You mean if you deal with the first mortgage, you are going to deal with the second at the same time?

Mr. DONOVAN. Exactly.

Senator SHELBY. Otherwise, you are not going to do it, right?

Mr. DONOVAN. Exactly. Now, here is the problem, Senator——

Senator SHELBY. So that is the——

Mr. DONOVAN. This is a real issue, and, frankly, it is—I think we have learned our lesson that as we think about what the housing finance system looks like going forward, these are the kinds of things we have to have clear rules on, that if you are writing down a first, you have to write down the second significantly more. Those kinds of things need to be implemented. We have done so in the various programs that we have the ability to control that second lien or force that on the second lien. But the problem is there were no rules on this except when you get to foreclosure. In a foreclosure, you have to write off all of the second lien before you touch the first.

Senator SHELBY. Otherwise, the second goes to the first, right?

Mr. DONOVAN. That is right. But the problem is we did not have rules of the road for what happens in a modification or particularly in a world where the second lien is current and you do not have the ability on the first. The good news here is for about half of all the underwater loans, there is no second. So this is only an issue for a portion of them, and where you only have a first lien, the issue is clear, right? But on the second liens——

Senator SHELBY. Well, that is the basic property law, isn't it?

Mr. DONOVAN. It is a basic property law in foreclosure.

Senator SHELBY. Yes.

Mr. DONOVAN. The problem is what we should have done is had rules of the road, and the investors will tell you this now. You know, we should not get fooled again. We should have, as loans are made going forward——

Senator SHELBY. At least not three times, right?

Mr. DONOVAN. What is that?

Senator SHELBY. Do not get fooled three times.

Mr. DONOVAN. That is right. I would prefer not to get fooled twice, but, yes, exactly. And I do think it is important that we have clearer rules of the road going forward.

On the other hand, what I do not think we can do is throw up our hands and say we cannot do anything——

Senator SHELBY. I agree.

Mr. DONOVAN. ——because there were not rules of the road. So we have tried to create them. Investors may not think they are perfect, and I agree, they are not perfect. And we are continuing to try to find ways to improve them. But we have made this a real priority to say—in the settlement, as an example, you have to write off the second lien at least as much as the first, and if it is seriously delinquent, you have to write it off 100 percent before you touch the first.

Senator SHELBY. Well, I can see the rationale of negotiating with a lender that has got a mortgage on a house that is probably precarious probably could be foreclosed, and renegotiating it, because they take a bath if they foreclose it, and they want to avoid—a lender generally—that is the law of banking. They are not in the housing business.

Mr. DONOVAN. Right.

Senator SHELBY. They are in the money lending business, so I can see them doing that. A lot of our concern—and I think Senator Corker has enunciated this, too, up here—is we do not want the taxpayer to take the hit. In other words, if we could see that a lot of the owners of second mortgage securities could be—it could be a back-door bailout to them. We do not want to do that, and I do not think you want to do that.

Mr. DONOVAN. We do not. Here is——

Senator SHELBY. You understand where I am coming from.

Mr. DONOVAN. Absolutely, and I think we should work on provisions that we could include in the legislation that would focus on second liens. Here is where——

Senator SHELBY. For example, how would you do that? Tell me what you mean.

Mr. DONOVAN. As we did in the settlement, we could require any servicer that was coming in to refinance a loan, they would have to take writedowns on the first lien to 140 LTV. We could also require that if they control the second, which a lot of them do——

Senator SHELBY. Otherwise, you do not do it.

Mr. DONOVAN. They would have to write down the second as well. We could do something like that similar to what we did in the settlement. Here is the issue, though——

Senator SHELBY. But you would not want to make them do it if they did not want to do it, would you? Do you want to make it mandatory?

Mr. DONOVAN. We are not proposing—this is a voluntary program.

Senator SHELBY. That is what I mean.

Mr. DONOVAN. Absolutely. Here is the issue, though. What you have oftentimes is a first lien holder with a servicer and the second is controlled by a completely third party, and the question is: Even if a writedown on the first is beneficial to the person who holds the first, are you going to cutoff your nose to spite your face? Are you going to refuse to do a writedown because the second lien is refusing? That is the problem with not having these rules, that there is the ability of a second lien holder to basically block whether it is a refinancing or a principal reduction, even if that principal reduction is good for the first lien holder. It may be good for the second lien holder as well. So that is the dilemma that we are in in this situation by not having clear rules on what you do here, and so we have tried to break that by putting in place rules, and we could certainly do that in the case that we are talking about here with the universal refinancing proposal.

Senator SHELBY. I want to go back to the GSEs a minute, and we have talked about this, and your administration has made some proposals in this area. What would concern some of us up here on the GSE writedowns is that the GSEs would take the hit, ultimately the taxpayer now, since the taxpayer is holding the GSEs. Do you see what I am getting at there?

Mr. DONOVAN. Yes. So to be clear, because any writedowns the GSEs would do would be done through the HAMP program, the requirements for the second liens to be written down would apply to that. In other words, any institution that was choosing to write down a first where they controlled the second, they would have to write down the second as well. So I think we have a way to deal with that particular issue.

The second thing I would say, though, is there is more and more evidence that for deeply underwater loans, those principal reductions actually benefit the taxpayer, and so we think it is important to move forward where there is evidence that these are—the technical term would be "net present value positive" where they actually benefit not just the homeowner but the taxpayer as well because there is more likelihood to repay.

Senator SHELBY. Do you believe that this year and maybe next year we will have at least a million foreclosures, as some people predict?

Mr. DONOVAN. The number of foreclosures is down substantially. The current expectation, last year there were less than a million actual foreclosures; certainly we are on track so far this year to be lower than that. We have seen some evidence of a slight increase following the servicing settlement in foreclosures, but not a substantial jump, and I think it is likely at this point that we are less than a million.

Senator SHELBY. Are the risk States California, Nevada, and Florida? I am sure you have some of it everywhere. Are those the——

Mr. DONOVAN. We have actually seen significant improvements in California and Arizona, some improvement in Nevada, an 80-percent reduction in foreclosures in Nevada, actually.

Senator SHELBY. What about Florida?

Mr. DONOVAN. Florida, because it is a judicial State, we have not seen as much improvement because the timeline——

Senator SHELBY. Judicial meaning they go to court to do the foreclosure.

Mr. DONOVAN. The timeline for foreclosures is much longer in Florida.

Senator SHELBY. OK.

Mr. DONOVAN. And that has meant that it has tended to be—the effects of these foreclosures have lasted longer. But it also means that more families now hopefully with the settlement have the ability to stay in their homes.

Senator SHELBY. I have one last question to shift over to the Menendez and Boxer legislation we have been talking about.

Mr. DONOVAN. Yes.

Senator SHELBY. Given that a lot of the Menendez-Boxer proposal has been adopted or addressed through HARP 2.0, how many additional homeowners, if you know, Mr. Secretary, do you estimate would be helped by the Menendez-Boxer legislation that are not already being helped by HARP 2.0?

Mr. DONOVAN. These kinds of predictions where you have a voluntary program, as we just talked about, are particularly hard to make, and so I am not going to give you a specific number. What I will tell you is a range. At the very high end, Christopher Mayer, who was here testifying before the Committee——

Senator SHELBY. I remember.

Mr. DONOVAN. ——thought that it could increase refinances by close to 12 million. Our expectations are significantly lower than that. There are some who would estimate that it is as low as a million. We think that is probably too low. But somewhere in that range, I think it is fair to say millions of homeowners would be able to benefit through refinancing. There are 11 million homeowners who are what we call "in the money," could benefit from a refinance with GSE loans that have not refinanced. We do not think all of them—under the criteria that were laid out in the bill, we do not think all of them will.

Senator SHELBY. How do you get them to do that? You know, interest rates are low, very low, historic low. You mentioned that earlier. The best thing anybody can do is lower a house payment say 5.5 to 3.7, or whatever, 3.6. Think about that. It would put money in their pocket every month. It would stabilize the housing market some. Under most loans, they can refinance without penalty, can't they?

Mr. DONOVAN. So here are the two key things that are stopping them.

Senator SHELBY. OK.

Mr. DONOVAN. One is they are not allowed at all to refinance. They may be, for example, above water on their first lien but have a second lien that puts them—makes it impossible for them to refinance.

Senator SHELBY. So it does not do any good.

Mr. DONOVAN. In that case this would allow that family to be able to refinance.

A second is that they may be able to refinance, but the costs are very high. They may need an appraisal. And what we are seeing in a lot of cases is that because there is essentially a monopoly on refinancing, whoever holds their current loan, whoever is the servicer, they can charge them—and we are seeing this—very high fees. Laurie Goodman estimated that it was as much as $15,000 in additional costs that were being charged because there was not competition between servicers. So what we are trying to do with this legislation is remove those barriers to competition, and that will take a family who may be eligible today, but they are going to look at the costs and say it just does not make sense for me to spend as much as $15,000 extra to refinance. Or they may not have it, frankly.

Senator SHELBY. Give me an example. What would the $15,000 be for?

Mr. DONOVAN. So it would be not just the costs of refinancing—closing costs, appraisals—appraisals that, frankly, are not necessary given that the risk is already at the GSEs. And then it would be additional fees that are being charged by that servicer for the refinancing.

Senator SHELBY. OK.

Mr. DONOVAN. And there is a range of those kinds of fees. We can detail them for you, but that is the issue.

Senator SHELBY. Thank you.

Chairman JOHNSON. Senator Merkley, do you have any questions?

Senator MERKLEY. Thank you, Mr. Chair. Yes, I do.

First, I wanted to just note that your comment about the window of opportunity that exists right now with low interest rates, I just want to accentuate that. The term "the fierce urgency of now" was coming to me as you were speaking. I recall that many years ago, in the early 1990s, I was involved in a project to help—it was called Project Downpayment, and it was an effort to try to put together a matching downpayment fund to help stabilize a very low income area in Portland. And over the 2 years it took us to raise the funds for that downpayment matching grant to help renters become stabilized in this community, home prices went from $60,000 to over $100,000, and we missed the window of opportunity. And I am afraid that that is going to happen here, and so I really applaud your stressing that point.

I want to turn back to the issue related to how to help homeowners who do not have GSE-guaranteed loans, and one reason I keep coming back to this is so many families come in to talk to my case work team about the challenges they are facing, and I feel like it is a lottery. We look up whether or not their loan happens to have been purchased by the GSEs, and sometimes it has and sometimes it has not, and the family rarely knows, and we would not know until we look it up in a computer data base. And it is like, well, hey, this is your lucky day, you are eligible for HARP; or, sorry, you are really stuck with no program. And so kind of addressing an opportunity for families whose loans were not purchased seems such an important part of this effort.

In the proposal as outlined by the Administration—and it does not really have a name, but this additional FHA program. I do not think you have put a name on the program.

Mr. DONOVAN. We have not.

Senator MERKLEY. So this additional strategy for non-FHA, non-GSE borrowers, do you envision this in terms of refinancing first mortgages or first and second mortgages together in terms of the 140 loan-to-value and how the writedowns would occur?

Mr. DONOVAN. First of all, Senator, let me just echo your point, which is this is not just an issue of the economic benefits that broader-based refinancing would have for families, for neighborhoods, for the economy overall, and, frankly, for the taxpayer through improvements to the performance of loans of the GSEs or FHA.

This is about fundamental fairness, the idea that—it is exactly as you say. Anytime you talk to a homeowner, it is very rare that they would know what type of loan they have—GSE, FHA. And it just seems inherently unfair to the President—this is a point he made in the State of the Union address—that a family who is doing all the right things, paying their loan despite whatever challenges they may have, cannot benefit simply because they have a different kind of loan from somebody else. So one of the important points here to us is this issue of fairness that you raise.

In terms of the question that you asked in addition to that—I am sorry. Can you just——

Senator MERKLEY. First and second mortgage, whether it would cover——

Mr. DONOVAN. As I was just discussing with Senator Shelby, that is an area where I think we would be very open to working with the Committee to specifically add some language to the legislation on that. We have done that in the other efforts that we have had, and I do think it is important, particularly where a servicer has control over a second lien and is coming in for a refinancing like this, that there would be a requirement not just that they write down the first lien to the 140 but that there be a requirement on the second lien as well.

Senator MERKLEY. Thank you, and I know that that first and second lien problem has bedeviled us, and certainly we are wrestling with it looking backwards. But we ought to fix it looking forward as well into the future.

Mr. DONOVAN. Absolutely. I would also add, though, that it is not a reason to not move forward here because half of all the loans that are underwater do not have that second lien. And so there is a huge opportunity outside of the second lien problem to make progress here, and I think there are ways to deal with the second lien issue that could be productive.

Senator MERKLEY. Turning to another point of this, in the modeling that I and my team have laid out to try to understand whether a fund would remain solvent or not and what the risk factors are, a huge issue is the percent of families that in the first couple years, while they are still substantially underwater essentially default—default strategically or default financially, lose their job, cannot make the payments, because at that point we have extended the Federal guarantee, and so the Federal Government is picking up those losses. It is offsetting them through insurance. It is offsetting them through a risk transfer fee or some other fund. But, still, the assumptions about that are critical.

That leads to a conversation about what type of restrictions there are on a family in the first few years after the Government picks up this guarantee. Do you basically put in place a rule as part of the mortgage that says, first, you cannot basically walk away from this—and so a legal requirement, if you will, that is kind of almost inherent in a mortgage to begin with. But then normally the issue of recourse is determined at a State level. Some States have recourse, some do not, but recoursers as a fact that may reduce the number of folks who say, well, our circumstances have changed, we want to move across town to a better school district, and we are just going to walk away from this house and then we are going to rent.

Has there been a discussion about the issue of rules related to recourse or whether we do anything as a Federal overlay on this?

Mr. DONOVAN. Yes, what I would say is those are particular issues where we have families who may be delinquent or where there is significant principal reduction happening. And that is, I think, the right focus in those types of situations.

To be clear, what we are talking about here is families who, one, are current, and they are not getting principal reduction through the refinancing itself. There may be a decision by the lender to reduce the balance to 140 loan-to-value, but they still have a significant payment. And, again, these are families that are paying, that are current on their loans.

So we did not see a need to go beyond that given that these families are responsible, have been doing the right thing and paying, and are not getting substantial principal reduction, at least below the 140 LTV, to be able to stay.

I think it is very appropriate in those cases what you have proposed, which is to give them an incentive to be responsible on reducing their principal balance, using this interest rate—as you know, but I think for Members of the Committee, the power of these low interest rates is such that anyone who is—or just about anyone who is below 125 loan-to-value can get back above water within just a couple years. And so what this is doing, if they are choosing to use those savings, instead of lowering their payment, to shorten their term and be able to reduce principal faster, they are really giving themselves a light at the end of the tunnel that makes it less likely that they will default in future years. And so that is something I think you are exactly right in your legislation to encourage.

The last thing I would just say is on the investor side, there is some concern that these families coming down to a low interest rate, are those loans going to be in place for a significant period of time? What investors are concerned about—they have been generally supportive of HARP and these other efforts. What they are concerned about is: Will we see a continuous cycle of refinancing for these? And so what we have been clear on—and that is the eligibility date—is that once you refinance to this record low level, you are not going to see a refinance in that loan quickly. And that is a protection for investors that we do think is important in HARP and that we certainly have been open to doing in this broader-based refinancing effort.

Senator MERKLEY. And I absolutely take your point about this is for families being current. The fact is many of the families bought these homes in, say, 2006, 2007, before the bubble was at its height, or even earlier, but the crash has taken them below where they started. They have been making payments from, you know, 4 to 10 years or sometimes a little longer.

Mr. DONOVAN. Yes.

Senator MERKLEY. And yet they are still underwater, and so they have shouldered this through the deepest point of this recession, and because of that they have good credit. And so walking away does have a cost in terms of impairing their credit, and this has led to this conversation that I have had with a number of housing experts and financial analysts about the assumptions about how many folks would default per year in that situation, and there is widely ranging variations on that. And since it is a key risk in those first couple years, that is why I am trying to get my hands around that as we wrestle with the exposure of the U.S. Government. But this issue over recourse was one of the ideas that had been raised.

Thank you very much again for your testimony. I join you in considering this as something we should be working on day and night until we can put it in place for the families and for our economy.

Mr. DONOVAN. Thank you.

Chairman JOHNSON. I would like to thank Secretary Donovan for sharing his perspective with us today. This Committee will continue to explore ways to improve the housing market immediately and then in the long term. This will require a multifaceted approach, and I look forward to working with my colleagues to continue that effort.

With that, this hearing is adjourned.

Mr. DONOVAN. Thank you.

[Whereupon, at 11:37 a.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN TIM JOHNSON

Our housing market faces dual problems—the continued lag in the housing recovery which is creating impediments to fixing the second problem—the need for large-scale, long-term housing finance reform. While the Committee continues to be concerned about the long-term structure of the housing finance system, today's hearing takes a closer look at one of the strategies to improve the struggling housing market.

During our hearings on the state of the housing market, several witnesses, including Secretary Donovan, discussed the need to expand refinancing opportunities for borrowers who were paying their mortgage. I would like to thank the Secretary for coming back to discuss this topic in greater detail.

In January, the Federal Reserve released a white paper entitled "The U.S. Housing Market: Current Conditions and Policy Considerations." In this paper, the Fed stated that "continued weakness in the housing market poses a significant barrier to a more vigorous economic recovery." One of the barriers identified in the white paper includes obstacles to refinancing at today's low interest rates.

The Administration's Housing Plan also identifies removing barriers and expanding refinancing opportunities as part of the solution. While FHFA made some changes to the HARP program last year at the urging of Members of Congress and the Administration, I continue to hear from constituents and the housing industry that more could be done to encourage competition in the refinancing market and give homeowners more options.

During a hearing in the Housing and Transportation Subcommittee 2 weeks ago, Senator Menendez outlined legislation he and Senator Boxer are working on to expand refinancing opportunities for borrowers with GSE held loans. I look forward to a further discussion of that legislation and any other proposals today.

As I stated during our state of the housing market hearings on this topic, I share the concern that ongoing challenges in the housing market are acting as a drag on economic recovery. As we have heard many times in this Committee, there isn't a silver bullet solution that will save the housing market, but several options implemented together could provide stability to the market. I hope that this Committee can work in a bipartisan fashion to find practical solutions to help overcome the barriers that are weighing down our housing recovery.

PREPARED STATEMENT OF SHAUN DONOVAN

SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

MAY 8, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for this opportunity to testify about the Administration's initiatives to help American homeowners refinance their mortgages and rebuild equity in their homes.

As this Committee knows, in the 3 months prior to President Obama taking office America's economy was shedding 761,000 jobs per month. Housing prices had fallen for 30 straight months. And foreclosures were surging to record levels month after month. This hearing comes at what the President has called "a make or break moment for the middle class"—but also one in which our housing market appears to be turn a corner following the best winter of home sales since the crisis began.

Today, because the Obama administration moved to keep interest rates low and took aggressive steps to stabilize the housing market, more than 14 million homeowners have refinanced their mortgages since April 2009—putting nearly $27 billion a year in real savings into the hands of American families and into our economy. Today, because we worked with lenders to develop a range of options for families struggling to hold onto their homes, more than 5.8 million loan modifications have been started in the last 3 years and foreclosure notices are down 50 percent since early 2009. Because we helped communities struggling with concentrations of foreclosures, three-quarters of those in which we've made targeted investments have seen vacancy rates go down—and two-thirds have seen home prices go up. Most important of all, our economy has added private sector jobs for 26 straight months, totaling 4.2 million jobs.

Mr. Chairman, this represents important progress. But to create the economy built to last as the President described in his State of the Union address, we need to do more. Indeed, as the President laid out in that speech, and as I discussed with this Committee in February, one of the challenges that prevents our housing market—and our economy—from fully recovering is that a range of barriers in the market is preventing struggling borrowers from getting economic relief that they and the economy need at this pivotal moment. It is time to finally remove those barriers so that we can turn the corner to recovery.

Millions of responsible homeowners, who have done the right thing paying their mortgages through these tough economic times, can't benefit from today's low interest rates because they face substantial obstacles to refinancing. For instance, homeowners with good credit and clean payment histories are rejected because home values in their neighborhood have plummeted and their mortgages are underwater.

For instance, consider Judy in Tucson, Arizona. Judy and her husband purchased their home in 2007 through one of the largest banks which continues to service their loan. However, because they now face the burden of a 7.0 percent interest rate on a mortgage increasingly underwater, they can't refinance and lower their monthly payment through today's low rates. That is not because Judy is delinquent. In fact, Judy has never been late on a mortgage payment. It is simply because her servicer sold her loan to a securitization trust—something she and her husband had nothing to do with and they never thought would preclude them from refinancing. And even though they've been customers of the bank for almost 40 years, that bank is unwilling to assume the risk of such a high loan-to-value (HLTV) mortgage.

If Judy had a loan insured by the FHA or guaranteed by Fannie Mae and Freddie Mac (GSEs), she would likely have some relief. This is because recent changes, announced by President Obama, to the Federal Housing Administration (FHA) and the GSEs have increased the opportunities for borrowers with underwater mortgages to refinance. These changes include the development of Streamline Refinance at FHA and HARP 2.0, which improve upon the original HARP established in 2009 but they are only available with those who have FHA or GSE loans Additional refinancing help is also being provided through the historic Federal–State Attorney General Servicer Settlement announced earlier this year which will provide $3 billion in refinance assistance for borrowers with underwater mortgages currently held on the balance sheets of the largest five banks. However, that still leaves millions of borrowers whose mortgages are held in securitization trusts or on the balance sheet of banks not subject to the settlement.

While we have made substantial progress and the Administration has taken action administratively to make millions of Americans eligible for lower interest rates, more needs to be done. But these additional steps require Congress to take action. With mortgage interest rates at their lowest in 50 years, refinancing can provide substantial benefits to millions of homeowners. We must do more so that every current borrower—no matter where their loan is located—has the opportunity to refinance. As economist Mark Zandi said, "There is no better way to quickly buoy hard-pressed homeowners than helping them take advantage of the currently record low fixed mortgage rates and significantly reduce their monthly mortgage payments."

That is why the President is calling on Congress to open up opportunities for refinancing to responsible borrowers who are current on their payments. These proposals will help "Judy" and the millions of Americans like her who not only have done the right thing, but also refuse to consider going delinquent on their obligations in hopes of obtaining relief.

Providing Non-FHA and Non-GSE Borrowers Access to Simple, Low-Cost Refinancing

Under the President's broad-based refinance proposal, borrowers with standard non-FHA and non-GSE loans would have access to refinancing through a new program operated by the FHA. The refinancing program would be open to all borrowers who are current on their mortgage payments and have standard, nonjumbo loans that are not currently insured by FHA or the GSEs.

The program will feature simple and straightforward eligibility criteria.

- *They are current on their mortgage.* Borrowers will need to have been current on their loan for the past 6 months and have missed no more than one payment in the 6 months prior.
- *They meet a minimum credit score.* Borrowers must have a current FICO score of 580 to be eligible. Approximately 9 in 10 borrowers have a credit score adequate to meet that requirement.
- *They have a loan that is no larger than the current FHA conforming loan limits in their area.* Currently, FHA limits vary geographically with the median area home price—set at $271,050 in lowest cost areas and as high as $729,750 in the highest cost areas.
- *The loan they are refinancing is for a single family, owner-occupied principal residence.* This will ensure that the program is focused on responsible homeowners trying to stay in their homes.

Borrowers will apply through a streamlined process designed to make it simpler and less expensive for borrowers and lenders to complete the refinance transaction. Borrowers will not be required to submit a new appraisal or tax return. To determine a borrower's eligibility, a lender need only confirm that the borrower is employed and meets the eligibility criteria outlined above. Those who are not employed may still be eligible if they meet the other requirements and present limited credit risk. However, a lender will need to perform a full underwriting of these borrowers to determine whether they are a good fit for the program.

In addition, the proposal includes parameters to reduce program cost, including the following, risk mitigating measures:

- *Establishing loan-to-value limits for these loans.* The proposal would restrict refinancing to loans up to a loan to value (LTV) ratio of 140. Lenders interested in refinancing deeply underwater loans would therefore need to write down the balance of these loans before they would qualify. This would reduce the risk associated with the program and relieve the strain of negative equity on the borrower.
- *Creating a separate insurance fund for new streamlined refinancing program.* This will help the FHA better track and manage the risk involved and ensure that it has no effect on existing Mutual Mortgage Insurance Fund (MMIF).

The cost will be driven in part by additional design choices and we are cognizant that we must ensure that FHA has adequate capacity to implement this program effectively. We are interested in working with Congress to design appropriate limits that meet the objectives of the program, including walling off any risk from the MMI fund and containing costs to a level that will not increase the deficit or impose additional costs on taxpayers.

There may be questions about this program significantly expanding the FHA's balance sheet, and potentially increasing the credit risk held by the Government, and moving in the opposite direction of the Administration's stated interest in stepping back from the housing market. To those concerns, I would like to reiterate that the program will be limited to those homeowners who have been making their payments on time for the better part of a year and in most cases considerably longer. These are responsible borrowers who have a demonstrated ability and willingness to pay and thus represent relatively low credit risk. Second, the program is designed to limit and contain any incremental credit risk to the FHA. Third, it is important that we work with Congress to offset the costs associated with this program, minimizing the incremental risk that these borrowers represent to taxpayers or the health of the FHA. Finally, while the Administration believes that over time the Government's footprint in the Nation's housing market must decrease, it is imperative at this time that we do what is necessary to ensure the continued recovery of the housing sector and broader economy. If we fail to take the steps necessary to speed the recovery, then the FHA's scaling back will take considerably longer, as private capital continues to wait on the sideline for a healthier market.

Steps Taken To Strengthen FHA

I also understand that there is some concern over whether FHA has the capacity to implement this program given the current state of the Mutual Mortgage Insurance Fund (MMIF). To be clear, stresses on the MMIF are a result of legacy books of business originated before mid-2009, not the books of business taken on today. In fact HUD moved expeditiously to limit risk going forward and strengthen the FHA's performance. Immediately upon taking office, this Administration acted quickly and aggressively to protect FHA's MMI Fund and to ensure its long term viability. We have taken more steps since January 2009 to eliminate unnecessary credit risk and assure strong premium revenue flows in the future than any Administration in FHA history. These actions coupled with the strength of FHA's recent books of business have significantly improved FHA's long-term outlook. FHA's improved trajectory is the result of a three-part strategy: systematic tightening of risk controls, increased premiums to stabilize near-term finances and expanded usage of loss mitigation workout assistance to avoid unnecessary claims.

Because we are very aware that stresses on the MMI Fund remain, we have also followed these efforts with significant additional steps to strengthen the Fund. In the 2013 Budget we announced a 10 bps annual premium increase on all FHA insured loans in accordance with legislation passed by Congress late last year, as well as an additional 25 bps annual premium increase on jumbo loans making the total increase for these larger loans 35 bps. And recently, we announced a series of premium changes that will further increase receipts to FHA by $1.48 billion in fiscal years 2012 and 2013, beyond the receipts already included in the President's budget submission. We have also taken significant additional steps to increase account-ability for FHA lenders. We recently published a final rule that clarifies the bases upon which FHA will require indemnification from lenders participating in our Lender Insurance program, making clear the rules of the road for lenders and giving FHA a solid basis upon which to require indemnification by lenders for violations of FHA guidelines.

In addition, we continue to seek expanded authority from Congress to further enable us to protect the MMIF from unnecessary and inappropriate losses associated with lenders who violate our requirements. The House is currently considering a bill that includes some provisions sought by FHA, and we look forward to working with this Committee on legislation to help manage the risk to FHA's portfolio arising from noncompliance on the part of FHA-approved lenders.

And as we have discussed, we have held lenders accountable for violating our rules and putting our fund at greater risk in the recently announcement settlement with America's largest lenders. Through these settlements, FHA will receive approximately $900 million in compensation for losses associated with loans originated outside of FHA requirements, or for which FHA's servicing requirements were violated.

Opening Up Access Through FHA While Maintaining Careful Risk Management

FHA has made great strides in reducing barriers to low cost refinancing through its FHA Streamline Refinance program. The Streamline Refinance program allows borrowers with loans insured by the FHA who are current on their mortgage to refinance into a new FHA-insured loan at today's low interest rates without requiring additional underwriting, allowing these borrowers to reduce their mortgage payments. This program benefits current FHA borrowers—particularly those whose loan value may exceed the current value of their home—and by lowering a borrower's payment, also reduces risk to FHA. As part of our efforts to help responsible homeowners who are current on their mortgages and because we see potential for more widespread use of this product, FHA will also make changes to the way in which streamline refinance loans are displayed in the Neighborhood Watch Early Warning System (Neighborhood Watch). By reducing lender concern about the potential impact associated with taking responsibility for loans they have not underwritten, lenders will be more willing to offer these loans to borrowers who are current on mortgages already insured by FHA.

In addition to making these refinance loans more widely available, FHA has reduced the upfront mortgage insurance premium (MIP) to 0.01 percent and the annual MIP to 0.55 percent for all Streamline Refinance transactions that are refinancing FHA loans endorsed on or before May 31, 2009. This change will ensure that borrowers benefit from a net reduction in their overall mortgage payment and reduce the risk to FHA.

FHA has a long track record of enabling millions of American families to purchase or refinance their homes, and coupled with its improved risk management system, is well positioned to provide refinancing to responsible non-FHA and non-GSE borrowers. We see this program as part of a broader effort to return the housing market to health, and along with the proposal described below, will speed the recovery of the market, benefiting homeowners and investors alike.

Fully Streamlining Refinancing for GSE-Insured Loans

Progress and Challenges of HARP

In his address before Congress last September, President Obama charged HUD and Treasury to work with the Federal Housing Finance Agency (FHFA) to lower barriers to refinancing. Following weeks of intensive discussions with lenders, mortgage insurers, regulators and investors, FHFA announced changes to help borrowers whose loans were purchased or guaranteed by Fannie Mae or Freddie Mac and who are located in areas suffering from house price declines. These changes have become known as HARP 2.0.

With HARP previously limiting refinancing to borrowers with high loan-to-value ratios of up to 125 percent and responsible for less than a million refinances, the need to pick up the pace was clear. Announced in October 2011, HARP 2.0 works to eliminate the LTV ceiling, reduce certain risk-based loan-level g-fees, also referred to as loan level pricing adjustments, or LLPAs, extend the program's end date by 1½ years to December 2013, streamline Automated Valuation Model (AVM) coverage and forego appraisal requirement when AVM is available, and provide additional representations and warranties relief.

Eliminating the LTV cap allows borrowers who have been responsible in paying their underwater mortgages the opportunity to take advantage of unprecedented mortgage interest rates. The extension of the program for 2 years will allow lenders to hire staff and upgrade systems to assure all eligible borrowers will have the opportunity to take advantage of the HARP program. It will minimize the amount of funds borrowers would be required to obtain for a refinance because the GSEs reduce the fees that borrowers have to pay on 30-year fixed rate loans with an LTV over 80 percent from 2 percent to .75 percent of the loan amount. And by ensuring that the GSEs do not require the HARP originator to take responsibility for the quality of the loan that is being refinanced, it will allow lenders to only be concerned about making the new HARP loan terms as advantageous as possible for the borrower.

We understand that most lenders have had their HARP 2.0 operations fully up and running since the end of March. These changes have met with a very positive response from homeowners, particularly in deeply underwater states where so many families have been locked out of the refinance market for years. Already, servicers report that they are processing applications from nearly a half-million families who stand to save on average $2,500 per year—the equivalent of a pretty good-sized tax cut—speeding our efforts to help responsible families stay in their homes and start to rebuild the wealth they lost in the economic crisis.

Further Action Is Necessary To Increase Scope and Improve Efficiencies

Significant changes have been made to HARP to improve access, but additional changes can be made to increase participation and improve its effectiveness, as detailed in the bill proposed by Senator Menendez and Senator Boxer. Namely, significant uptake could be achieved by evaluating automated valuation models as approval alternatives to appraisals, removing operational barriers that preclude or hinder cross-servicer refinances, and extending the current program to those borrowers with LTVs under 80 percent. More specifically, the bill would:

- *Extending streamlined refinancing for all GSE borrowers:* The President's plan would extend these steps to streamline refinancing for homeowners to all GSE borrowers. Those who have significant equity in their home—and thus present less credit risk—should benefit fully from all streamlining, including lower fees and fewer barriers. This will allow more borrowers to take advantage of a program that provides streamlined, low-cost access to today's low interest rates—and make it easier and more automatic for servicers to market and promote this program for all GSE borrowers. Specifically, this would eliminate the restriction on borrowers who have loans with an LTV of less than 80 percent LTV, applying the HARP changes to GSE borrowers irrespective of their loan to value ratio.
- *Increasing competition so borrowers get the best possible deal:* Today, lenders looking to compete with the current servicer of a borrower's loan for that borrower's refinancing business continue to face barriers to participating in HARP. This lack of competition means higher prices and less favorable terms for the borrower. The President's legislative plan would direct the GSEs to require the same streamlined underwriting for new servicers as they do for current servicers, leveling the playing field and unlocking competition between banks for borrowers' business. Specifically, this would eliminate the requirement of any lender to assume representations and warranties that are not required of same servicers. Additionally, the GSEs could not charge any loan level pricing adjustments (LLPAs), post-settlement delivery fees, adverse delivery charges or other similar up-front fees.
- *Eliminating appraisal costs for all borrowers:* Borrowers who happen to live in communities without a significant number of recent home sales often have to get a manual appraisal to determine whether they are eligible for refinancing into a GSE guaranteed loan, even under the HARP program. Under the Administration's proposal, the GSEs would be directed to use mark-to-market accounting or other alternatives to manual appraisals for any loans for which the loan-to-value cannot be determined with the GSE's Automated Valuation Model. This will eliminate a significant barrier that will reduce cost and time for borrowers and lenders alike.

Allowing Borrowers To Rebuild Equity Expeditiously

All underwater borrowers who decide to participate in either HARP or the refinancing program through the FHA outlined above will have a choice: they can take the benefit of the reduced interest rate in the form of lower monthly payments, or they can apply that savings to rebuild equity in their homes. The latter course, when combined with a shorter loan term of 20 years, will give the majority of underwater borrowers the chance to get back above water within 5 years, or less.

To encourage borrowers to rebuild equity in their homes, we recommend that the legislation provide funding for the closing costs of borrowers who choose this option—a value averaging about $3,000—to be paid for on behalf of the borrower by either the FHA or GSEs. To be eligible, a participant in this option must agree to refinance into a loan with a term of no more than 20 years and with monthly payments roughly equal to those they make under their current loan. For those who agree to these terms, their lender will receive payment for all closing costs directly from the FHA or GSE, depending on the entity involved.

For example, a borrower has a 6.5 percent $214,000 30-year mortgage originated in 2006. It now has an outstanding balance of $200,000, but the house is worth $160,000 (a loan-to-value ratio of 125). The monthly payment on this mortgage is $1,350. While this borrower is responsibly paying her monthly mortgage, she is locked out of refinancing. By refinancing into a 4.25 percent 30-year mortgage loan, this borrower will reduce her monthly payment by $370. However, after 5 years her mortgage balance will remain at $182,000. Under the rebuilding equity program, the borrower would refinance into a 20-year mortgage at 3.75 percent and commit her monthly savings to paying down principal. After 5 years, her mortgage balance would decline to $152,000, bringing the borrower above water.

This program would provide a path out from an underwater position over a reasonable period of time to borrowers who qualify for either of the two programs set forth above rather than only those who are particularly distressed or for whom principal reduction is clearly NPV positive. We are focused on the broader group not only because of its importance to the continuing recovery of the housing markets, but because we frankly do not believe that only those who are distressed in their mortgages should have an opportunity to work their way above water.

Strengthening Communities Through NSP and Project Rebuild

At the same time we provide relief to responsible homeowners and keep families in their homes, we also need to address the overhang of foreclosed properties that continue to drag down home prices. While the legislative proposals described above seek to reduce barriers to refinancing and afford homeowners the opportunity to save thousands of dollars per year, we cannot simply stabilize neighborhoods by refinancing one mortgage at a time. Aside from addressing challenges associated with concentrated foreclosures, the Neighborhood Stabilization Program (NSP) has played an important role in halting the slide in home values in neighborhoods, and as a result helped preserve homeowner's equity.

NSP has helped improved sale prices and vacancy rates in areas with concentrated investments. Indeed, according to HUD data, three-quarters of neighborhoods that received targeted investments through the first two rounds of NSP showed increased home prices—largely as a result of improved vacancy rates. And, furthermore, the $7 billion that has been allocated under the three phases of NSP will support nearly 90,000 jobs by the time the funding is fully spent.

This success is why President Obama has proposed Project Rebuild to further stabilize neighborhoods and communities, an initiative that would create 200,000 jobs in the places that need them most. I am pleased that Senator Reed has introduced legislation to establish this program, and I urge Congress to move forward on the bill.

Nearly two-thirds of the $15 billion Project Rebuild funding will be provided to States and local governments by formula as specified in the American Jobs Act. Project Rebuild proposes important modifications to the NSP model to extend the benefits of the program beyond affordable housing, enabling greater job creation, and a broader positive impact on neighborhoods.

Recognizing that it's not just abandoned homes that can drag down an entire neighborhood, but also vacant commercial properties, Project Rebuild broadens eligible uses to allow commercial projects and other direct job creating activities, capped at 30 percent of funds. Up to 10 percent of formula grants may be used for establishing and operating jobs programs to maintain eligible neighborhood properties. Formula funding will go directly to States and entitlement communities across the country. Competitive funds will be available to States, local governments, for-profit entities, nonprofit entities, and consortia of these entities.

Each State will receive a minimum of $20 million of the $10 billion in formula funds. Funds will be targeted to areas with home foreclosures, homes in default or delinquency, and other factors, such as unemployment, commercial foreclosures, and other economic conditions. Project Rebuild also will expand the ability of the private sector to participate with localities—ensuring there is the expertise and capacity to bring these neighborhoods back in a targeted way.

A Make or Break Moment for the Middle Class

Mr. Chairman, we have made significant progress in recent months to get our housing market back on track. With the changes made to date to existing refinance programs, we have helped tens of thousands of additional families refinance. We have not only helped them save on their monthly payments, we've also set the foundation for the provision of fair and equitable treatment by servicers of many of these new and existing loans with the servicing settlement—establishing critical consumer protections that hold powerful institutions that service nearly 2 out of every 3 mortgages accountable for their actions. Through the settlement and subsequent efforts, these institutions are being required to take action to address problems uncovered during our investigations and help our housing market recover, giving every homeowner the dignity, respect, and fair treatment they deserve.

In spite of all this progress, we aren't done. As President Obama said in his State of the Union, this is "a make or break moment for the middle class and those trying to reach it" and the defining issue of our time is how to build a Nation where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same rules.

Mr. Chairman, the millions of families who will benefit from these proposals are playing by the rules. They're doing more than their fair share. They haven't walked away from their obligations—and we can't walk away from ours.

And that starts with making sure every responsible family in America has the opportunity to refinance in an open and competitive market. Achieving success on this front will be a significant step in the direction of a balanced national housing policy that ensures Americans have access to credit for those in a position for sustainable home ownership, assistance for those who feel the strain of high housing costs, rental options near good schools and good jobs, and above all, choices in housing that make sense for Americans and their families. I look forward to working with Congress to make it possible. Thank you.