SUBPRIME MORTGAGE CRISIS AND AMERICA'S VETERANS

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BEFORE THE

SUBCOMMITTEE ON ECONOMIC OPPORTUNITY

OF THE

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THURSDAY, FEBRUARY 28, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC OPPORTUNITY,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:00 p.m., in Room 334, Cannon House Office Building, Hon. Stephanie Herseth Sandlin [Chairwoman of the Subcommittee] presiding.

Present: Representatives Herseth Sandlin, Donnelly, McNerney, and Boozman.

OPENING STATEMENT OF CHAIRWOMAN HERSETH SANDLIN

Ms. HERSETH SANDLIN. Good afternoon, ladies and gentlemen. The Committee on Veterans' Affairs Subcommittee on Economic Opportunity hearing on the subprime mortgage crisis and America's veterans will come to order.

I would like to call attention to the fact at the outset that the Iraq and Afghanistan Veterans of America and Mortgage Bankers Association have asked to submit written statements for the hearing record, I ask for unanimous consent that their statements be entered for the record. Hearing no objection, so entered.

[The statements of Iraq and Afghanistan Veterans of America and the Mortgage Bankers Association appear on p. 62.]

Ms. HERSETH SANDLIN. In July 1943, President Franklin Delano Roosevelt recognized the need to invest in our Nation's troops after their service to our country by highlighting that, "The members of the Armed Forces have been compelled to make greater economic sacrifice and every other kind of sacrifice than the rest of us and they are entitled to definite action to help take care of their special problems."

One year after this speech, President Roosevelt signed the "Servicemembers Readjustment Act 1944," which included readjustment benefits to help our veterans with education, housing, and employment opportunities.

Sixty-four years later, we on this Subcommittee, find ourselves reevaluating that law and others to address the needs of today's servicemembers, veterans, and their dependents.

While we have held at least nine Subcommittee hearings on education and employment issues, today's hearing gives us the opportunity to assess how the current housing market affects our veterans and determine if the U.S. Department of Veterans Affairs'

(VA's) Home Loan Programs have a role to play in addressing the foreclosures affecting our communities.

This past Tuesday, Realty Track, an online retailer of foreclosed properties, released its January 2008 foreclosure report that highlights that the foreclosure rate has increased 57 percent when compared to the same month in 2007.

It might be safe to say that no one on this Subcommittee has seen more recent foreclosure rates in his congressional district than Congressman Jerry McNerney in his metro area of Stockton, California, which had the second highest rate of foreclosures in 2007.

As we will hear from our distinguished panelists today, data specific to veterans does not exist or is limited in scope leaving us with an incomplete puzzle. This makes it harder for us to get a good idea of how current mortgage problems are affecting our veterans.

However, many of us have heard from returning servicemembers that we represent and veterans back home about the problems they have encountered. Problems such as that expressed by Mr. Marty DuBois, a veteran concerned about losing his home because he does not qualify for a VA home loan due to equity requirements.

We have also heard several complaints from veterans residing in high-cost residential areas in which the current VA home loan is insufficient and this will effectively price them out of the market.

As you can see on the television screen above, veterans have been caught in the mortgage crisis and some economic projections suggest that we should only expect the problem to worsen.

The image of Mr. Hector Masas, a veteran emotional after telling Senator Hillary Clinton about the difficulty he has with paying his mortgage, was posted on yesterday's Washington Post Express. Mr. Masas, and thousands of veterans like him throughout our country, deserve better and we must do better to ensure that they are afforded the protections they need as they adjust to life after their military service, which includes the stability and security of home ownership.

I look forward to working with Ranking Member Boozman and Members of the Subcommittee to continue to improve readjustment benefits available to all servicemembers and veterans.

I now recognize our distinguished Ranking Member, Mr. Boozman, for any opening remarks he may have.

[The prepared statement of Chairwoman Sandlin appears on p. 33.]

OPENING STATEMENT OF HON. JOHN BOOZMAN

Mr. BOOZMAN. Thank you very much, Madam Chair.

The topic that we are going to be discussing and hearing more about today certainly is a very timely topic for today's hearing. Every day the media reminds us of the difficulties facing our national economy because of the subprime mortgage crisis.

It is clear from reading today's testimony that America's veterans regardless of whether they have a subprime mortgage or not, whether they are current in their payments or not, will be affected in some way by this financial mess.

It is also clear from our witnesses' statements that there is plenty of blame to go around. It appears that every level of our national economic structure has played a role in allowing this to happen.

It would be easy to blame just the borrowers who fooled themselves into believing they would never be faced with increased payments or the lenders and brokers who encouraged such behavior with highly speculative mortgage products or big investors in Wall Street financial services giants who appear to have demanded increasingly risky transactions. I guess you could say there was enough greed to go around.

So the question before us today is what can VA do to help veterans stuck in the mess that they are in. Under current law, their options are limited, but we must be careful here. The VA wisely has maintained its underwriting standards and as a result, taxpayers are not seeing their funds wasted.

The VA Guaranty Program is solvent and does not reflect the difficulties in the subprime market. As we will hear from our witnesses, the mortgage business is very complex with multiple levels of markets, borrowers, lenders, and investors, and the potential for negative unintended consequences is significant.

So we want to work hard, you know, to keep the VA program stable and financially viable so that tomorrow's veterans will benefit just as yesterday's and today's have.

So I look forward to any suggestions from our witnesses that they may have to ease the situation.

Thank you, Madam Chair.

[The prepared statement of Congressman Boozman appears on p. 33.]

Ms. HERSETH SANDLIN. Thank you, Mr. Boozman.

I would now like to welcome those on our panels today who are testifying before the Subcommittee for the first time. We appreciate your insights and the written statements that you have already submitted.

I would like to remind all of our panelists that your complete written statement has been made part of the hearing record. Please limit your remarks to 5 minutes so that we have sufficient time to follow-up with questions we may have once everyone has had the opportunity to provide their initial and opening testimony.

Joining us on the first panel, and I would like to invite them to the witness table as I introduce them, Mr. Roger Kubarych, Chief U.S. Economist for UniCredit Markets and Investment Banking, and Mr. Donald Bisenius, Senior Vice President of Credit Policy and Portfolio Management for Freddie Mac.

Please let me know if I am not pronouncing your last name correctly. I appreciate both of you gentlemen being with us here today. We will start with you Mr.——

Mr. KUBARYCH. Kubarych.

Ms. HERSETH SANDLIN. Kubarych. Okay. Very good. I have the emphasis wrong. Kubarych. Very good. Mr. Kubarych, thank you for being here. You are now recognized for 5 minutes.

STATEMENTS OF ROGER M. KUBARYCH, CHIEF U.S. ECONOMIST, UNICREDIT MARKETS AND INVESTMENT BANKING, AND HENRY KAUFMAN, ADJUNCT SENIOR FELLOW FOR INTERNATIONAL ECONOMICS AND FINANCE, COUNCIL ON FOREIGN RELATIONS; AND DONALD J. BISENIUS, SENIOR VICE PRESIDENT, CREDIT POLICY AND PORTFOLIO MANAGEMENT, FREDDIE MAC

STATEMENT OF ROGER M. KUBARYCH

Mr. KUBARYCH. Madam Chairwoman, thank you for inviting me and Members of the Subcommittee.

Veterans are affected by the subprime mortgage crisis and the broadening financial turbulence that has developed in at least four ways.

First, some veterans are directly involved because they bought homes financed by subprime mortgages which too often contained a raft of abusive terms and conditions and now they are unable to meet their obligations. Some may already be facing delinquency or even loss of their homes through foreclosure.

Second, many more veterans are impacted indirectly as a result of persisting declines in home prices. One recent survey say they are down 9 percent over the last year. It is not good. So the equity they have in their homes is contracting and standards of living will take a hit.

Third, all veterans are hurt by the diminished availability of credit because of the squeeze on banks and other financial institutions who made unwise investment decisions, suffered losses that are now straining to repair wounded balance sheets.

And, fourth, veterans along with the rest of us are facing higher costs of energy and other imports as a result of the decline in the value of the dollar and the rise in commodity prices, both traceable in part to the erosion of confidence in our financial markets and our currency. These are big negative effects and they could lead to a business recession.

I have been asked to try to give some historical perspective of how we got into this mess and I have just a few simple points that are not so simple.

One, securitization of mortgages is not new. Securitization, the pooling of thousands of individual mortgage loans into mortgage-backed securities that can be sold to institutional investors in the marketplace, got started in the early 1980s. It was so good that within a few years, it had caught on so that over half of all mortgages were securitized. And since 1995, it has always been over a half.

Secondly, securitization done prudently provides immense benefits to nearly everyone, especially borrowers. It is more efficient than traditional lending done as a single business when you separate out the business into three: origination of mortgages, loan servicing, and investing. That allows mortgage market participants to amass expertise, advanced technology, and to operate on a national, even global scale.

Three, securitization could not have thrived without indispensable government support mainly from Ginnie Mae, Fannie Mae, and Freddie Mac originally. These were government-sponsored enterprises (GSEs). They facilitated the bundling of loans into mortgage-backed securities by taking over the risk of loss or default of individual homeowners and setting high credit standards.

Four, subprime mortgages represented an almost inconsequential part of the mortgage financing system until early in this decade. The pivotal event was when Fannie and Freddie, now stockholder owned and privately managed since the early nineties, lost control of their operations and were forced by Office of Federal Housing Enterprise Oversight (OFHEO) to shrink.

Private mortgage banking stepped in, but not always prudently. And as a result, we saw a development of a lot of terms and conditions which on the face of it none of us would recommend our own children or family members would take, but people did in massive amounts. They were securitized and resecuritized into mortgage-backed securities, collateralized debt obligations, and other forms and by last year had reached 20 percent of all holdings of mortgage securities.

Growth of these mortgage-related securities created a time bomb. We know what happened. It started last July and it has gotten worse.

The next point is that the U.S. financial regulatory system was ill-equipped to deal with abusive lending practices of many financial institutions. Too many just fell through the regulatory cracks.

Number eight, the rating agencies made poor judgments and they awarded high ratings with little or no evaluation of risk.

Nine, institutional investors were lazy and cheap, lazy because they did not do their own due diligence, cheap because they did not hire other outside experts to help them.

And, finally, many borrowers overextended themselves by assuming that the housing price boom would go on forever.

What do we do next? I do not have any big program to recommend, but I do think that there is a role for specific government support over and above the voluntary programs that are now in place.

[The statement of Mr. Kubarych appears on p. 34.]

Ms. HERSETH SANDLIN. Thank you.

Mr. Bisenius.

STATEMENT OF DONALD J. BISENIUS

Mr. BISENIUS. Thank you, Chairwoman Herseth Sandlin, Ranking Member Boozman, and Members of the Subcommittee.

Good afternoon. My name is Don Bisenius and I am the Senior Vice President for Credit Policy and Portfolio Management at Freddie Mac. Thank you for the opportunity to address the Subcommittee today.

Freddie Mac is a government sponsored enterprise or GSE created by Congress with a public mission, to bring liquidity, stability, and affordability to the Nation's mortgage markets.

Today's conventional conforming market that is supported by the GSEs and the government market for mortgages backed by the Federal Housing Administration (FHA) and VA are the only well-functioning segments of the mortgage market.

The GSEs like the VA do not originate mortgages. We do not control the loans that the primary market originates. What we can do, however, is to define the mortgages we are willing to purchase and guarantee. And because of our size and continued presence in the marketplace, the GSEs can influence the primary market.

Freddie Mac has participated in the subprime market as a responsible and prudent investor. We have not historically purchased or securitized subprime mortgages directly, but, instead, limited our participation to investing in the least risky segments of the subprime private label securities market.

This participation reflects our charter objectives to bring additional liquidity to the market. It has also been an important contributor to our efforts to meet our U.S. Department of Housing and Urban Development (HUD) mandated affordable housing goals.

In addition to providing liquidity, Freddie Mac has taken a leadership role in addressing some of the excesses of the subprime lending market.

Last winter, we were the first to announce that we would restrict our subprime investments in securities backed by short-term, adjustable rate mortgages (ARMs) to those that have been underwritten to fully indexed, fully amortizing levels, meaning we limited our purchases of the 2/28s and 3/27 ARMs that were made to borrowers that were qualified at the highest interest rate for the full length of the loan.

Last April, we also pledged to buy $20 billion in consumer-friendly mortgages that provide better choices for subprime borrowers. We have already exceeded that pledge. Since May of 2007, we have bought $42.5 billion of prime mortgages that financed borrowers whose credit profiles would have otherwise relegated them to the subprime market. That helped almost a quarter of a million families.

As to the data related to veterans, we do not track whether mortgages we buy go to veterans. Further, I am not aware of any data that would tell us how many veterans have subprime loans. But I think it is fair to say that the impact of this crisis is at least as severe on veterans as it is on other borrowers.

When the subprime crisis erupted as a national issue over a year ago, the conditional wisdom blamed the structure of the short-term 2/28 and 3/27 subprime ARM, products where interest rates are fixed for the first 2 or 3 years and then adjust, the cause of the problem.

The theory was that exploding interest rate resets caused large increases in payments and made mortgages unaffordable. We have come to understand that the resets are not the only, nor necessarily the most important, element of this story.

More fundamentally, the subprime foreclosure crisis derives from a combination of looser lending underwriting standards and subsequent house price depreciation that makes it impossible or uneconomic for stretched borrowers either to sell or to refinance into new higher-balance loans as they might have in the past.

Unfortunately, there are too many borrowers stuck in subprime loans who simply cannot qualify for prudent, sustainable mortgages.

For example, as part of our subprime commitment, we developed our Safe Step subprime alternative product. But when we required originators to validate the borrower's income, the property's value, and other information, borrowers simply could not qualify.

At Freddie Mac, we spend a fair amount of time thinking about how to address this situation. And like almost everyone else, we have concluded that there is no silver bullet.

Nevertheless, let me quickly suggest some things that can be done to mitigate its effects. Focus on servicing practices to keep borrowers in their homes whenever possible. At Freddie Mac, we have found that early intervention can help borrowers avoid foreclosure and last year, we helped nearly 47,000 borrowers keep their homes through early intervention.

Help some borrowers refinance into more sustainable mortgages such as Freddie Mac Safe Step or the FHA Secure.

Support community stabilization efforts of local and national nonprofits and State and local governments hard hit by the crisis.

And, finally, help families transition to more affordable housing. Despite all of our efforts, not all borrowers can afford the house they are currently living in.

The housing crisis is going to be painful and take time to resolve. Freddie Mac remains committed to working with Congress, the Administration, our lender partners, and other industry participants to find and implement effective solutions to this vexing problem.

Thank you for the opportunity to appear, and I would be happy to answer any questions.

[The prepared statement of Mr. Bisenius appears on p. 37.]

Ms. HERSETH SANDLIN. Thank you, Mr. Bisenius.

Let me start with a question to you both based on, Mr. Kubarych, what you said that we have to do something beyond just the voluntary steps that may be taken by certain lenders, certain banks.

In each of your opinion, who is best equipped and in the best position to provide for loan modifications, for repayment plans, and any other foreclosure prevention initiatives? Some of which, Mr. Bisenius, you described as early intervention. Is it the lender? Is it a different entity? Should it be mandatory? What steps should we be taking in terms of an appropriate Federal Government response?

Mr. KUBARYCH. So we started out with a program, basically voluntary work-outs which is affecting a relatively small proportion of those homeowners at risk. Until we stop the rise in delinquencies, there will be continued downward pressure on housing prices, particularly in those parts of the country where subprime was particularly, let us say, overused, California, Florida, Detroit, northern Ohio, and so on.

Now, we can identify quite easily the people who are most at risk. And my simple suggestion is the U.S. Government is now borrowing money in the markets for 5 years for about 3 percent. And the same people, if they had to borrow on their own 5-year money, it would be about 12 percent. There is a big spread there.

If the U.S. Government utilizing existing agencies, FHA, VA, and so on, were simply to set up a program to extend loans to individuals so they could take the money and repay abusive mortgages, they would be in a position to retain their houses and to maintain the debt service on those new loans.

And the taxpayer would be a beneficiary of two things. One, less downward pressure on everybody's home prices, which will otherwise suppress the economy a lot, and, two, there will be a reward to the taxpayer from the operation of such a system. It is not as extensive as what we did in the depression. That was much more elaborate and I do not think we need that much.

But in that expanded role, for the U.S. Government would take a voluntary program, add a specific government lending program to it that would be tailored for low- and medium-income people for the houses that they are living in, not for speculative or second homes, and all it would require is the ability to prepay those abusive mortgages.

Mr. BISENIUS. I have maybe just two additional thoughts to his comments. One is what makes this problem particularly challenging is the nature of the market. Historically, with Freddie Mac and Fannie Mae being the two largest participants in the overall market, we were very capable of being able to define servicing standards, foreclosure prevention standards that effectively became adapted as an industry standard.

In the private-label securities market, where most of the subprime mortgages exist, there is not one entity. There are a collection of investors who each have to independently decide what they want done with the loans that they have invested in.

What we have observed is that many of the private-label security investors are actually suggesting, and at times requiring, that their servicer follow the standards set out by Freddie Mac and Fannie Mae. So in some sense, they are migrating to adapt our servicing standards both because they have observed that they have been pretty effective at loss mitigation and at helping homeowners stay in their mortgages.

So there is not one entity that can dictate in the private-label securities market, but we are at least seeing a migration of people adopting Freddie and Fannie type standards.

Ms. HERSETH SANDLIN. Thank you both for your insights.

Mr. Boozman, do you have questions?

Mr. BOOZMAN. Yes.

Mr. Kubarych, could you comment on a statement that the GSEs lost control of their operations. I think you mentioned that and it was in your written testimony.

Mr. KUBARYCH. When they first started out, they basically were facilitating securitization and providing comfort to investors to buy those securities.

They got involved in buying their own paper and investing in mortgages and they got to the point where they were one of the biggest mortgage holders in the country. Some years, they were buying more than half of the product that they were generating and holding it themselves. They would finance that quite readily because they had almost as good a credit rating in the capital markets as the U.S. Government.

But this exposed them to enormous market risk, the technical term is convexity risk, which has to do with the fact that you cannot really predict the repayment rates of the mortgages that they were holding. And they became one of the world's biggest users of financial derivatives.

Now, that is a very tough business and they got involved in accounting problems that led to a couple of Chief Executive Officers leaving, a couple of Chief Financial Officers being fired, and fines and other constraints by the regulator, OFHEO. And that is how they lost control.

And only yesterday those handcuffs have been taken off. So now they are viewed to have made tremendous progress toward putting their houses in order.

While they were under these handcuffs, that was a great opportunity for good institutions and bad to rush into the mortgage market and do all kinds of lending which probably would not have met their high standards and led to this problem.

Mr. BOOZMAN. How do you respond to that, Mr. Bisenius? In your testimony, to me, you did not seem to acknowledge any blame at all.

Mr. BISENIUS. What I do is I separate out the phenomenon that was described and suggest that while it is true that the operating systems of Freddie Mac were not sufficient to be able to properly account for the nature of the business that we were taking on, that actually had little to do with the developments that went on in the subprime market. In fact, what we observed was that there were investors who were willing to take on loans that were riskier and underwritten to looser standards than what we historically would buy.

That market developed outside of us and even if we had perfect financial books and been able to have been active, our standards would have been ignored over the last 3 or 4 years as other market participants either thought they understood the risk better or who were willing to put capital at risk more aggressively than we were.

What we have seen over the last year is as those investors have lost money, more and more have come back to say we now want to originate to the standards of Freddie and Fannie.

So I do not believe the accounting issues that Freddie and Fannie had are directly correlated nor causal of what went on in the subprime market.

Mr. BOOZMAN. Mr. Kubarych, you mentioned regulated and unregulated financial institutions. Can you give us some examples of each one of those?

Mr. KUBARYCH. Well, one example is New Century Financial. Based in California, but operating in many markets, it went bust a year ago in February. And if you were to ask who is the regulator of New Century Financial, I think that around the main banking regulatory organizations a year ago, they would have scratched their head and eventually maybe said that there must be somebody in California that was the primary regulator, but nobody really knew.

That was one example. There were many others. There have been about 200 failures of mortgage banks of varying size not all of which had any regulator and some who had regulators that were unskilled in dealing with the kind of rapid growth in the business they represented.

Now, Mr. Bernanke, Chairman Bernanke, has testified, and I have listened in on a number of them, where he has pointed out that the Federal Reserve had the responsibility for setting certain rules for consumer protections and other rules of the game, guidelines for mortgage activities and abusive tactics and so on, but they do not have the enforcement powers. And, you know, basically nobody really wanted to take the initiative to say we want enforcement powers.

Mr. BOOZMAN. Thank you, Madam Chair.

Ms. HERSETH SANDLIN. Thank you, Mr. Boozman.

Mr. McNerney.

Mr. MCNERNEY. Thank you, Madam Chair. I want to thank you specifically for holding this hearing and for bringing to light the severity of the problem in my own district.

Mr. Kubarych, I am going to follow-up on Mr. Boozman's question a little bit concerning how we got into this situation.

You mentioned that there was a change in behavior at Fannie Mae and Freddie Mac. What caused that change in behavior? Were there new products out there? Was there a different economic theory or was there a loosening of regulation on the Federal level? What caused these managers to start making those kinds of investments?

Mr. KUBARYCH. I think that they underestimated the risks and they thought that they could earn higher rates of return for their shareholders and get bigger bonuses. I mean, I think that is what led them to be putting more and more of their own product on their own balance sheets. And I think they were kind of caught by surprise, blind-sided by just how risky it is.

I have been managing, off and on, mortgage portfolios a good part of my career. It is very tough, very, very tough. It is one of the hardest things in the fixed-income markets to do. And they did it very well for periods of time. But then as the volatility in the markets increased in this decade, it became very difficult for them to do it as well as they should have.

So I think that has been cured, but it was not easy and it has taken a long time.

Mr. MCNERNEY. So it is just a difference in philosophy? I mean, maybe new managers came in and saw that there was some——

Mr. KUBARYCH. I think a difference of incentives. I think we were in a period where the incentives were to take more risk because the shareholders wanted you to carve out rates of return on equity that would drive the stock price up.

Mr. MCNERNEY. Thank you.

Mr. Bisenius, you said that you did not track veterans that are using the services. Is there some reason that is not done? Do you think it is a good idea and if it is a good idea, what are the obstacles to doing that?

Mr. BISENIUS. I do not have a strong view on whether it is a good or bad idea. We have never been asked to in the past. We have not. The only obstacles would be whether the originator in creating the loan captures that as a data field and is able to deliver it into the delivery systems.

Mr. MCNERNEY. So you do not have any specific ideas on that? Do you have any specific ideas on how we can help veterans specifically that are caught in this kind of a foreclosure situation?

Mr. BISENIUS. Well, I think it is twofold. The good news is we do not differentiate either and as such we are helping all the people who take out loans that Freddie Mac invested in, veterans as well as nonveterans. And, therefore, we make available to them all the loss mitigation efforts that I described in my testimony.

My understanding is that the VA does similar types of loss mitigation, foreclosure prevention type efforts. So I think both the VA themselves, as well as Freddie Mac and Fannie Mae, are taking similar actions with veterans as they are with other borrowers in the products that we invest in and guarantee. Whether those same activities are occurring for veterans who are part of subprime or private label mortgage securities, I do not know for sure.

Mr. MCNERNEY. Thank you.

One more question. How helpful do you think it would be to help families transition to more affordable housing or to get them out of their expensive homes?

Mr. BISENIUS. How helpful would it be?

Mr. MCNERNEY. Yes.

Mr. BISENIUS. I think it would be tremendously helpful.

Mr. MCNERNEY. That is basically the goal?

Mr. BISENIUS. Right. When we look at the underlying homes and the incomes of the borrowers who are facing some of these foreclosure situations, there is no way they have the income with almost any amount of modification to be able to afford the house that they are currently in.

Mr. MCNERNEY. So we might look at that in terms of veterans as a part of our Committee.

Thank you, Madam Chairwoman.

Ms. HERSETH SANDLIN. Thank you, Mr. McNerney.

Mr. Donnelly.

Mr. DONNELLY. Thank you, Madam Chairwoman.

This first question, if you could just give me a quick answer to. We are into this process now of working through these loans. How much longer do you think this process is going to go?

Mr. KUBARYCH. You want my guess?

Mr. DONNELLY. Yes.

Mr. KUBARYCH. Two years. Yeah. I would bet somewhere between 2 to 5 years.

Mr. DONNELLY. You figure we are about 25 percent into it right now, 20, 25 percent? When you figure the overall total is, we are going to hit about a $1.5 trillion of loans on this or about $1 trillion and that we are about $300 billion into it right now?

Mr. KUBARYCH. Well, I figure there's $2 trillion in loans that are at risk, that delinquency rates will get in the 20 to 30 percent range. So take 30 percent of $2 trillion.

Mr. DONNELLY. Okay.

Mr. KUBARYCH. Of those that go delinquent, not all of them will end up in foreclosure. And I think the number that seems to be a good one is about a third.

Mr. DONNELLY. Okay.

Mr. KUBARYCH. So a third times 30 percent times $2 trillion. Then take 50 percent of that because about half the value of the house is erased in a foreclosure and there are costs and all that kind of nonsense. And that will give you an estimate of the dead weight loss on the economy, but that gets multiplied through all the leverage in the collateralized debt obligations (CDOs).

Mr. DONNELLY. Right. The next question is, you had mentioned a concept, and forgive me if I phrase it wrong, but you are here to correct me, the government is borrowing about 3 percent.

Mr. KUBARYCH. Yes.

Mr. DONNELLY. Some of these loans are at about 12 percent.

Mr. KUBARYCH. That is where they are going.

Mr. DONNELLY. That is where they are going?

Mr. KUBARYCH. Yes.

Mr. DONNELLY. Your idea is let us use some of this government lending or borrowing power——

Mr. KUBARYCH. Right.

Mr. DONNELLY [continuing]. To try to get reduced rates for the homeowners?

Mr. KUBARYCH. That is right.

Mr. DONNELLY. Okay. Now——

Mr. KUBARYCH. I put strings attached on the loan.

Mr. DONNELLY. Right. And what I was wondering is, I have so many questions, I am trying to get them into my time here, what are some of those strings and then would the government continue to handle all the loans as well or would we have private servicers who handle it for us? What is your vision on that?

Mr. KUBARYCH. I think the government is perfectly well-equipped to service the loans.

Mr. DONNELLY. Okay.

Mr. KUBARYCH. That is the least of our problem. I am sure there are many servicers that would be delighted to bid for the right to actually do the computer work. The strings are very simple. Limits on the ability of the homeowners that do this to borrow on their credit cards or entertain other kind of debt.

It really is very similar to what we are familiar with in debtor-in-possession lending.

Mr. DONNELLY. Okay. And what that would do is some of these people who are going to bounce from 5-percent ARMs to 12 percent will be able to keep their homes?

Mr. KUBARYCH. Yes. That is the idea. I do not know what to do about people that are so under water that they have huge negative equity. That is beyond the scope of my limited idea.

Mr. DONNELLY. What you are looking at is a process where there is equity, where you look and you go this person with this income can handle this house——

Mr. KUBARYCH. They can carry the 5 percent, but they cannot carry the 12.

Mr. DONNELLY. Right. Okay. Next thing I wanted to ask you about is, or this is almost a statement, one of the things, Madam Chairwoman, that is so disturbing to me in this past year or two is in disability claims that veterans make.

We have a lot of vets coming back from Iraq and Afghanistan who wind up making a disability claim who are injured and cannot go back to their jobs and find themselves in this ARM situation——

Mr. KUBARYCH. Yeah.

Mr. DONNELLY [continuing]. Where they have this going off in the next 4 or 5 months and they cannot get a hearing on their disability claim for another 7, 8 months. So they do not even have money to pay against where they are now and they have this ARM going off. And it is almost a hopeless situation that these vets are put in in some proportion because of the disability situation that we face.

Mr. KUBARYCH. As a taxpayer, I just think it is a waste of my taxes not to be doing that for them.

Mr. DONNELLY. It is approximately 188 days now, I think, that it takes. So you can come back injured from Iraq or Afghanistan, not be able physically to handle your old job, and then you do not even have the money to make present payments on your ARM as opposed to the time bomb that is coming down the road.

And then just as an aside, I wanted to mention that we had veterans in my district who are losing their jobs this June at a Citicorp statement processing center. And the reason they are losing their jobs is because this statement processing center is closing down, one of the most efficient operations in the country, extraordinary productivity, they hit all their targets, hit all their goals, because of what Citicorp did in this subprime situation. They said, well, sorry. We screwed up here on Wall Street in New York and we are closing down your 200-person processing center in South Bend, Indiana. You guys did a good job. You are out of luck.

And so it is not only homeowners. It is the regular folks all throughout the country who have been working hard and have been devastated. As you said, what I see more than anything is the chase for a bonus. It is a chase if I can catch a couple extra points on return, we will get more in, my bonus will be bigger.

Mr. KUBARYCH. Yeah.

Mr. DONNELLY. Twenty million dollars is not enough. I need a $30 million bonus. I think that is what we are dealing with.

Thank you, Madam Chairwoman.

Ms. HERSETH SANDLIN. Thank you, Mr. Donnelly.

Mr. Boozman, did you have any further questions?

Mr. BOOZMAN. No thank you.

Ms. HERSETH SANDLIN. If I could just pursue this a little bit further, I appreciate your willingness to give us your estimates.

Mr. Kubarych, when you said, okay, if we could have a specific government lending program, 5 percent, borrow that at 5 percent versus the twelve. I know Mr. Donnelly probed some of the same questions I had, but I take it then that you think that there are a certain number of these borrowers, maybe a third of the 30 percent of the $2 trillion that is at risk, that are not necessarily in homes they cannot afford, but they just got a bad loan.

Mr. KUBARYCH. Right.

Ms. HERSETH SANDLIN. Do you have——

Mr. KUBARYCH. I cannot put it as precisely as a third. I would say somewhere between a quarter and a half are in loans that are defective——

Ms. HERSETH SANDLIN. Okay.

Mr. KUBARYCH [continuing]. With abusive conditions——

Ms. HERSETH SANDLIN. Okay.

Mr. KUBARYCH [continuing]. Exploding ARMs, misstatement of terms, many of the things that you heard of before.

Ms. HERSETH SANDLIN. Okay.

Mr. DONNELLY. Madame Chairwoman.

Ms. HERSETH SANDLIN. Mr. Donnelly.

Mr. DONNELLY. This is to either of you and this follows up on the Chairwoman's question. How many of these loans, what percent would you say, are simply you look at it and even if we fix it, the income just will not be able to carry it?

Mr. BISENIUS. My best guess it would be at least a half.

Mr. DONNELLY. So it is about half one way, half the other way?

Mr. BISENIUS. Right.

Mr. DONNELLY. Okay.

Mr. BISENIUS. Actually, a point relative to the earlier comment is, one, with all of the recent rate cuts, the amount of payment shock many borrowers are going to face has actually gone down pretty significantly. They will still face some, but the amount of shock that they are going to face today is actually less than it would have been, say, a year ago when rates were higher.

The challenge you have is many of these borrowers and the lenders working with them created loans where they could barely afford the payment at the start rate and, therefore, it is not just the shock. It is they could not hardly afford what they had and were hoping for house price appreciation to allow them to either refinance or extract equity. In the absence of that, they are now struggling just to make the payment itself.

Mr. DONNELLY. Do you figure that in terms of the housing market and housing values that it will stay either stagnant or fall more until we work through this $2 trillion?

Mr. KUBARYCH. The average will fall more. But the concentration of declines will still be greatest in those areas that have the disproportionate portion of subprime mortgages.

In other words, in South Bend, Indiana, my friend John Brademas used to be the Congressman from South Bend.

Mr. DONNELLY. Well, I have been blessed to follow him. And——

Mr. KUBARYCH. He is a wonderful——

Mr. DONNELLY. He set an extraordinary record.

Mr. KUBARYCH. He is an extraordinary man. Anyway, the volatility of housing prices in most of Indiana is much less than in the Miami area, or in Phoenix, or Las Vegas, or Los Angeles. There is no doubt about it.

But we are looking at a distribution. And there will still be parts of your district in which prices will go down 10 or 15 percent, even though the average only goes down 1 or 2 percent.

And that is the key point here. We have a spectrum of outcomes, which leave a noticeable percentage of people disproportionately hurt. And my guess is a lot of veterans are living in those kinds of neighborhoods.

Mr. DONNELLY. Thank you, Madam Chairwoman.

Ms. HERSETH SANDLIN. Mr. Boozman.

Mr. BOOZMAN. Again, I apologize. I had to run outside for a second for a call. But the people that were making these loans, was it more in an effort to figure out a product where they could make loans to make money, or were the people that were making them not devious enough to, I guess, in the sense of figuring out a product so that people could qualify, make the loan, so that you could do business that way, and never really feel like the ARM would come into play like it is now? Or is it more that they were just devious, and really felt well, I am going to jack this person around down the line?

But to me that really doesn't make any sense, because that does have the potential of getting us in the——

Mr. KUBARYCH. They were in business to earn commissions. It was a commission-based business. They wanted to push out as much product as possible, because they were getting paid basically piece work.

Now what happened to the mortgages that they created was that they were getting securitized, but not with the oversight of a Fannie or Freddie with the strong credit standards.

They were being securitized. And then those securities themselves were not being sold. They became mortgage pass through securities. But no institutional investor was particularly interested in them, because they were—they were defective.

But then they were repackaged. Wall Street repackaged the mortgage-backed securities into collateralized debt obligations. They were able, with rating agencies' advice and judgment, to package them in such a way that trenches, in other words, parts of the CDOs were judged to be triple A. And other parts were judged to be single A.

And lots of lazy investors, the world over and some very, very big, you know, well-heeled institutional investors in Asia and the Middle East and so on, were buying these tranches, because they were rated triple A without any due diligence of their own. They trusted the ratings. They trusted the salesforce of the Wall Street firms that were presenting them to them. Everybody told them this was a great deal.

And so nobody checked on the base. But it goes right back down on the ability of the individual homeowner to keep making the mortgage payments. And nobody asked that question.

And once they couldn't make the payments, the cash flows that were supposed to go into the mortgaged-backed securities, which went into the CDOs, they evaporated. And then everybody asked: Gee wiz, does my CDO have bad loans in it too? Sell.

And so then you had the normal market response to go to the other extreme. And that led to these fantastic losses. The Congressman, Mr. Donnelly, mentioned one institution involved in it. And that is why we had this gargantuan losses.

Mr. BOOZMAN. We have seen that there is a portion of that market that was actually stretching. I would say stretching for housing, right? There were consumers who were at the fringe. And you were trying to figure out how do I get them into the house, because every year I wait, house prices were going up. And they weren't able to get in. So the scenario that has been described clearly existed. There was also a subset of these borrowers who it was stretching for housing with kind of a hope that they could grow into the mortgage. And that hope got burst.

Mr. KUBARYCH. By the way, these people had an incentive not to qualify people for prime loans.

Mr. BOOZMAN. Yeah.

Mr. KUBARYCH. Their incentive was to put them into subprime loans with the higher commissions. Even for people who could have qualified for the prime loans, had they been encouraged to do things like give the W2 form, provide information on their bank accounts, etc. They were encouraged to say you don't have to give me any proof of your income and your assets. And I will be able to make your decision in a day. You don't have to wait a month or two. Lots of encouragement for people.

And, you know, obviously, you know, I have friends who say, "Well, it is the fault of the borrower. They didn't do enough work on it." But, all right, that is easy to say. We have to deal with the reality of the fact that people maybe they should have done more careful due diligence. But we are dealing with ordinary people not experts. And this was set up in a way with a lot of advertising and Internet support and so on.

Mr. BISENIUS. It is——

Mr. KUBARYCH. It is a very—it is a very sad and shameful part of our financial history.

Mr. BISENIUS. It is a portion of those borrowers that has just been described are the ones that I mentioned in my testimony that we have been able to refinance into prime mortgages. They probably would have qualified before. They fortunately still qualified today.

Mr. KUBARYCH. Yes.

Mr. BISENIUS. And we were able to get them into a prime——

Mr. KUBARYCH. Yeah. And we would like to see more of that happen.

Mr. BISENIUS. Yeah.

Mr. BOOZMAN. Thank you, both of you very much. That is very helpful.

Mr. BISENIUS. Okay.

Mr. KUBARYCH. Thank you.

Ms. HERSETH SANDLIN. Yes. We all appreciate the insights and the expertise that you have brought to the table. I don't want to make any assumptions about what your response would be, so let me ask just one final question.

Do you think that there should be government intervention of some kind in regulating the market going forward to ensure that those who would qualify for a prime loan are always given the option, through disclosure requirements, that they would qualify, that they go through the steps to determine whether or not they are eligible for a prime loan?

Mr. KUBARYCH. I believe that if we go back to time-tested common sense banking principles, we can solve this problem. And government can really help get us on that route.

Mr. BISENIUS. I probably share the view that to the extent consumers could qualify for a prime mortgage, a GSE-eligible mortgage, it is in their best interest. And we ought to do everything we can to encourage that.

Ms. HERSETH SANDLIN. Okay. I think that is along the lines of yes. Right. I think what you are identifying is that we have had some actors in an unregulated environment whereby they are not only operating without a regulator. But they are also seemingly operating outside of the sphere of the self regulation within the industry in terms of what the best practices have been, either on servicing or on disclosure. Also in some of the——

Mr. KUBARYCH. Right.

Ms. HERSETH SANDLIN [continuing]. You said the core principles in banking.

Mr. KUBARYCH. You are right.

Ms. HERSETH SANDLIN. Whereby some government intervention may be necessary at this point.

Mr. KUBARYCH. Yeah. And we don't want to leave it just to the courts. That is not an efficient way to do it.

Ms. HERSETH SANDLIN. Thank you. Thank you very much.

Mr. KUBARYCH. Thank you.

Ms. HERSETH SANDLIN. We appreciate your time and testimony. We look forward to working with you in the future as we explore some of the proposals for further consideration.

Joining us on our second panel is Mr. Anthony Agurs, member of the Board of Directors for the NATIONAL ASSOCIATION OF REALTORS® (NAR); Ms. Ellen Harnick, Senior Policy Counsel for the Center for Responsible Lending; and Mr. Larry Gilmore, Deputy Director, for HOPE NOW Alliance.

Welcome to all three of you. Thank you for joining us here today and providing your written statements. We will go ahead. Again, if you could keep your opening comments to 5 minutes, as you can tell we have some questions. We will give you other opportunities after your opening statement to add further comments to questions that are posed or other testimony that is offered.

Mr. Agurs, we will go ahead and begin with your testimony, you are recognized for 5 minutes.

STATEMENTS OF ANTHONY AGURS, ABR, CRS, MEMBER, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF REALTORS®, AND REALTOR®, AGURS GROUP, EL CAJON, CA; ELLEN HARNICK, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING; AND LARRY GILMORE, DEPUTY DIRECTOR, HOPE NOW ALLIANCE

STATEMENT OF ANTHONY AGURS

Mr. AGURS. Madam Chairwoman and Members of the Subcommittee, thank you for inviting me to testify on behalf of the NATIONAL ASSOCIATION OF REALTORS®.

My name is Tony Agurs. I am a 21-year veteran of the United States Marine Corps and a REALTOR® with the Agurs Group in El Cajon, California.

The NATIONAL ASSOCIATION OF REALTORS® is a strong supporter of housing opportunities for veterans. We commend the Subcommittee for its attention to this important issues. I passionately believe that the American dream of home ownership is for anyone who desires to achieve that goal for themselves and their families. But especially for the soldiers, sailors, Airmen, and Marines of our Armed Forces who sacrificed so much in defense of the American way of life, yet we ask for so very little in return.

Unfortunately, like many Americans, our military families have been hit hard by the subprime mortgage crisis. These homeowners are in financial crisis and need our help, because no veteran in high-cost areas can use their VA Home Loan Guarantee.

We believe the Veterans Home Loan Guarantee is a valuable asset to help our Nation's veterans achieve the dream of home ownership in a way that is safe, fair, and affordable. The VA Home Loan Guarantee Program is designed to provide veterans who are unable to qualify for a conventional loan with favorable terms. And I will go even further to say every veteran would rather use a VA Home Loan than a convention loan anyway.

A study conducted in 2004 found the program did just that. The percentage of VA borrowers who could not qualify for a conventional loan was 82 percent for first-time home buyers, 78 percent for repeat borrowers.

And in addition, the typical VA borrower could not qualify for an FHA loan. Sixty-one percent of VA first-time borrowers could not meet either the down payment or maximum debt-to-income ratio required to obtain an FHA loan. The VA program, therefore, offers unique and important benefits for helping our military families, veterans, and retirees achieve the dream of home ownership.

Despite offering borrowers a zero-downpayment loan, one of the hallmarks of the VA Home Loan Program, the delinquency rate is extremely low. And according to the most delinquency rates survey published by the Mortgage Bankers Association, the rate was 6.58 percent, foreclosures was 1.03 percent. In contrast, subprime delinquency rates, which were a staggering 16.31 percent and foreclosures 6.89.

Part of the real reason is we are proud, we are disciplined, and we do what we are expected to do. In addition, the VA Home Loan Program offers protection for borrowers when financial difficulties occur by offering a variety of supplemental loan servicing programs that help military families avoid foreclosures.

In 2007, VA accomplished more than 8,400 successful interventions, which translated into saving the government over $181 million in claims avoided.

However, without reforms, this program has not served many veterans who could use its benefits. We urge the following three enhancements to the VA program.

Increase the VA Loan Limits in high cost areas. The current VA loan limit is equal to $417,000. States with the largest veteran populations are California, Florida, Texas, Pennsylvania, New York, and Ohio. Twenty-five million veterans live in 60 percent of the urban areas. Thirty-six percent of them live in these high-cost areas out of the—four of the six States. Veterans in these areas should not be penalized for geographic differences in the housing market. NAR supports legislative efforts to increase the VA limits to 150 percent of the conforming loan limit.

Ease refinancing for veterans. Some veteran homeowners, a lot of veteran homeowners, have risky sub-prime mortgage loans, because they couldn't afford to use their VA eligibility.

Veterans are required to have at least 10-percent equity in a home in order to refinancing it. We believe that Congress should reduce that down to 5 percent.

FHA has a component that allows 3-percent equity only in order to refinance. In addition, the law limits the guaranty that can be used for a typical VA refinance loan to $36,000.

As a result, refinancing loans of more than $144,000 will result in a lender not receiving the 25-percent backing from the VA. And as a result, probably will not do the loan. We urge Congress to eliminate this refinancing restriction and make the maximum VA guaranty applicable to all VA loans.

Permanently authorize ARMS. I know ARMS are a bad terminology in a convention sense. But for what the VA does with them, it makes perfect sense. And there is no prepaid penalty, because we know servicemembers have an escalating rate of promotion. And they actually get promoted on a regular basis, which helps them afford those programs.

And finally, you ought to do this because of the promise that you made.

I would like thank the Subcommittee for allowing me to present here today. The NATIONAL ASSOCIATION OF REALTORS® strongly support housing opportunities for our Nation's veterans and active-duty military professionals.

It is our hope that the Subcommittee will support our recommendations for enhancing and improving the VA home loan guarantee program, so it may be a real benefit to those who have so bravely served our country.

[The prepared statement of Mr. Agurs appears on p. 40.]

Ms. HERSETH SANDLIN. Thank you very much. Ms. Harnick, you are recognized.

STATEMENT OF ELLEN HARNICK

Ms. HARNICK. Well thank you very much. I am very pleased to be here today. Much of what I was prepared to say was said previously by Mr. Kubarych and others.

So rather than repeat, I think I want to pick up on two points that were made during the first panel. One was the point that Mr. Kubarych said—made that many of these loans are loans that none of us would encourage a family member to make. They were structured in a way that were abusive in the sense that they were designed to fail.

And this relates to a second point that came up on the first panel, which is the problem that we have borrowers who are getting homes that they simply could not afford, or is the problem fundamentally caused by people getting loans that were unsustainable when sustainable loans were available?

And the unfortunate and very tragic aspect of this particular crisis is that most of the borrowers who received these unsustainable loans, qualified for loans that would have been sustainable for them.

And part of it relates to a point that was made on the first panel. That a number of these borrowers who received these subprime loans actually did qualify for prime. The *Wall Street Journal* did a study released a couple of months ago looking at loans originated in 2005 and 2006. These are subprime loans. And in each of those years, over 50 percent of the people who received these subprime loans actually had credit scores that would have qualified them for prime loans.

And what that means in very practical terms, is that these people could have had 30-year fixed rate loans at below the cost of that introductory rate on the adjustable rate mortgage they got.

And a second point worth noting is that for even—for the minority of borrowers who didn't have the credit scores that would have qualified them for prime, they could have gotten, even in the subprime market, a 30-year fixed-rate loan at a relatively nominal cost above the introductory rate they got, on average for an additional 65 basis points, which means, you know, there are 100 basis points to a percentage. So less than 1 percentage point higher than the introductory rate would have gotten these people 30-year fixed rate loans. And so a lot of the problems we are seeing now would not have happened.

And it is certainly true, the comment that was made on the first panel, that—by Mr. Bisenius that a lot of these people, because of LIBOR being reduced, will face payment shock that is less than the payment shock that people who are currently in default—currently in foreclosure have faced.

Nevertheless, they are going to face payment shock. And the point he made is very well taken. These loans were underwritten so people could just afford them at that starter rate, but just.

And so an interest—you know, an interest rate increase of even just a percentage point or 1.5 percent was going to push those into the realm of being unaffordable.

So that is the real tragedy here. To put numbers on what we are talking about, in the subprime—on these subprime mortgage loans alone, the expectation is that two million families will lose their homes to foreclosure on these unsustainable loans over the next few years.

And to put a number on the sort of spillover effect that people have been talking about, 40 million other families who are repaying their loans on time, will suffer the consequences of their home prices diminishing as a result of these foreclosures.

And I think you all are aware that there are other quality of life issues that become implicated. Boarded up homes on a block are not merely an eyesore, which would be bad enough, but they are also a magnet for crime which puts, you know, burdens on police departments.

Children are moved from one school district to another. It puts burdens on the school districts. And all this happens at a time when the tax base is declining.

There is one solution out there that has passed through the House Judiciary Committee with bipartisan support. A compromised bill was passed out of the Committee. And to get the bipartisan support, it was narrowed very much to make sure that it would relate only to those loans that will end in foreclosure.

It guarantees the lender at least what they would recover from a foreclosure sale. And it is all done under the supervision of the courts in an existing system under the bankruptcy court system.

This is H.R. 3609. And I would urge you to look at this. Although it would help everyone, not vets alone, it will help everyone including vets.

And I do believe—well, we will hear about some voluntary efforts that have been underway. There have been many programs since May of 2007 and most recently the Hope Now Program. These are good programs. They will help some people. But they are not going to address the problems sufficiently.

Foreclosures are outstripping loan modifications by 13 to 1 on these loans we really need to see modified.

Thank you.

[The prepared statement of Ms. Harnick appears on p. 45.]

Ms. HERSETH SANDLIN. Thank you very much for your testimony. Mr. Gilmore, you are recognized.

STATEMENT OF LARRY GILMORE

Mr. GILMORE. Madam Herseth Sandlin and Ranking Member Boozman, thank you for the opportunity to testify today.

My name is Larry Gilmore. And I want to tell you how the HOPE NOW Alliance is making real progress to reach at-risk homeowners, including veterans and active personnel to find solutions to prevent foreclosures.

The HOPE NOW Alliance is made up of a very diverse group of organizations, which includes counselors, lenders, investors, other mortgage market participants as well as key trade associations. All focused on at-risk homeowners with the goal to provide solutions to avoid foreclosure.

We now have a total of 27 loan servicers who are active participants that make up over 90 percent of all subprime service loans and a good portion of prime service loans.

We also have a strong group of counseling organizations that are active participants. That includes NeighborWorks, which represents over 240 on-the-ground grass-roots committee organizations, as well as the Home Ownership Preservation Foundation, which serves to facilitate all the calls that come through our national HOPE Hotline.

The members of HOPE NOW are committed to producing results. Loan servicers who join HOPE NOW commit to a statement of principles, which includes assisting distressed homeowners to remain in their homes.

My written testimony contains those principles, which include contacting and assisting at-risk borrowers 120 days prior to any adjustable rate mortgage resetting. That also includes servicers working to provide counseling agencies toll-free 1–800 numbers, fax numbers, and email addresses to increase communication with servicers.

We are also publicizing a list of phone numbers of HOPE NOW servicers that consumers can call to receive help. In fact, Financial Services Committee Chairman Frank and Ranking Member Bachus recently sent a “Dear Colleague” letter to House Members to alert them of these numbers.

The major challenge is that borrowers in trouble are reluctant to ask for assistance. It has been stated that over 50 percent of borrowers who go into foreclosure have very little to no interaction with their servicer. We are attempting to make a difference in that space.

HOPE NOW has an aggressive monthly direct mail outreach campaign to at-risk borrowers. This effort is in addition to thousands of letters and telephone calls that servicers make on their own to customers.

We have seen major results with this campaign. This campaign has been in place since November of 2007. And to date, we have sent out over 100—excuse me, over one million letters to borrowers who are 60-plus days delinquent. In November, we experienced a response rate of 16 percent, in December a response rate of 21 percent. And this response rate is a lot higher than the typical response rate servicers receive on their own of 2–3 percent to letters.

And so we are increasing contact we are having with borrowers who are most at risk of going into default. HOPE NOW is actively reaching out to borrowers and providing counseling services, mainly through our national HOPE NOW—excuse me, HOPE Hotline, 888–995–HOPE. This hotline is managed by the Home Ownership Preservation Foundation. We are currently averaging over 4,500 calls per day that go into this counseling hotline.

And we have over 400 counselors who are ready to assist borrowers 24 hours a day, 7 days a week, providing counseling services in English as well as in Spanish.

To date, the HOPE Hotline has received over 456,000 calls, which led to counseling for over 165,000 homeowners. The call volume has increased nearly ten fold between the first quarter of 2007 and the fourth quarter of 2007. More homeowners with adjustable rate mortgages are also calling. Forty-eight percent of callers in the fourth quarter of 2007 compared to only 34 percent the first quarter of 2007.

The Home Ownership Preservation Foundation also has an exciting partnership with the USA Cares to assist families of active-duty military personnel. To date, they have assisted 154 families by making back mortgage payments. And 130 loans have been reinstated and 24 are in repayment plans. I provided a few of these examples in my written testimony.

The Bush Administration, during his State of the Union Address, spoke directly about the HOPE NOW Alliance initiative as well as Secretary Paulson with the Department of the Treasury. And Secretary of HUD Jackson also speaks to encourage borrowers to use this hotline.

We strongly encourage Members of Congress to continue to encourage borrowers to call this hotline to ask for assistance.

NeighborWorks also worked with the Ad Council on anational television, radio, and print advertisement campaign to encourage homeowners to also call this hotline. In addition to these efforts, we have other efforts where we are directly targeting borrowers on the ground, providing assistance.

Over the next 4 months, we are going to be in multiple markets across the country where we are focused on providing assistance to assist borrowers through having our servicers meet with borrowers face to face on the ground. And we are starting this campaign in California next week, on March 3rd, in Riverside. And then we are moving to Anaheim on March 5th and concluding in Stockton, California. And we are working directly with local non-profit agencies on the ground in our servicing community.

With that said, I will conclude my comments. Again, we appreciate you allowing HOPE NOW the opportunity to speak. And we can talk a little bit later hopefully in regards to data results.

[The prepared statement of Mr. Gilmore appears on p. 51.]

Mr. DONNELLY. Thank you very much. And I would like to turn it over to Ranking Member Boozman.

Mr. BOOZMAN. Thank you very much. Ms. Harnick, you note the need for policy action to realign the interest of people who buy homes, institutions that provide the loans, and the entities that invest in the mortgages.

What would be the central feature of the policy that you are talking about? How do we do that?

Ms. HARNICK. Well, in order to address that issue, what we need to do is when we say "misaligned incentives," what we are speaking of is a state of play now. What Mr. Kubarych was saying the broker is—just has an incentive to just make a commission.

And the Wall Street investor has an incentive to get the most return on the loan. And all of this operates without regard to whether you are putting the borrower into a loan that is going to be sustainable over the long term.

And so for the aspect of the policy that we are referring to there, what you need is to mandate sensible underwriting standards, ensure that borrowers are put into loans that they can actually afford to remain in over the long term, and make sure that responsibility for that translates to all the market actors who would have an incentive to either behave consistent with that or not.

Mr. AGURS. Mr. Boozman, there is another part to that. Being one of the guys who is on the ground with the borrower, with the home buyer, driving them around in my car, and looking at homes and everything else, people are desperate for home ownership.

But on the other side, when the prime and conventional lenders disenfranchise whole segments of a population, people have to go someplace, because they want the dream of home ownership. When the prime lenders block them out and disenfranchise them, and when they—when they—when the FHA and the VA programs are so low that they can't even use those tools that are designed to help those segments of the population, people have no choice but to fall to the subprime market.

So part of everything that is going to help solve that problem, let us not forget about how people are being disenfranchised. The prime and conventional lenders also are going to have to look at that to open up their window a lot more to allow these people who are desperate for home ownership all across America achieve that dream as well.

Mr. BOOZMAN. How do you respond to that, Ms. Harnick? I guess what you are saying is that because the prime standard is too high?

Mr. AGURS. Yes, sir.

Ms. HARNICK. Well I am not sure. I wouldn't diagnose the problem that way. I mean, I think the two fundamental problems we face today are one, how do we ensure that the kinds of loans that have been made don't get made going forward.

And, two, how do we deal with the people who are in those loans today?

Mr. BOOZMAN. Right. No. I think what he was saying was that in the future we have got the problem that we are dealing with now.

Ms. HARNICK. Yes.

Mr. BOOZMAN. And I think you have addressed that well. On the other hand, he is saying that there, and again, I am not putting words in your mouth. But my understanding was there is such pressure from people that don't quite qualify for the prime qualifications.

Ms. HARNICK. Mm-hmm.

Mr. BOOZMAN. What do you do about those people in the future?

Ms. HARNICK. Well you can make responsible subprime loans. You can lend to people who don't qualify for prime loans. It is just that you need to ensure that the terms of those loans are not going to doom them to fail.

Mr. BOOZMAN. Right. I agree. That is very good. Thank you.

Ms. HERSETH SANDLIN. Mr. Donnelly.

Mr. DONNELLY. Thank you, Madam Chairwoman. In regards to H.R. 3609, it would be good for the borrowers, good for the lenders too?

Ms. HARNICK. Is that the question? Yes.

Mr. DONNELLY. Yeah, that is the question.

Ms. HARNICK. Yes, Mr. Donnelly.

Mr. DONNELLY. Does it work for both ends?

Ms. HARNICK. I think that is absolutely right. The way the bill has been narrowed to get the bipartisan support it needed in Committee, the bill will only apply—the only loans that will be subject to modification are those loans that would end in foreclosure.

And the way they accomplish that is you have to pass—the borrower has to pass a means test. So you look at the homeowner's monthly income. And then you make a deduction for modest living expenses set by the IRS. And if the homeowner has enough money left over to pay the mortgage, they have to pay the mortgage. They can't benefit from this help.

The help is available only for those families who will lose the home in foreclosure without modifying the loan. And so what the bill does is it says we will guarantee that the modification is structured in a way that the lender will get at least as much as they would get from the foreclosure sale.

Mr. DONNELLY. So why would a lender object to that?

Ms. HARNICK. Well——

Mr. DONNELLY. If there is any reason.

Ms. HARNICK. I mean, I think——

Mr. DONNELLY. If they are going to come out with a decent loan as opposed to one that goes underwater and sinks.

Ms. HARNICK. I think it is very difficult frankly to articulate a reason why this outcome is not good for the lender. That is all I can say.

I know that there are different—servicers sometimes have different incentives. And that is part of the problem. But there is not a good reason.

And, in fact, what I think everyone recognizes is that the only way to avoid these foreclosures is to modify these loans so that they are sustainable.

And everyone recognizes that to go to foreclosure sale, where a lender gets liquidation value at best after incurring substantial costs, often having to maintain the property for the 2 years it could take to complete the foreclosure, it is very difficult to see why guaranteeing market value paid back at a rate that is above prime—it is prime plus a risk premium to account for the fact that this is a risky borrower, it is very difficult to see why that is not at least as good an alternative to a liquidation sale.

Mr. DONNELLY. Okay. And, Mr. Agurs, in my home State of Indiana, in 2003, there were about 8,000 VA loans made.

Mr. AGURS. Mm-hmm.

Mr. DONNELLY. In 2007, 2,000, about 25 percent of what there was just 3 or 4 years earlier. Is that because you think a lot of these vets were steered into some of these loans, or how would you explain that kind of a drop?

Mr. AGURS. Mr. Donnelly, I will use California as an example.

Mr. DONNELLY. That would be great.

Mr. AGURS. That is the State that I am in. Our median home price in California is $588,000. The maximum loan amount on a VA loan is $417,000.

Mr. DONNELLY. So they can't be used.

Mr. AGURS. It can't be used. And even if we roll that back a few years, when the VA loan guarantee was $240,000, the only way for somebody to own a home that was a veteran who had a VA certificate of eligibility—and I will say that is one of the most important things that we as veterans look to is that VA guarantee, is to go outside of that arena. And one of the hallmarks is the 100-percent financing on the VA dollar down ability to purchase a home.

Most of our active-duty servicemembers and veterans don't have 3-percent, 5-percent, 10-percent, or 20-percent downpayment to become a homeowner. But because of the promise, because of the guarantee, we absolutely believe that the VA—the VA home loan guarantee is a very best bet. But because of the low limits, not only can they not afford it, and to a great degree a lot of the lenders don't even understand the VA program.

And I will say as a result of that, they send them somewhere else where they would find it an easier fit to help them achieve the dream of home ownership, yet there is ramifications on the backside of it, which is what we are seeing right now.

Mr. DONNELLY. So do you think it is a fair statement to say that with a lot of the vets, the price of the homes just start to get so much that they couldn't stay in the game?

Mr. AGURS. Absolutely.

Mr. DONNELLY. And that is probably—do you see that as one of the main reasons for the drop?

Mr. AGURS. I see it as one of the main reasons for the drop. And the other reason for the drop, if you look on part of it, bottom line it is more profitable for lenders to do a conventional or FHA loan than it is to do a VA loan.

Mr. DONNELLY. Okay. And then, Mr. Gilmore, in regards to the HOPE NOW, and we appreciate everything that has been done in regards to that and everybody who is participating.

With servicers, we talked about starting 60 days before. Do you think it would help even more if they started contacting these homeowners 6 months before the ARM goes off to get in touch with them and say, okay, what product can we work with? What is a price point for you, as opposed to 60 days? I know 60 days may sound like a lot to some. But to others when you have four kids running around and you have other bills you are working on, that can sometimes be a very short time frame for the largest investment you will ever make in your life.

Mr. GILMORE. Yeah, definitely, the earlier the better. And actually in our statement of principles, all of the servicers agree to contact borrowers who are in adjustable rate mortgages 120 days prior to loan reset. And so that is close to 6 months.

But the earlier they can contact that borrower to inform them that that rate is going to change, they can better prepare that borrower to either refinance into another product or change the situation where they can prepare for the loan resetting.

Mr. DONNELLY. You know, I am fortunate enough to also be on the Financial Services Committee. And I can tell you that a large number of the Members of that Committee look at that 6-month timeframe as the timeframe that really provides both the lender, or the servicer rather, and the homeowner with the time to get in contact with the homeowner, who is probably nervous and scared anyhow, and hears from the bank, or hears the bank's name, and wants to put the phone under the bed and pretend it didn't ring.

Mr. GILMORE. Right.

Mr. DONNELLY. And so you have to spend some time just talking just to get them to talk to you. And so many of us look at that 6-month timeframe as one that provides an appropriate time to start working on these things.

Mr. GILMORE. That is good to know. The good thing about the HOPE NOW Alliance, what we are attempting to do is really set the floor for the servicing industry. And the good thing is many servicers have established their own best practices. But we have a number of members who are participating. And that is something we could take back as a potential option for the Alliance members to consider.

Mr. DONNELLY. If you would—I would appreciate it, because it doesn't cost you anything more. You just have to get engaged a little bit earlier. Thank you, sir. Thank you, Madam Chairwoman.

Ms. HERSETH SANDLIN. Thank you, Mr. Donnelly.

This may have been mentioned while I had to step out. Mr. Agurs, I think you will be happy to know, and you maybe already know, that there have been bills introduced already including from Chairman Bob Filner and Ranking Member Buyer of the full Committee that include some of the provisions that you have identified and recommended as improvements to the VA Home Loan Guarantee Program. We appreciate the recommendations that you have made today.

I would like to pursue a little bit further, separate from what H.R. 3609 includes, Ms. Harnick, do you think that we need to approach the problems that we are seeing in a way that makes a distinction between those who are in trouble that would have qualified for a prime loan and those who wouldn't have?

For example, what is your response to the idea of a specific government lending program that gets us away from the 12-percent interest versus the 5 percent? Should we target that to the people who wouldn't have qualified for a prime loan? Do we require the lenders to refinance and do loan modifications with those that would have been eligible for a prime loan? What are your thoughts on that?

Ms. HARNICK. The distinction between someone who would have qualified for prime and not, we should also remember that there are those who would have qualified and could have afforded a 30-year fixed rate subprime loan as well. But I don't know that that's the key distinction. To answer the question about this idea of refinancing, having a refinancing option, I think it is certainly very much worth looking at. I think as we said on the first panel, it is an option that makes sense for borrowers who have equity in their homes. If you tried applying that option to borrowers who were upside down, as they say, where they owe more than the home is worth, then what you have is the taxpayers transferring money to the lenders to pay them the fair market value on a loan that is only secured, pay them more than the fair market value on the loan.

So I think it is a solution that is definitely worth thinking about for people whose problem is not that their loan is worth more than their home. I think that for people whose loan is worth more than their home, I think what you want to see is a modification of that loan that would get the lender what they would get if it was sold at foreclosure, which is the option, get them at least that. But you may as well get that for them in a way that keeps the family in the home because not only does it benefit that family, but it helps avoid the decline in the rest of the neighborhood.

Ms. HERSETH SANDLIN. Mr. Hall. We have been joined by Mr. Hall from New York, also another Subcommittee Chairman. Did you have questions for witnesses?

Mr. HALL. Thank you, Madam Chair, and Ranking Member Boozman. And I apologize to both of you and to the witnesses for being late. I am, as are many of us, double and triple booked. And I just had one question I guess, and forgive me if it's already been asked. But I guess first for Mr. Gilmore, are the problems affecting active-duty veterans who are returning soldiers different from those affecting the Guard and Reserve?

Mr. GILMORE. That is a good question that I really do not have an answer for. Our effort is really designed to assist all borrowers who are in delinquency and who are headed to foreclosure. And we have not done any specific analysis to separate how veterans and active-duty workers are assisted compared to all borrowers, all of those borrowers who are headed toward delinquency.

Mr. HALL. Anybody else, Ms. Harnick?

Ms. HARNICK. You know, I——

Mr. HALL. I am just curious because in my, well, in all of our districts, but in my district in particular there is a deployment, redeployment, redeployment of Guard and Reserve, as if they were active duty. And many of these soldiers live in very different circumstances from active-duty people who are on a base. And I think they are, you know, leaving jobs and homes that they did not think they were going to be taken away from for a year or two at a time. And their families are under financial and other stress that I would imagine it would translate into the danger of foreclosure. But——

Ms. HARNICK. Well the one thing I could say is that some of the, the way these loans were structured that was so dangerous, some of those aspects are particularly problematic for servicemembers, or people who are called up in the Reserves. So that for instance, the prepayment penalty, the loans are structured so that if you pay the loan off before the rate jumps up you have to pay a fine for that. And that is hard for anybody. But I would, anecdotally, what I have heard from veterans is that it is particularly difficult for people who have a military career because they move so much. They are often called upon to move before the rate resets, which means they are going to have to pay a prepayment penalty. And it is, these are pretty expensive. In fact, they are so expensive that typically people pay them, in the subprime market anyway, pay them by increasing their loan balance to cover the new fine they have to pay on top of repaying the loan. So things like that I think are particularly problematic for people who are called upon to move. Particularly when they move on short notice.

Mr. GILMORE. Mr. Hall, I can give you a more specific answer to that as well. In regard to active duty, plus the Guard and Reserve who are called to active duty, I think that if you look at using a more judicious use of the Soldiers, Sailors, and Airmen's Relief Act it will have a lot more teeth in it that will help our active duty and Reserve folks who are in these issues right now. And I do not think that has really been explored, using that effectively.

Mr. HALL. So it seems that as with other issues that we try to help veterans deal and help the VA deal with, that information and outreach is probably one of the key components to make sure that, that the veterans or soldiers, servicemen and women are educated as much as possible about the options that are open to them, or the ones they shouldn't take. And also, that we probably should be doing more to educate lenders about their responsibility, or their patriotic responsibility, I think, to treat our veterans or our soldiers fairly in this regard. Some of it is bully pulpit and education, as well as——

Mr. GILMORE. When the Servicemembers Civil Relief Act is specifically designed to help active duty and Reserve component servicemembers specifically for situations like this.

Mr. HALL. Thank you very much, Madam Chair.

Ms. HERSETH SANDLIN. Mr. Boozman, did you have any further questions? I have one follow-up in terms of the distinction, in terms of where the problems become more manifest, active-duty servicemembers versus National Guard and Reserve. I know, Ms. Harnick, you talked about some of the anecdotal evidence you are hearing in terms of the number of times that active-duty personnel move. Are any of you aware of any type of evidence similar to what we were hearing a couple of years ago in the payday loan industry? An unregulated area where servicemembers were the targets of some predatory lending? There are allegations about that in terms of where they were setting up right outside of bases. Do we have any evidence to suggest this? I know we have heard different testimony today in terms of how we got to this problem. Servicemembers and their families were being identified by some of those operating in the unregulated sphere of pushing the product in terms of the adjustable rate mortgages for those higher commissions. Is there any evidence?

Ms. HARNICK. Well I can say this, and again it is going to be just anecdotal evidence. But I know, I have a vet who works with me and he is constantly getting mailings that are aimed at veterans that are, you know, come from subprime lenders. And I have seen some of the ads for some of the subprime lenders that specifically target, you know, they call them patriot loans or things like this, and that meant to particularly target veterans. But this is simply anecdotal.

Ms. HERSETH SANDLIN. Is that for people who have separated from service? Or?

Ms. HARNICK. I am sorry, I cannot answer that.

Ms. HERSETH SANDLIN. Well, I appreciate your testimony and responses to our questions. There may be some follow up in written form, but thank you again for being here before the Subcommittee. We appreciate the good work that you're doing in the industry and the insights that you have offered to us here today. Thank you.

I would now like to invite panel three to the witness table. We have one final witness here on our third panel today. We invite her back to the Subcommittee, Ms. Judith Caden, Director of Loan Guaranty Service for the U.S. Department of Veterans Affairs. Thank you for being here. Thank you for your written statement, and you are recognized for 5 minutes.

STATEMENT OF JUDITH A. CADEN, DIRECTOR, LOAN GUARANTY SERVICE, VETERANS BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF VETERANS AFFAIRS

Ms. CADEN. Thank you for the opportunity to appear here today to discuss the subprime mortgage crisis and America's veterans. As we have been hearing, subprime is a generic term to describe mortgage loans with interest rates higher than prime rates. The subprime loans that are causing the current crisis usually have several layers of risk associated with them. These layers of risk are generated by a combination of one or more factors, such as lack of income verification, lack of asset verification, lack of underwriting, low borrower credit scores, large margins, low teaser rates, etc. VA Guaranty Loans, on the other hand, have none of these characteristics and have carried an average borrower Fair Isaac Corporation (FICO) credit rating of around 680 as opposed to the subprime average of below 620.

Credit losses mounted from the record setting losses of the subprime loans made in 2000 and since, and secondary market investors recognize this risk and have priced the potential losing money on future investments to the point where originators of subprime mortgage loans could no longer afford to sell them. This lack of liquidity in the secondary market has had a tremendous impact on the ability and desire of lenders to originate subprime loans.

Again, VA guaranteed home loans are not subprime products. VA guaranteed home loans must be written and made in accordance with our credit underwriting standards. Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses, and that the veteran is a satisfactory credit risk. The VA program has faired well in recent years with regard to foreclosure rates. According to data from the Mortgage Bankers Association, between the third quarter of 2005 and the third quarter of

2007, VA's serious default rate declined while all other mortgage types, including prime loans, rose.

That said, we do operate in the broader mortgage marketplace and will be collaterally affected by the subprime turmoil currently affecting the market. This collateral effect will generally be the result of declining housing prices. With additional foreclosed homes on the market, a glut of new construction available, and weak demand, the inventory of unsold homes has risen. Concurrently, credit has tightened as investors withdraw funds from the mortgage market, causing even some well qualified buyers to experience difficulties in obtaining new mortgages. With supply now exceeding demand, prices for homes have naturally declined. In the current marketplace there are fewer borrowers able or choosing to purchase homes and therefore fewer opportunities to sell homes. We expect that the deflation in house prices will eliminate certain foreclosure avoidance tools that were previously available to us, especially the ability to sell a property to prevent foreclosure, with the net result being more foreclosures.

For veterans who have obtained a VA guaranteed home loan we can offer supplemental servicing assistance during times of financial hardship and default. When we receive notice that a veteran borrower has become seriously delinquent we take an active role in working to avoid foreclosure. We intercede on his or her behalf with the loan holder. And we work to make them get mortgage payments that they can handle. There are other alternatives that we also work on. I think it was already mentioned that we were able to intervene in over 8,000 instances. We kept those veterans in their homes. For a veteran or servicemember who has obtained a subprime loan we can offer general advice and guidance through our nine regional loan centers, and they have been getting some calls. But there really is nothing we can do on their behalf with a lender. Regrettably, there are veterans who have subprime mortgages who will be adversely affected by the subprime crisis. We are authorized to guarantee refinancing loans, however I think, as you have already heard, there are limits on those loans and what we can do. There has to be an equity position and they are effectively limited to $144,000.

We are proud of the success of the VA Home Loan Program in helping veterans obtain and retain homes. While we have expanded and modified over the years we have retained sound underwriting criteria.

Madam Chairwoman, that concludes my testimony and I look forward to answering any questions you or the Committee may have.

[The prepared statement of Ms. Caden appears on p. 59.]

Ms. HERSETH SANDLIN. Thank you, Ms. Caden. The Home Mortgage Disclosure Act does not require veteran status to be collected as part of the applicant's data. What are your thoughts? Do you think we should, in light of some of what we heard in some of the earlier panels, relating to going forward with making sure that if we make any modifications to the VA Home Loan Guaranty Program that they are well-informed changes that can be sustained in light of what else is happening in the current housing market?

What are your thoughts? Do you think it is worthwhile to collect that data?

Ms. CADEN. I think that would be very helpful. We have been asked, just like many others, about how many veterans are affected by what is going on right now. We cannot answer that question, and really no one can because that is not a demographic that is collected. So I certainly think it would be helpful.

Ms. HERSETH SANDLIN. Do you think it would be helpful to respond to some of the questions we are getting about how many veterans are affected? Also, perhaps upon application, if a particular veteran is either denied a prime loan or moves and is looking to finance another home? An application that would give you data to access to be able to outreach and share information about the VA Home Loan Program?

Ms. CADEN. I think it would. We could certainly be more communicative with veterans because we would know who they are, where they are, and what they are doing. The education and the outreach are very important. We work mostly through the lenders and the real estate agents to inform veterans of the VA program and make sure they are aware of it. Certainly if they are asking that question and it is being disclosed up front, that is an opening to start to talk about the Home Loan Program.

Ms. HERSETH SANDLIN. Mr. Boozman.

Mr. BOOZMAN. In follow up, if you did that would that help you with knowing if veterans were being targeted?

Ms. CADEN. I would think it would. We would be looking at what types of loans they are getting and also at the denial rates.

Mr. BOOZMAN. Yeah, I think that would be very helpful.

Ms. CADEN. I think it would.

Mr. BOOZMAN. All of our witnesses have done a very good job of telling us and really helping me understand a lot more about the problem as to why we are there and things. The reality is that we are there. If, in your opinion, what kind of a PAYGO problem would we run into if we authorized VA to refinance loans for properties with a 10, 15 percent negative equity as long as they were current on their payment? Would that be a big PAYGO problem or not?

Ms. CADEN. I do not believe it would, especially if there were certain parameters of how much VA's payment would be, and also if we were still underwriting the loans and making sure the veterans qualify. And I think we would.

Mr. BOOZMAN. Do you have any opinion as to whether or not that would be a worthwhile thing to do, or?

Ms. CADEN. In my personal opinion, looking at what is happening right now, I think it would be worth looking into.

Mr. BOOZMAN. Mm-hmm, very good. That is really all the questions that I have, Madam Chair.

Ms. HERSETH SANDLIN. Thank you, Mr. Boozman. In light of what we heard from Mr. Donnelly, and I think you were here during his questions, and when we see the data and the fewer number of not only foreclosures, which is a good thing, but of the guarantees. Is the number too low? You know that there have been bills introduced, and we may be having a legislative hearing to get your comments in more detail about some of the bills that have been introduced. Is your sense that in light of what has been happening in the current housing market, particularly in the States that were cited earlier that have a very high veteran population, where those home values have been and the trend upward that we have been seeing until the current housing crisis in those communities, is it too low? Do we need some more flexibility as it relates to the equity restrictions or the total amount that can be guaranteed?

Ms. CADEN. Well, certainly in the area of the regular refinancing loans because those are limited to the $144,000 and require an equity position. In today's market, that's probably not realistic, in my opinion. Even with the $417,000 effective loan cap, I think there are areas where veterans are not able to utilize their earned benefit because of that.

Ms. HERSETH SANDLIN. Okay. I think that is the only question that I have for now as well. Again we look forward to working with you as we work toward addressing some of the proposals that we have heard today, and some of the bills that have been introduced, as we take a closer look at those. The Subcommittee is interested in your insights, in addition to what we heard from Mr. Bisenius with what some of the GSEs have done in terms of the servicing standards. It is clear here, as well in terms of what the VA has done in intervening on behalf of the borrower with the lender as well as some of the suggestions that were made with regard to FHA and other programs that have been very useful to many borrowers, that there is a way that we can find different mechanisms that do not overreach. Rather, working with existing programs, working with the mortgage industry, to find a way to help borrowers in different situations.

Mr. Donnelly made a very good point earlier about the fact that many of our veterans are in this discrete subgroup that are waiting for disability ratings and compensation. That would help alleviate some of their problems in the short term. One of the recommendations of Ms. Harnick in her written testimony was protection for a year for veterans, perhaps, or at least for some period of time. We have addressed some of that in the Subcommittee previously. We appreciate your expertise and the information that you consistently provide to the Subcommittee and members of our staff. I thank you for joining us and for your testimony, and I look forward to working with you.

I do want to commend, in particular, all of the staff at the VA for being such staunch advocates for our veterans on a whole host of issues, but particularly with how they are getting caught in the mortgage crisis that the entire country is experiencing right now. We value everyone's expertise and insights that they offered, and interest in today's topic. Thank you, Ms. Caden, we look forward to seeing you again soon. Thank you to all of our panelists today. The hearing stands adjourned.

[Whereupon, at 3:45 p.m., the Subcommittee was adjourned.]

A P P E N D I X

Prepared Statement of Hon. Stephanie Herseth Sandlin, Chairwoman, Subcommittee on Economic Opportunity

In July 1943, President Franklin Delano Roosevelt recognized the need to invest in our Nation's troops after their service to our country by highlighting that "the members of the armed forces have been compelled to make greater economic sacrifice and every other kind of sacrifice than the rest of us, and they are entitled to definite action to help take care of their special problems." One year after this speech, President Roosevelt signed the Servicemember's Readjustment Act of 1944, which included readjustment benefits to help our veterans with education, housing, and employment opportunities.

Sixty-four years later, we in this Subcommittee find ourselves reevaluating that law and others to address the needs of today's servicemembers, veterans and their dependents. While we have held at least nine Subcommittee hearings on education and employment issues, today's hearing gives us the opportunity to assess how the current housing market affects our veterans and determine if the VA's home loan programs have a role to play in the closures affecting our communities.

This past Tuesday, RealtyTrac, an online retailer of foreclosed properties, released its January 2008 foreclosure report that highlights that the foreclosure rate has increased 57 percent when compared to the same month in 2007. It might be safe to say that no one in this Subcommittee has seen more recent foreclosure rates in his Congressional district than Congressman Jerry McNerney where his metro area of Stockton, California, was ranked the second highest rate of foreclosures in 2007.

As we will hear from our distinguished panelists, data specific to veterans does not exist, or is limited in scope, leaving us with an incomplete puzzle that makes it harder for us to get a good idea of how current mortgages are affecting our veterans. Fortunately, many of us have heard from our returning servicemembers and veterans back home about the problems they have encountered. Problems such as that expressed by Mr. Marty Dubois, a veteran, concerned about losing his home because he does not qualify for a VA home loan due to the equity requirements. We have also heard several complaints from veterans residing in high-cost residential areas in which the current VA home loan is insufficient, and this will effectively price them out of the market.

As you can see on the television screen above, veterans are still being caught-up in the mortgage crisis and we should only expect this problem to worsen. The image of Mr. Hector Mesas, a veteran crying after telling Senator Hillary Clinton about the difficulty he has with paying his mortgage, was posted on yesterday's Washington Post Express paper. Mr. Mesas, and the thousands of veterans throughout our country deserve better, and we must do better to ensure they are afforded the protections they need as they adjust to life after their military service.

I look forward to working with Ranking Member Boozman and Members of this Subcommittee to continue to improve readjustment benefits available to all servicemembers and veterans. I now recognize Mr. Boozman for any opening remarks he may have.

Prepared Statement of Hon. John Boozman, Ranking Republican Member, Subcommittee on Economic Opportunity

Good afternoon. Madame Chairwoman, you have chosen an especially timely topic for today's hearing.

Every day, the media reminds us of the difficulties facing our national economy because of the subprime mortgage crisis. It is clear from reading today's testimony that America's veterans, regardless of whether they have a subprime mortgage or not, whether they are current in their payments or not, will be affected in some way by this financial mess.

It is also clear from our witnesses' statements that there is plenty of blame to go around. It appears that every level of our national economic structure has played a role in allowing this to happen. It would be too easy to blame just the borrowers who fooled themselves into believing they would never be faced with increased payments. Or the lenders and brokers who encouraged such behavior with highly speculative mortgage products. Or big investors and Wall Street financial services giants who appear to have demanded increasingly risky transactions. I guess you could say there was enough greed to go around.

So, the question before us today is what can VA do to help veterans stuck in this mess? Under current law, their options are limited. But we must be careful here. VA wisely has maintained its underwriting standards and as a result, taxpayers are not seeing their funds wasted. The VA guaranty program is solvent and does not reflect the difficulties in the subprime market. As we will hear from our witnesses, the mortgage business is very complex, with multiple levels of markets, borrowers, lenders and investors and the potential for negative unintended consequences is significant. I want to work with you to keep the VA program stable and financially viable so that tomorrow's veterans will benefit just as yesterday's and today's have.

I look forward to any suggestions our witnesses may have to ease this situation.

Prepared Statement of Roger M. Kubarych, Chief U.S. Economist, UniCredit Markets and Investment Banking, and Henry Kaufman Adjunct Senior Fellow for International Economics and Finance, Council on Foreign Relations

Madame Chairwoman, members of the Subcommittee:

Thank you for inviting me to testify on the important topic "Subprime Mortgage Crisis and America's Veterans." As a financial-sector economist trying to make sense for UniCredit management and clients of what has gone wrong in the U.S. mortgage market, and as a part-time scholar with the Council on Foreign Relations engaged in a multi-year project assessing the strengths and deficiencies of what I've called "Americanization of Finance," I am still stunned by the severity of the developments that have taken place. From an unsustainable boom in U.S. housing markets, we have watched a massive contraction in activity since 2006, evidenced by plunging housing starts, sales and prices. The consequences have been truly painful for many. Numerous homeowners are struggling with mortgages they cannot afford. Major banking and other financial institutions here and abroad have suffered enormous losses, and their ability to conduct normal lending activities is impaired. And the whole sorry episode has contributed to diminished respect internationally for the integrity of the U.S. financial system and its guardians, perhaps most conspicuous in the decline in the value of the dollar in foreign currency markets since the crisis broke out last summer and a worrisome escalation of commodity prices, not least crude oil.

Veterans are affected by the subprime mortgage crisis and the broadening financial turbulence that developed in its wake in at least four ways:

First, some veterans are directly involved because they bought homes financed by subprime mortgages, which too often contained a raft of unfriendly or outright abusive terms and conditions, and are now unable to stay current on their debt-servicing obligations. Some portion of these veterans may be already facing delinquency or even loss of their homes through foreclosure.

Second, many other veterans are impacted indirectly, as a result of the widespread decline in the value of houses throughout much of the United States. The current values of their homes are caught in the overall housing slump, and their personal net worth is or will be contracting. Not all will be impacted equally. Those veterans who bought their homes years ago probably still have substantial unrealized capital gains, despite the recent moderate declines in average home prices. But any recent veterans who bought houses near the peak in the housing boom are going to lose a good portion, maybe all, of the equity they had in their homes. The standards of living of many veterans will take a hit.

Third, all veterans, just like every American, are hurt by the diminished availability of credit because of the squeeze on many banks and other financial institutions who made unwise investment decisions, suffered losses, and are now straining to repair wounded balance sheets.

Fourth, veterans, along with the rest of us, are facing higher costs for energy and other imports as a result of the decline in the value of the dollar and the rise in commodity prices, both traceable in part to the erosion in confidence in our financial markets and our currency.

These are big negative effects. That's why it's understandable why so many economists, whether in the private sector, in the Federal Reserve or in the U.S. Government, are either predicting a business recession or raising the odds that a recession might develop.

Before making a few suggestions about what might be done to ameliorate the adverse effects on veterans and other homeowners with these radioactive subprime mortgages, let me make a few points—highly abbreviated to save time—that might help put the current mess in some perspective.

1. Securitization of mortgages is not new. Securitization—that is, the pooling together hundreds or thousands of individual mortgage loans into a mortgage-backed security, MBS, that can be sold to institutional investors much like a traditional corporate bond—got started in the early eighties. That was a time when high inflation and correspondingly high interest rates were making it almost impossible for many commercial banks and savings & loan associations to offer mortgages. Within a few years, the useful innovation had caught on to such an extent that over half of all outstanding mortgages were securitized (the rest were held mostly by banks and thrifts). Here's some useful data, drawn from the Fed's Flow of Funds accounts, showing quickly and pervasively mortgage securitization caught on:

Mortgage Securitization:
From Humble Beginnings to Central Part of the System

	1975	1980	1985	1990	1995	2000
Total mortgages $ trillion	0.46	0.96	1.52	2.62	3.46	5.13
Percent securitized	5.3	11.1	25.2	39.9	50.2	54.8

Source: Federal Reserve Board, Flow of Funds.

[I left out the more recent data until later: since 2000 the market has had a new element: explosive growth in subprime mortgages and a different way of securitizing them, but I will come back to that shortly.]

2. Securitization done prudently provides immense benefits to nearly everyone: borrowers, investors, and the banks who engineer the process. From humble beginnings, securitization blossomed because it is a superior way of doing the business. Its inventors recognized that the traditional business practiced by banks and thrift institutions of originating mortgage loans, doing the servicing of those loans in-house, and holding them on their balance sheets posed enormous problems. Those problems were especially nasty when short-term interest rates were elevated or when individual cities and towns encountered localized economic distress. It was far more efficient to divide the single business model into three parts, with specialization in origination of mortgages, loan servicing, and investing. By this separation, large mortgage-market participants could amass expertise and advanced technology. And they could do it on a national playing field, reducing the risk of undiversifiable geographic lending concentrations that were often the bane of many local banks and thrifts.
3. Securitization couldn't have thrived without indispensable government support. Mainly that came from GNMA, FNMA, and FHLMC, commonly referred to as Ginnie Mae, Fannie Mae, and Freddie Mac. These government-sponsored enterprises, GSEs, facilitated the bundling of loans into MBSs, most importantly by taking over the risk of loss through default by individual homeowners on their mortgages and by setting high standards on the quality of the mortgages that they were prepared to guarantee (called "conforming" mortgages). That meant that buyers of pass-through securities (the simplest kind of MBS) didn't have to worry about credit risk so they could focus on the very difficult, but manageable, exposure to market risk that they took when investing in mortgage-backed securities. The private markets couldn't do it alone, but didn't have to, because of the integral role of the GSEs in the financial system.
4. Until the early 2000s, subprime mortgages represented a modest, almost inconsequential, part of the mortgage financing system. But by about 2002, things were changing rapidly. What happened? First, Fannie and Freddie, stockholder-owned and privately managed since the early nineties, lost control

of their operations. They got in the habit of doing more than absorbing credit risk and facilitating securitization but instead began to hold more and more mortgages in their own portfolios, financed through borrowing (relatively cheaply because of an implied U.S. Government safety net) in the capital markets. Some market professionals thought of them as running the biggest hedge funds in town. But in so doing they were taking huge market risks and relied on massive transactions in financial derivatives in order to try to hedge the risks they were taking. They handled this badly and for years their financial accounts have been a mess. CEOs and CFOs were replaced, fines were paid, and their overseer, OFHEO, essentially put limits on their growth until they got their financial houses in order.

5. This opened the door for major players in the private sector to move into the home mortgage financing business in a major way. And that included pushing the envelope on creditworthiness of borrowers. Long-tested rules of thumb on what once constituted sound banking practices went out the window. By 2006, upward of 40% of all new mortgages being originated were subprime or Alt A, i.e. deficient in some ways. It created a time-bomb when these loans were securitized through privately issued MBS or then recombined into collateralized debt obligations, CDOs. These are complex securities comprised of a variety of MBSs and other financial instruments, often involving substantial leverage. Last summer, they became almost unmarketable when buyers realized the potential for loss was far greater than they had ever imagined.
6. The growth in mortgage-related securities by what the Fed calls "asset-backed securities issuers" was stupendous. The data are in the chart below. From a relatively modest level, private securitization, increasingly involving subprime mortgages in the 2002–2007 period, has taken on an increasing and probably inordinate share of overall mortgage financing business:

Mortgage Securitization in This Decade, End of Period

	2000	2002	2003	2004	2005	2006	Q3 2007
Total home mortgages $ trillion	5.13	6.44	7.23	8.28	9.34	10.42	11.03
Total percent securitized	54.8	56.1	53.6	52.1	53.5	55.4	57.0
Percent securitized privately	7.5	8.5	9.2	12.7	16.7	19.7	19.8

Source: Federal Reserve Board, Flow of Funds.

7. The U.S. financial regulatory system was ill-equipped to deal with abusive lending practices of financial institutions not under the formal supervisory authority of the Fed or other traditional bank regulators. The majority of mortgage banks fell between the cracks. That was dangerous once their role in the mortgage financing suddenly escalated. As the housing boom fueled soaring home prices, large numbers of potential home buyers were eager to get in on the action. Many were not creditworthy under normal standards. But the mortgage bankers developed variations on conventional loans to allow them to borrow. Subprime mortgage products offered low teaser rates to attract customers. They let applicants lie about their incomes and put up small or even zero downpayments. But those borrowers would have to accept stiff prepayment penalties, a sharp break from normal U.S. customs, and agree to pay sharply higher interest rates when their initial low rates were adjusted in a year or two. A more responsive regulatory system would have stepped in to catch the most abusive tactics before thousands were trapped in loans they would likely not be able to carry.
8. The ratings agencies made poor judgments and were subject to intense conflicts of interest, since their compensation was paid by the issuers. They awarded high ratings evidently with little or no evaluation of the likelihood of default should house prices fall back.
9. Institutional investors were lazy and cheap: lazy, because they relied almost entirely on credit ratings rather than performing their own due diligence; cheap, because they didn't pay outside experts to "stress test" the conclusions of the ratings agencies under differing scenarios.
10. And many borrowers cynically got themselves into trouble by assuming that the housing price boom would go on forever. Instead they chased the dream of becoming mini-real estate speculators, while subjecting themselves to high and escalating interest rates in return for not having to tell the truth about their incomes and not having to put up sizable downpayments.

In short, there is more than enough blame to go around. What can be done, now that the situation has gone beyond the danger point?

While I don't have a formal policy proposal to offer, I do have four observations with which to conclude:

First, every first-year economics student comes across the concept of "externalities" or what are also described as "neighborhood effects." What this means is there is a market failure. And when there is market failure there is a strong case for public policy to counteract the negative effects. Foreclosures present an especially brutal externality as the adverse neighborhood effects are visible to everyone: who wants to live next door to a boarded up home taken over by a lender? Isn't it obvious that the value of every house in such a neighborhood is going to be undermined, to some extent or perhaps a lot, by foreclosures? So isn't there a strong public policy case for preventing them? Yes, and President Bush himself acknowledged such a case in his remarks of early September 2007. The sad thing is that the administration was agonizingly slow in following up on his call for a program to assist troubled borrowers so as to minimize foreclosures. Subsequent efforts, from Hope Now to the latest iteration announced by the Treasury Secretary a few days ago, are useful but insufficient.

Second, the case for a public policy response is further strengthened by another example of market failure: the provision of flood insurance. Everybody knows that private insurance companies have no interest whatsoever in offering flood insurance. Most homeowners are not at risk and wouldn't buy it. Only those who live in familiar exposed areas, along the Gulf Coast, or the Ohio River system, or similar spots, desperately need coverage but couldn't afford what a private insurance company would have to charge in order to provide such coverage profitably. So government has to step in, and even then not everybody who would benefit bothers to buy the affordable coverage government provides. Analogous arguments can be made for credit risk insurance.

Third, now that hundreds of thousands of homeowners, including veterans, are at risk of becoming delinquent and possibly losing their homes, the voluntary program for individual loan work-outs that is in place needs to be supplemented by something more comprehensive. The simplest approach would be for the government to offer affordable medium-term loans to low- and middle-income individuals to allow them to repay abusive subprime mortgages on their primary residences. That may require legislation to override particular terms in mortgage contracts that impose stiff prepayment penalties, a feature that was almost unheard of in American mortgages before the subprime mortgage explosion.

Finally, the financial regulatory system governing mortgage financing and securitization, by far the largest part of the credit markets and easily the most important for the vast majority of Americans, has to be fundamentally upgraded. The administration has put its emphasis on FHA and the GSEs. That is their prerogative. But other key elements of the system failed to function in the public interest. Appropriate implementation of the Banking Holding Company Act by the Federal Reserve has been spotty. The SEC has been slow in recognizing its enormous mistake in giving special pride of place to credit ratings agencies, thereby nurturing an unwarranted complacency among investors that somehow the SEC stands behind their methods and the ratings themselves.

America's veterans have served this country with skill and valor. They have a right to expect that the economy and financial system of this country is similarly managed in the national interest, even if that sometimes means that certain participants in financial markets must accept restraints on their activities. No one should be proud of what has happened in the field of mortgage financing in the past five years. And it shouldn't be allowed to get worse.

Prepared Statement of Donald J. Bisenius, Senior Vice President, Credit Policy and Portfolio Management, Freddie Mac

Chairwoman Herseth Sandlin, Ranking Member Boozman, members of the Committee:

Good afternoon. My name is Don Bisenius, and I am the Senior Vice President of Credit Policy and Portfolio Management at Freddie Mac. Thank you for the opportunity to address the subcommittee today, and to offer some of our thoughts on the subprime mortgages crisis and the effects it may be having on America's veterans.

Freddie Mac's Role in the Mortgage Market

Freddie Mac is a government-sponsored enterprise, or GSE, created by Congress with a public mission to bring liquidity, stability and affordability to the Nation's residential single and multifamily mortgage markets. Unlike the Federal Housing Administration or the Department of Veterans Affairs, we are not part of the federal government. We are a shareholder-owned corporation, capitalized entirely by private-sector money. We currently guarantee about $1.75 trillion of mortgage-backed securities, providing home ownership opportunities for nearly 11 million families.

Historically, Freddie Mac has guaranteed mortgages in the conventional conforming segment of the mortgage market—so-called "prime" mortgages for no more than the "conforming" limit, currently $417,000. Today, the conventional conforming market, supported by Freddie Mac and Fannie Mae, and the government market for mortgages insured by FHA or guaranteed by the VA, are the only well-functioning segments of the mortgage market. Long-term fixed-rate mortgages are widely available and rates are low. The market shares of the GSEs, the FHA and the VA all grew significantly in 2007, especially in the second half of the year, as the supply of funds from other investors disappeared. We are doing the job that Congress assigned us: helping to maintain stability by providing liquidity to the markets that we were created to serve.

The GSEs, like the VA, do not originate mortgages. We do not control what loans the primary market originates. What we can do is define what mortgages we are willing to purchase and guarantee. Because of our size and constant presence in the marketplace, in most economic environments the GSEs can influence what loans the primary market chooses to originate. Over the past 3 or 4 years, however, our influence waned as subprime originators found investors who were willing to assume more risk than we felt was prudent.

We do not track whether mortgages we buy are made to veterans, so I cannot tell you how many veterans' homes we have financed over the years. I am not aware of any data that would tell us how many veterans have subprime loans, but it is reasonable to assume that the impact of the crisis is at least as severe on veterans as it is on other borrowers.

We do offer mortgage products that help active-duty servicemembers and recent veterans buy homes. In 2006, we extended our flexible Home Possible® Neighborhood Solutions affordable mortgage products (originally targeted at teachers, police, fire and other public sector employees) to members of the Armed Forces and recently separated and retired military and military reservists. These are prime mortgages that permit eligible families with limited credit or downpayment savings to finance up to 100% of the value of their new home. Together with our lender customers, we have specific initiatives for military communities at Fort Benning, Fort Riley, Fort Drum and the naval installations in the Virginia Tidewater that focus on financial literacy and home ownership opportunities for active-duty servicemembers. Deployed servicemembers qualify for capped interest rates on mortgages sold to Freddie Mac under the Servicemembers Civil Relief Act.

The Subprime Issue

When the subprime crisis erupted as a national issue about a year ago, the conventional wisdom blamed the structure of short-term 2/28 and 3/27 subprime adjustable-rate mortgages (ARMs), in which interest rates are fixed for the first two or three years of the loan, and then adjust periodically. The theory was that "exploding" interest-rate resets caused large increases in monthly payments that made mortgages unaffordable for many families, and public policy responses focused on blunting the effects of payment shock. This remains a concern, but the Federal Reserve Board's continuing cuts in short-term interest rates will help avert "payment shock" for recent subprime borrowers by significantly lowering upcoming increases in their monthly payments.

We have come to understand that resets are not the only or necessarily the most important element of the story. More fundamentally, the subprime foreclosure crisis derives from a combination of (1) looser lender underwriting standards, especially with recent originations, that allowed speculation and may have put families into homes they could not afford to keep without continued house price appreciation; and (2) subsequent house price depreciation that makes it impossible or uneconomic for stretched borrowers either to sell or to refinance into new higher-balance loans as they might have in the past.

This does not mean that subprime mortgages are intrinsically bad; many subprime loans perform as agreed, even in today's market. Historically, they have helped families with weak credit become homeowners, in return for a higher interest rate to compensate the lender for the higher risk of default these loans pose.

Freddie Mac has participated in the subprime market as a responsible and prudent investor. We have not historically purchased or securitized subprime mortgages directly, and instead have limited our participation to investing in the highest-rated, least risky segment of the subprime mortgage securities market (also known as the subprime "private label" market). This participation reflects our charter objectives to bring additional liquidity to the mortgage market. It has also been an important contributor to our efforts to meet our HUD-mandated affordable housing purchase goals. In fact, by carefully tailoring our securities purchases, nearly 80% of the units financed by our 2007 subprime purchases met one or more of our three affordable goals—the low- and moderate-income goal, the special affordable (or deeply targeted) goal, and the underserved areas goal. This approach has proven to be very prudent, given the losses others are taking in this market.

In addition to providing liquidity, Freddie Mac has taken a leadership role in addressing some of the excesses of subprime lending. As an investor in the least risky subprime securities, we have a limited ability to influence the market's practices. Nevertheless, last winter we were the first to announce that we would restrict our subprime investments in securities backed by short-term ARMs to those that have been underwritten to a fully indexed, fully amortizing level. We also restricted the use of stated income in lieu of more traditional documentation standards and encouraged subprime lenders to escrow borrower funds for taxes and insurance.

Last April, we pledged to buy $20 billion in consumer-friendly mortgages that provide better choices for subprime borrowers. We have already exceeded that pledge. Since May 1, 2007, we have bought about $42.5 billion of prime mortgages that financed borrowers whose credit profiles might have otherwise relegated them to the subprime market. These purchases have helped nearly a quarter of a million families.

As part of this commitment, we created our SafeStep℠ subprime alternative product, introduced in July and designed to give subprime borrowers more sustainable alternatives. But through the end of 2007, we have bought only $207 million of these mortgages. It is not that our credit parameters on the product are particularly conservative, but we did require originators to validate borrowers' incomes, property values and other information, and most borrowers simply could not qualify. This illustrates a dilemma that we all face in trying to clean up the subprime mess—that there are too many borrowers stuck in subprime loans who simply cannot qualify for prudent, sustainable mortgages.

This dilemma is greatly compounded by the significant decline of house prices in many areas. Many families bought a home over the last couple of years that are now worth less than they borrowed to buy it. If this family can afford the monthly payment and does not need to sell the house, this may not pose an immediate problem. It can be a problem, however, if the payments are too high or the family wants to move or sell for some other reason. It is difficult for even a creditworthy borrower to refinance or sell when the house is worth less than the total of the outstanding mortgage debt.

Thinking About Solutions

At Freddie Mac, we spend a lot of time thinking about how to address this situation. Like almost everybody else, we have concluded that there is no silver bullet, and that, unfortunately, things are going to get worse before they get better. For the moment, the combination of lack of borrower capacity and falling house prices demonstrates that there are no easy solutions to this problem.

Nevertheless, let me suggest some things that can be done to mitigate its effects:

- Focus servicing practices on keeping borrowers in their home whenever possible. Loan modifications, repayment plans and other foreclosure prevention initiatives are important. The Hope Now subprime loan modification program and the related Project Lifeline project fall into this category. At Freddie Mac, we have found that early intervention can help some borrowers avoid foreclosure, and last year helped nearly 47,000 borrowers keep their homes. I understand that the VA uses a similar approach.
- Help some borrowers refinance into innovative mortgages like SafeSteps and FHASecure. It may be appropriate to consider other approaches that take house price declines into account. But unless the borrower has the capacity to afford the monthly payments, a refinance simply sets up both the lender and the borrower for a repeat of the earlier failure.
- Support, with the participation of the public and private sectors, community stabilization efforts of local and national non-profits and state and local governments hard-hit by the crisis. In many communities, such as Las Vegas, we have to deal with the problem of foreclosures on investment properties. While no one wants to "help" speculators, a foreclosed investment property is just as dam-

aging to a community as a foreclosed family home. Moreover, foreclosures on investment properties often throws tenants out of their homes and cuts the supply of affordable rental housing.

- Help families transition to more affordable housing. Despite all our efforts, not all borrowers can afford the house they are now living in. For these families, short sales and deeds-in-lieu of foreclosure can help make the transition smoother. We should consider ways to help these families buy less expensive homes or shift into affordable rental housing.

I wish I could be more sanguine, but the housing crisis is going to be painful and take time to resolve. Freddie Mac is committed to working with Congress, the Administration, our customers and other industry participants to find and implement effective solutions to this very difficult problem.

Thank you for the opportunity to appear today, and I will be happy to answer your questions.

Prepared Statement of Anthony Agurs, ABR, CRS, Member, Board of Directors, NATIONAL ASSOCIATION OF REALTORS®, and, REALTOR®, Agurs Group, El Cajon, CA

Executive Summary

The NATIONAL ASSOCIATION OF REALTORS® is a strong supporter of housing opportunities for veterans. We commend the Subcommittee for its attention to issues impacting American veterans. Many veterans, like other Americans, were seduced by the low payments promised by abusive subprime lenders. However, military families seem to be an especially attractive group for those wishing to prey on people with less than perfect credit.

We believe the Veterans Home Loan Guaranty Service can be a valuable asset to help our Nation's veterans achieve the dream of home ownership in a way that is safe, fair, and affordable. This program, created under the GI bill, encourages private lenders to offer favorable home loan terms to qualified veterans. However, without reforms, this program has not served many veterans who could use its benefits. We urge the following enhancements to the VA program to assure all our military families have the opportunity to reach the American dream of home ownership.

- **Increasing the VA Loan Limits in High Cost Areas**—The current VA loan limit is equal to $417,000. States with the largest veteran population are CA, FL, TX, PA, NY and OH, respectively. Four of these states include areas where the median home price is well above the national average and above the current loan cap of $417,000. Veterans in these areas should not be penalized for geographic differences in the housing market. NAR supports legislative efforts to increase the VA limits to 150% of the conforming limit in high cost areas.
- **Easing Refinancing for Veterans**—Some veteran homeowners have a risky sub-prime loan that they will not be able to afford when the interest rate or loan terms reset. But current law makes it nearly impossible for veterans to refinance into a VA home loan.
  - VA requires veterans to have at least 10% equity in a home prior to refinancing. This limitation makes it impossible for many veterans in risky subprime loans to refinance into a safer, more affordable VA loan. We urge Congress to revisit this provision of law to reduce to 5% the equity required to refinance a home.
  - In addition, law limits the guaranty that can be used for a typical VA refinance loan to $36,000. As a result, refinance loans of more than $144,000 will result in the lender not receiving 25 percent backing from VA and, as a result, probably not making the loan. We urge Congress to eliminate this refinancing restriction and making the maximum VA guaranty applicable for all VA-guaranteed loans.
- **Permanently Authorize ARMS**—While the vast majority of VA loan guarantees are for fixed term loans, VA does have authority to guaranty adjustable-rate mortgages (ARMs) and hybrid ARMs through September 30, 2008. We urge Congress to make these programs permanent and continue to provide VA with the flexibility to serve all America's veterans.

I thank the Subcommittee for this opportunity to share the views of NAR regarding veterans housing. The NATIONAL ASSOCIATION OF REALTORS® strongly supports housing opportunities for our Nation's veterans and active duty military professionals. It is our hope that the Subcommittee will support our recommendations for enhancing and improving the VA home loan guarantee program, so it may be a real benefit to those who have so bravely served our country.

As a veteran and a REALTOR® thank you for inviting me to testify on the Subprime Mortgage Crisis and its impact on American veterans. My name is Anthony Agurs, and I am a REALTOR® with the Agurs Group in El Cajon, CA. I am proud to say I served 21 years in the United States Marine Corps and have now been in real estate for nearly 14 years.

I am here on behalf of 2008 NAR President Dick Gaylord and the 1.3 million members of the NATIONAL ASSOCIATION OF REALTORS® representing a wide variety of housing industry professionals committed to the development and preservation of the Nation's housing stock and making it available to the widest range of potential home buyers.

The NATIONAL ASSOCIATION OF REALTORS® is a strong supporter of housing opportunities for veterans. We commend the Subcommittee for its attention to issues impacting American veterans. Military veterans represent more than 25 percent of the U.S. homeless population, although they comprise only 11 percent of the civilian adult population.[1] Men and women who have served this country deserve better. As NAR Past President Pat V. Combs said at a press conference on VA home loans last year, "The homelessness rate among our veterans is unacceptable to REALTORS®, who believe in building safe, healthy communities. . . . Many of our members are veterans and active service personnel who know firsthand the struggles and sacrifices faced by those who have fought to protect our safety and freedom."

REALTORS® across the country are also doing their part to help our veterans. In November, NAR presented a 2007 Good Neighbor award to Phil Landis. Chosen from over 320 REALTOR® nominees nationwide, Phil is a REALTOR®, a Vietnam vet, and since 2001 has been Chairman of the Veterans Village of San Diego (VVSD). VVSD provides food, clothing, housing, substance abuse treatment, mental health counseling, and job training and placement services to homeless veterans. Since becoming active in the organization, Phil has utilized his real estate acumen to improve the financial standing of the VVSD, growing its net worth from $1.5 million to almost $16 million. Today, VVSD has 100 employees, a five-acre site with 127 treatment beds and a new 112-bed facility scheduled to open in 2008. Phil has been in real estate for 21 years and currently is a sales associate with RE/MAX Ranch & Beach in San Diego.

In addition, NAR has partnered with U.S. Vets, an organization serving the homeless veteran population. U.S. Vets works to break the cycle of homelessness by fostering individual responsibility. NAR sponsored its inaugural U.S. Veterans Day Golf Tournament in Washington, DC. All proceeds from the event went to U.S. Vets-DC. In addition, as part of our Annual Convention in 2007, NAR President-elect Charles McMillan and First Vice President Vicki Cox Golder visited the Las Vegas office of U.S. Vets on Veteran's Day and presented a donation to help the more than 5,000 homeless veterans living in Clark County, Nevada.

I passionately believe in the American Dream of Home Ownership for anyone who desires to achieve that goal for themselves and their families especially the Soldiers, Sailors, Airmen, and Marines of our Armed Forces who sacrifice so much in defense of the American way of life, yet ask for so very little in return. Unfortunately, like many Americans, our military families have been hit hard by the subprime mortgage crisis. These homeowners are in financial crisis and need our help.

Subprime Mortgage Crisis

Irresponsible and abusive lending practices are a major problem for all of our Nation's communities. While responsible subprime lenders have played an important role in helping millions of consumers achieve homeownership, abusive lending occurs much too often in subprime markets. Unfortunately, some lenders have abused their role and taken advantage of some borrowers, including veterans, by charging extremely high interest rates and loan fees unrelated to risk, using aggressive sales tactics to steer consumers into unnecessarily expensive or inappropriate loan products, advertising "teaser" interest rates (like the 2/28 or 3/27 adjustable rate mortgage) that steeply increase after the first few years of the loan and basing their lending on artificially high appraisals. Real estate professionals have a strong stake in preventing abusive lending because:

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[1] Vital Mission: Ending Homelessness Among Veterans, Homelessness Research Institute (November 2007).

- Abusive lending erodes confidence in the Nation's housing system.
- Legislative and regulatory responses to lending abuses that go too far can inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers in a credit-driven economy. When responses to abusive lending constrain the ability of the secondary mortgage market to provide liquidity for home finance, consumers will find it more difficult and expensive to buy a home.
- Citizens of communities, including real estate professionals, are harmed whenever abusive lending strips equity from homeowners. This is especially the case when irresponsible lenders concentrate their activities in certain neighborhoods and create a downward cycle of economic deterioration.

Just last month, the Center for Responsible Lending (CRL), which more than a year ago warned Congress about the more than 2 million American families projected to lose their homes to foreclosure, released startling research on the spillover effect on our Nation's communities and neighborhoods. Specifically, CRL estimates:

- More than 40 million neighboring homes will suffer a decline in property values because of foreclosures in their neighborhood;
- Homeowners living near a foreclosed home will see their property value reduced by about $5,000; and
- The total decline in property values and reduced tax base from foreclosures will total $202 billion.[2]

Recently, the U.S. Conference of Mayors[3] commissioned a report on the economic and fiscal impact of foreclosures. The findings were largely consistent with the CRL report and concluded that 2008 will bring more foreclosures, curtailed consumer spending and significant financial stresses for state and local government budgets. NAR research shows that due to the housing market contraction, the U.S. economy expanded only 2% in 2007. A further weakening of the housing market has the potential to tip the economy into recession in 2008.

State and local governments will immediately feel the impact of the reduced property tax revenue, which goes to fund important county/city services we depend on every day (police protection and fire rescue services, schools, social services, public transportation etc.). Some have already begun to cut back or curtail funding for critical programs that help the homeless. Furthermore, what many people do not realize is that foreclosures actually require local governments to spend money "for inspections, court actions, extra law enforcement, visits from city utilities and sometimes demolition."[4]

Someone once said that foreclosures are like mold—once it starts, it's difficult to rid a community of it. Families struggling to make mortgage payments and living in a neighborhood where homes have already been lost to foreclosure will find it difficult to refinance or sell due to declines in neighborhood home values. Far too often these financially stressed families will end up losing their home and feeding the vicious cycle of foreclosures.

Impact on Veterans

Many veterans, like other Americans, were seduced by the low payments promised by abusive subprime lenders. However, military families seem to be an especially attractive target for those wishing to prey on people with less than perfect credit. A report by the National Consumer Law Center found the following:

"Military personnel are ripe targets for consumer predators because many are low-income (always the most targeted group) but have a far longer list of economically attractive qualities than most low-income people. Periods of deployment like those for the recent war in Iraq are especially vulnerable times. And military conduct codes that stress the need for orderly personal lives, including orderly finances, may inadvertently be driving service people toward the quick fixes many consumer predators offer."[5]

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[2] Subprime Spillover: Foreclosures Cost Neighbors $404 Billion; 40.6 Million Homes Lose $5,000 on Average, Center for Responsible Lending (January 2008).

[3] The Mortgage Crisis: Economic and Fiscal Implications for Metro Areas, Global Insight for the United States Conference of Mayors and the Council for the New American City (November 2007).

[4] T.W. Farnam, As Foreclosures Rise, Mayors Brace for Fallout, Wall Street Journal (January 28, 2008).

[5] "In Harms Way—At Home: Consumer Scams and the Direct Targeting of America's Military and Veterans", National Consumer Law Center (May 2003).

Veterans are more likely to have lower credit scores due to their service to our country. Sporadic civilian work due to calls to service and low military pay lead some military families into financial difficulties.

Committee Chairman Filner recently stated, "For many of our returning servicemembers and veterans, the stress of what they have gone through in war is still prevalent when they return home. Unfortunately, for many of these heroes, subprime loans are the only option when they do not have the best credit score, and more often than not, their low credit score is a direct result of their service to our country."[6]

VA Home Loan Guarantee Program

We believe the Veterans Home Loan Guaranty Service can be a valuable asset to help our nation's veterans achieve the dream of homeownership in a way that is safe, fair, and affordable. This program, created under the GI bill, encourages private lenders to offer favorable home loan terms to qualified veterans. The VA home loan guarantee program made its first loan for a home in Washington, DC in 1944. Today, the VA has guaranteed well over 18 million loans to American veterans. We believe this program is a vital homeownership tool that provides veterans with a centralized, affordable, and accessible method of purchasing homes as a benefit for their service to our nation.

The VA home loan guarantee program is designed to provide veterans who are unable to qualify for a conventional loan with favorable loan terms. A study conducted in 2004 found the program did just that. The percentage of VA borrowers who could not qualify for a conventional loan was 82% for first-time home buyers, and 78% for repeat borrowers. In addition, the typical VA borrower could also not qualify for an FHA loan. Sixty-one percent (61%) of VA first-time borrowers could not meet either the downpayment and/or maximum debt-to-income ratios required to obtain an FHA loan.[7] The VA program, therefore, offers unique and important benefits for helping our military families achieve the dream of home ownership.

Despite offering borrowers a zero-downpayment loan, VA's delinquency rate is low. According to the most recent delinquency survey published by the Mortgage Bankers Association, VA's delinquency rate was 6.58%, and the foreclosure rate was 1.03%. In contrast, sub-prime delinquency rates were a staggering 16.31%, and foreclosure rates were 6.89%.[8]

In addition, the VA home loan program offers protections for borrowers when financial difficulties occur by offering a variety of supplemental loan servicing programs to help military families avoid foreclosure. VA offers financial counseling and can serve as a conduit between the veterans and the private lender holding the loan. VA will try and negotiate repayment terms for borrowers in financial difficulty. Under some specific conditions, VA may also purchase the loan and allow the borrower to make payments directly to the VA at a reduced interest rate.

These interventions not only help the veteran retain their home, but save the VA money by avoiding the payment of a guarantee claim. In 2007, VA accomplished more than 8,453 successful interventions, which translated into a savings to the government of $181.3 million in claims avoided.

The VA home loan program has a proven record for promoting homeownership amongst our nation's veterans. However, with the increasing costs of housing, and abuse in the subprime market, we believe additional enhancements are needed to improve the program's usefulness and position it as a viable homeownership vehicle in this changing world. We are pleased to note the bills introduced by Rep. Murphy and Chairman Filner (H.R. 2385 and H.R. 4884 respectively) which will implement some of these changes. NAR strongly supports these bills, and urges the Veterans' Affairs Committee to move them to markup.

Increasing the VA Loan Limits in High Cost Areas

The VA loan guaranty limit is currently set at 100% of the conforming loan limit. Despite recent increases to the conforming loan limit included in the Economic Stimulus Act of 2008, it does not appear that the VA loan guaranty will increase above the current $417,000 loan limit. This is unfair to our military personnel and veterans who live in high cost communities where FHA and conventional limits will exceed $417,000 but will be excluded from homeownership and refinancing opportu-

[6] Hon. Bob Filner, "Filner Introduces Legislative Package to Help Veterans Survive the Subprime Mortgage Crisis", Press Release, December 19, 2007.

[7] Evaluation of VA's Home Loan Guarantee Program, Final Report. Economic Systems Inc.; ORC Macro; The Hay Group; Department of Veterans Affairs, July 2004.

[8] National Delinquency Survey, Mortgage Bankers Association, Q307 (December 2007).

nities that would be available to them if the VA loan limit were allowed to move in concert with the conforming loan limit for those communities.

Of the 25 million veterans currently alive, sixty percent (60%) live in urban areas. States with the largest veteran population are California, Florida, Texas, Pennsylvania, New York and Ohio, respectively. These six states account for about 36% of the total veteran population. Of these, California, Florida, Pennsylvania and New York all include areas where the median price of homes are well above the national average, and above the current loan cap of $417,000. Veterans in these areas should not be penalized for geographic differences in the housing market.

NAR supports legislative efforts to increase the VA limits to 150% of the conforming limit in high cost areas. The VA loan guarantee is a critical entitlement for our men and women in uniform, providing them a safe, affordable, and accessible method of purchasing homes in return for their service to our nation. In light of risky and sometimes predatory alternative loan products being marketed, the veteran's loan guarantee needs to serve all veterans, regardless of where they live.

Easing Refinancing for Veterans

Some veteran homeowners are certainly among those who are currently in a risky sub-prime loan that they will not be able to afford when the interest rate or loan terms reset. But current law makes it nearly impossible for veterans to refinance into a VA home loan.

VA requires veterans to have at least 10% equity in a home prior to refinancing. This limitation would make it impossible for many veterans in risky sub-prime loans to refinance into a safer, more affordable VA loan. We urge Congress to revisit this provision of law to reduce to 5% the equity required to refinance a home. Increasing the cap from 90% to 95% will provide more opportunities for veterans to refinance. In light of the high number of non-VA adjustable rate mortgages that will reset in the coming months, allowing veterans the opportunity to use the loan guarantee is critical. The highly touted FHASecure program permits refinance loans with only 3% equity. Veterans should be afforded the same type of opportunity that FHASecure provides other homeowners.

In addition, current law limits the guaranty that can be used for a typical VA refinance loan to $36,000. As a result, refinance loans of more than $144,000 will result in the lender not receiving 25 percent backing from VA and, as a result, probably not making the loan.[9] We recommend eliminating this refinancing restriction and making the maximum VA guaranty—25% of the Freddie Mac conforming loan limit applicable for all VA-guaranteed loans—be they purchase or refinance.

Raising the guarantee on VA refinancing loans and reducing the loan-to-value ratio will allow more qualified veterans to refinance their loans and save their homes. In light of the high number of non-VA adjustable rate mortgages that will reset in the coming months, allowing veterans the opportunity to use the loan guarantee will save many from foreclosure.

Permanently Authorize ARMS

The *Veterans Benefits Improvement Act of 2004,* which was signed into law by President Bush as Public Law 108–454 on December 10, 2004, extended the VA's authority to guaranty adjustable-rate mortgages (ARMs) and hybrid ARMs through September 30, 2008. In addition, the law indexed the VA guaranty to the Freddie Mac conforming loan limit.

The bulk of the VA's guaranty activity is in fixed-rate mortgage loans and this trend is likely to continue even if Congress reauthorizes the VA to guaranty adjustable- and hybrid adjustable-rate mortgage loans. However, these adjustable- and hybrid adjustable-rate loans provide the VA with additional flexibility to better meet the needs of the nation's veterans, service members and reservists.

ARMs are especially useful for active duty military. These soldiers can purchase a home with a low interest ARM, and will likely get orders to relocate prior to the first rate adjustment. Since military families tend to move often, an ARM or hybrid ARM can be a very good choice. In addition, many military families can anticipate promotions or salary increases, making payments on the adjusted interest on an ARM possible. The VA does not allow lenders to charge borrowers a prepayment penalty, and so the risk is low for the veterans if they move or chose to refinance. We encourage Congress to authorize these products permanently.

Education and Outreach

NAR strongly believes the private sector has an obligation to help educate homebuyers about today's mortgage products. Starting in 2005, NAR worked with the

[9] On a standard loan the VA limit goes to $104,250, or 25% of $417,000.

Center for Responsible Lending (CRL) to produce a series of brochures that describe the pros and cons of conventional loans and nontraditional mortgages, give consumers tips on how to avoid predatory loans. In May of 2007, NAR partnered with CRL and NeighborWorks on a brochure that focuses on helping financially stressed homeowners understand their options and offers tips on how to avoid foreclosure. Shortly after the brochure was released, NAR's President sent an e-mail to over 1.3 million REALTORS® informing them of the foreclosure prevention brochure and encouraging REALTORS® to put the brochure into the hands of every consumer they help to become a homeowner.

In 2006, NAR partnered with the Department of Housing and Urban Development to produce a brochure promoting FHA home loans. ***Shopping for a Mortgage? FHA Improvements Benefit You*** has been a valuable resource for REALTORS® and their clients.

NAR is now in discussions with the Department of Veterans Affairs to work together on a similar brochure promoting the VA Home Loan Guarantee Program. Getting the word out about VA loans and steps veteran homeowners should take when loan trouble is on the horizon is a critical way to prevent additional military families from falling prey to abusive or predatory lending.

Conclusion

I thank the Subcommittee for this opportunity to share the views of NAR regarding veterans housing. The NATIONAL ASSOCIATION OF REALTORS® strongly supports housing opportunities for our Nation's veterans and active duty military professionals. It is our hope that the Subcommittee will support our recommendations for enhancing and improving the VA home loan guarantee program, so it may be a real benefit to those who have so bravely served our country.

Prepared Statement of Ellen Harnick, Senior Policy Counsel, Center for Responsible Lending

Chairwoman Sandlin, Ranking Member Boozman, and members of the Subcommittee, thank you for holding this hearing to examine the foreclosure crisis, a problem that is affecting many veterans. We appreciate the opportunity to speak today.

I offer this testimony as Senior Policy Counsel of the Center for Responsible Lending (CRL) (www.responsiblelending.org), a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. We are affiliated with a community development lender, Self Help, which provides carefully underwritten subprime loans to people who have been under-served by other lenders. Self Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses, and nonprofit organizations, and our loan losses have been less than one percent per year.

EXECUTIVE SUMMARY

It is difficult to overstate the magnitude of today's foreclosure crisis. According to Moody's Economy.com, America's "housing and mortgage markets are suffering an unprecedented downturn," and unless policymakers take significant action, home losses due to unsustainable loans will continue to rise through the rest of this decade.[1] A significant number of the families who lose their homes will be men and women who have served our country.

This crisis, which has not been confined to the housing market but has impacted the entire economy, has brought our Nation to the brink of recession. In the past, families typically experienced foreclosures due to an unexpected personal crisis, such as job loss, illness, divorce, or death. Now, however, the leading cause of foreclosure is the nature of the mortgage loans themselves. This crisis was caused by a number of factors, including the following:

- Dangerous loan products.
- Reckless underwriting.
- No escrow for taxes and insurance.
- Risk layering.
- Broker abuses.
- Wall Street demand for more, riskier loans.

[1] Testimony of Mark Zandi, "The Looming Foreclosure Crisis: How to Help Families Save Their Homes," before the U.S. Senate Committee on the Judiciary (December 5, 2007).

- Lack of oversight and regulation.

Today, we offer a number of policy recommendations aimed at cushioning the impact of the foreclosure crisis on veterans. The first two items relate to all homeowners, while the final three items relate specifically to veterans.

1. Permit bankruptcy judges to fix distressed home loans.
2. Establish common-sense standards for sustainable mortgage origination.
3. Expand the VA home loan program to address the current situation.
4. Assist veterans who are seeking loan modifications.
5. Consider extending period of post-service foreclosure protection.

Below, we describe both the causes and the policy recommendations in more detail.

BACKGROUND

A year ago this month, our organization appeared before the Senate Banking Committee to sound an alarm about the subprime market. At that time, we had just released new research predicting that due to predatory and unsustainable lending practices, 2.2 million families were likely to lose their homes to foreclosure. We knew that those lending practices would cause a crisis in the housing market; indeed, the subprime fiasco is causing the largest disaster in the housing market since the Great Depression.

What we did not anticipate is how extensive a spillover effect the housing crisis would have on the global economy, nor did we anticipate the effects on the prime mortgage market. Irresponsible lending, fueled by Wall Street demand for highly risky loans, has pushed our Nation to the brink of recession. Part of the reason for the spillover is that the impact of foreclosure is not confined to the families who lose their homes. In addition, 40 million Americans who pay their mortgage on time also are poised to experience drastic drops in their property value as a direct result of subprime foreclosures.[2] The consequent pullback in spending by homeowners whose properties have lost value is further fueling a downward economic spiral.

The housing crisis is hitting veterans especially hard. As a recent Pentagon study has shown, military personnel are particularly vulnerable to predatory lending,[3] and the financial stresses for many military families have been well documented. Although military personnel on active duty receive some protections related to their mortgages, these protections are phased out when they separate from service.

Illustrative stories are not hard to come by. One case, reported by *Newsweek* as well as other sources, involved an Iraq war veteran from Kentucky, a man named Shawn Howell.[4] Mr. Howell bought a home for his wife and four children shortly before he was deployed. He felt good about having a secure place for his family while he served his country. Following the advice of his mortgage broker, the Howells took out two adjustable-rate mortgages. The interest rate started at 5.4%, but—just after Howell returned from a difficult and dangerous year in Iraq—the rate shot up to 9.9%. The increase was completely unmanageable, especially since Mr. Howell was no longer receiving combat pay. He took on two jobs and made numerous attempts to contact the lender to find a way to avoid foreclosure. In spite of Mr. Howell's best efforts, the lender, Countrywide Financial, refused to modify the terms of the loan. The Howells weren't able to sell their home, and the lender foreclosed. Today, they live in a trailer.

Another veteran who received an abusive loan testified at a field hearing held by Chairman Filner last November, Air Force veteran Nellie Cooper. Ms. Cooper refinanced her home loan into an adjustable-rate loan. Her mortgage payments ballooned while local property values dropped, which has prevented her from refinancing into a more secure, fixed-rate loan. She testified, "Nobody will finance 92 percent value of a house, and I am getting more in arrears." Cooper, who lives in Oceanside, Calif., was not able to get help from the VA, because right now, except in very rare cases, VA does not refinance mortgages it didn't make originally. She didn't initially buy the house through VA because she was told repeatedly by real

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[2] See CRL Issue Brief, "Subprime Spillover: Foreclosures Cost Neighbors $202 Billion; 40.6 Million Homes Lose $5,000 on Average," rev. January 18, 2008.

[3] See "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents,"August 9, 2006, which can be found at http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf.

[4] Dick Gordon radio broadcast, "The Story," American Public Media (June 12, 2007). *See also,* Karen Springen, "This is Not My Beautiful House," *Newsweek* web exclusive (March 28, 2007).

estate professionals and brokers that she didn't qualify and the paperwork was "too cumbersome." [5]

What Caused the Foreclosure Crisis?

The foreclosures faced by these veterans are not just the typical foreclosures of years past, such as those precipitated by catastrophic and unforeseen events such as job loss, divorce, illness or death. In many cases, these foreclosures are due to the unsustainability of the mortgage itself, even without any changes in the families' situation, and even where the family qualified for, but was not offered, a loan that would have been sustainable. Moreover, while significant losses so far have been concentrated in the subprime market, it is becoming increasingly evident that the problems are spreading to the Alt-A and even prime markets.

This crisis has been created by a matrix of factors. I have outlined each of these factors below.

Dangerous products. Subprime lenders flooded the market with high-risk loans, making them appealing to borrowers by marketing low monthly payments based on low introductory teaser rates. The most well known of these products is the hybrid adjustable-rate mortgage (ARM), often known as a 2/28 or 3/27. This type of loan begins with a fixed interest rate for either two or three years, then converts to a higher interest rate pegged to an index such as LIBOR. The loan then continues to adjust every six months, which can be as much as 30–50% more than the original rate.

Another complex product that has put many low-income families at risk is the payment option adjustable-rate mortgage (POARM). This product allows people to make monthly payments that do not cover principal and interest, which means that the home experiences "negative amortization"—that is, the principal balance of the loan grows larger—during the period that the minimum payment is being made. Unfortunately, lenders like Countrywide offered these loans to borrowers for whom they were not suited, structured the products so that the payments substantially increase in five years or less when they hit their negative amortization cap, used excessive teaser rates, and failed to document income. Unlike 2/28s, the POARMs that were poorly underwritten are largely Alt-A mortgages as opposed to subprime.

Reckless underwriting. It is widely recognized today, even within the mortgage industry, that lenders became far too lax in qualifying applicants for subprime loans.[6] They underwrote ARMs only to the initial rate, which means they did not even consider how homeowners would be able to pay their loans once the payment adjusted upward, even with rates constant in the economy. Even worse, many lenders qualified borrowers without any verification of income at all, using so-called "stated-income" or "no-doc" loans. Fitch recently noted that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector".[7]

No escrow. Subprime lenders also didn't escrow for taxes and insurance as prime lenders do, which left many families reeling when those bills came due. This deceptive practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs. A study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor.[8]

Risk layering. In many cases, lenders combined multiple risk elements in one loan, such as hybrid ARM products with no documentation of income and no escrow. Regulators have expressed concern about this practice, stating that "risk-layering features in loans to subprime borrowers may significantly increase risks for both the . . . [lender] and the borrower." [9]

Broker abuses. Mortgage brokers are individuals or firms who find customers for lenders and assist with the loan process. Brokers provide a way for mortgage lenders to increase their business without incurring the expense involved with employing sales staff directly. Brokers also play a key role in today's mortgage market:

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[5] "Mortgage Crisis Hits Home for Troops, Vets," Army Times, December 2, 2007.

[6] See, e.g., Vikas Bajaj and Christine Haughney, "Tremors at the Door—More People with Weak Credit are Defaulting on Mortgages," *The New York Times,* citing *Inside Mortgage Finance* (January 26, 2007).

[7] See *Structured Finance,* note 21, p. 4.

[8] *Partnership Lessons and Results: Three Year Final Report,* p. 31 Home Ownership Preservation Initiative, (July 17, 2006) at www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf.

[9] See Interagency Guidance on Nontraditional Mortgage Product Risks, note 42.

According to the Mortgage Bankers Association, in 2006, mortgage brokers originated 45 percent of all mortgages, and 71 percent of subprime loans.[10]

Unfortunately, given the way the current market operates, abuses by mortgage brokers are not surprising. First, mortgage brokers hold themselves out to consumers as trusted advisors for navigating the complex mortgage market: that is the service they sell, and it is the service consumers assume they are buying. Yet, for the most part, brokers deny that they have any legal or ethical responsibility to refrain from selling inappropriate, unaffordable loans, to avoid benefiting personally at the expense of their borrowers, or even to offer homeowners the best loan they qualified for.

Second, the market as it is structured today gives brokers strong incentives to ignore the best interests of homeowners. In the majority of subprime transactions, brokers are paid more by lenders if they deliver mortgages with rates higher than those for which the borrower qualifies. This payment is called a "yield spread premium." Not all loans with yield-spread premiums are abusive, but because they have become so common, and because they are easy to hide or downplay in loan transactions, unscrupulous brokers can make excessive profits without adding any real value. A related problem is racially discriminatory steering, in which lenders or brokers "upsell" minority borrowers into loans more expensive than those for which they qualify. The Wall Street Journal recently commissioned a study that found of those receiving subprime loans originated in 2005, more than half would have qualified for prime loans—in fact, for loans originated in 2006, that number was as high as 61%.[11]

Wall Street demand for more, riskier loans. Wall Street's appetite for risky mortgages encouraged lax underwriting and the marketing of unaffordable loans. Demand from Wall Street for subprime loans was so intense that it encouraged subprime lenders to abandon reasonable qualifying standards, to forget about standard documentation requirements, and to ignore whether borrowers could actually afford the loan. As Alan Greenspan told Newsweek, "The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size." [12]

Market participants readily admit that they were motivated by the increased profits offered by Wall Street in return for risky loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?" [13] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many loans that they knew were unsustainable, replied, "Because investors continued to buy the loans." [14]

Lack of oversight and regulation. Policymakers have long recognized that the primary federal law governing predatory lending (HOEPA) is inadequate and outdated. Although the Federal Reserve Board has long had the authority to step in and strengthen relevant rules since the legislation's passage, they completely failed to do so until this crisis had already unfolded, and now, their proposed rules are significantly weaker than would be necessary to prevent this crisis from occurring again. As for other regulators, not only have most bank regulators taken a hands-off approach until recently, but many of the most egregious abuses were perpetrated by non-bank financial institutions that were largely unregulated. For the majority of subprime mortgage providers, there were no regulatory consequences for making abusive or reckless home loans.

The Crisis is Only Growing

It is important to recognize that while the rate of subprime foreclosures is alarming today, the worst is still ahead. Many additional homeowners will find themselves in trouble due to rate resets on their hybrid ARM, payment option ARM, and interest-only Alt-A loans. Given the slowdown in housing prices, these homeowners will not have the option to refinance or sell that they may have had in the past, increasing the likelihood of foreclosure. As the chart below shows, a large majority

[10] See MBA Research Data Notes, "Residential Mortgage Origination Channels," September 2006.

[11] See Subprime Debacle Traps Even Credit-Worthy, *Wall Street Journal,* December 3, 2007

[12] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

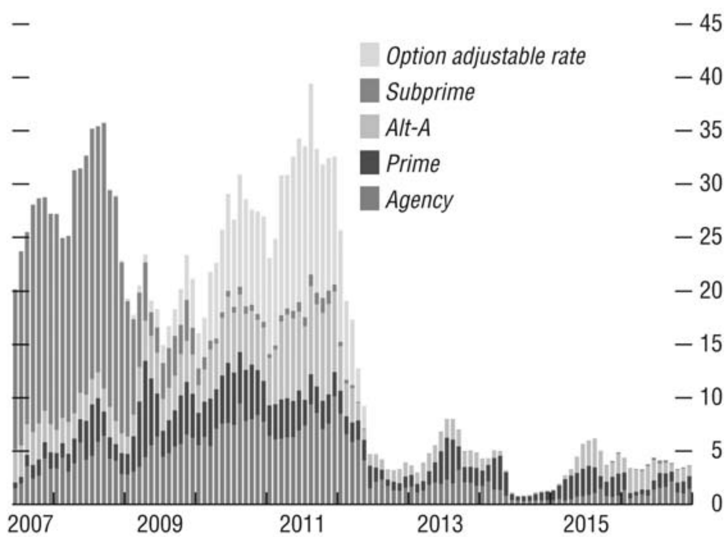
[13] The New York Times, January 27, 2007.

[14] "Subprime Loans Defaulting Even Before Resets," CNNMoney.com, February 20, 2008.

of these hybrid ARM rate resets will occur throughout 2008, peaking in October, followed by spikes in payment option ARM resets in 2009, 2010, and 2011.[15]

Even worse, we are beginning to see many mortgages originated after 2005 beginning to fail even before the reset date. The laxity in underwriting for these loans was so dramatic that many homeowners cannot even afford the initial monthly payments.

Figure 1.7. Monthly Mortgage Rate Resets
(First reset in billions of U.S. dollars)



Source: Credit Suisse.

What Can We Do To Help?

While it would be ideal if lenders voluntarily stepped in to rescue homeowners who were given dangerous and abusive loans, such voluntary efforts do not appear to be happening on a scale commensurate to the problem. The Mortgage Bankers Association—after denying for months that a foreclosure crisis even existed—now insists that lenders are making significant efforts to prevent foreclosure, but the numbers belie that claim. During the third quarter of 2007, mortgage lenders started about 213,000 foreclosures on subprime loans, but offered meaningful fixes ("loan modifications") for only 28,000.[16]

While we welcome the Treasury Department's Hope Now initiative, which has brought together a coalition of lenders and servicers to encourage voluntary loan modifications, we fear that the portion of the program designed to permit servicers to modify loans without engaging in a case-by-case analysis—the "ASF fast track modification"—will not help enough homeowners. Only 3% of subprime ARM borrowers are likely to receive streamlined permanent modification under its terms. Repayment plans, which require a subprime ARM borrower to pay the full often 12% interest rate while catching up on delinquent payments at the same time, are ineffective. In the absence of detailed reporting, it is not even clear that the few modifications that have occurred are sustainable. Countrywide has acknowledged that most of its modifications "involved deferring overdue interest or adding the past due amount to a loan," not reducing interest rates or principal balances on subprime ARMs.[17]

To step into this breach, there are a number of actions that Congress can take to help veterans at risk for foreclosure.

[15] See Credit Suisse, Fixed Income Research, October 23, 2006.

[16] See http://www.mortgagebankers.org/NewsandMedia/PressCenter/59454.htm.

[17] Gretchen Morgenson, "Can These Mortgages be Saved?" New York Times (September 30, 2007).

1. **Permit judges to fix distressed home loans.** The best solution to the current mortgage crisis is a small change to the bankruptcy code that would allow courts to make limited modifications to a mortgage loan when the borrower is facing foreclosure, ensuring that the borrower stays in their home and the lender continues to receive a payment stream. This change, H.R. 3609, has passed the House Judiciary Committee in a bipartisan compromise struck by Chairman Conyers and Representative Chabot.

   This change does not implicate the 2005 Bankruptcy Code changes, but rather relates to an older provision of the law. Right now, wealthy investors and speculators may receive loan modifications in bankruptcy proceedings for the debt they owe on their yachts, vacation homes and investor properties. Yet current law bars middle-class homeowners from receiving a loan modification to save the roof over their heads. Permitting bankruptcy judges to modify loans on primary residences could prevent as many as 600,000 foreclosures. (In reality, this remedy will accomplish its objective even without requiring most of these families to actually file for bankruptcy. Changing the Code will provide a template for modification and will give servicers the precedent and protection they need from lawsuits by tranches of investors who might otherwise object.)

   Making this small fix to the bankruptcy code will be a win-win for homeowners, lenders, neighbors, taxpayers and the economy as a whole. Homeowners can stay in their homes. Lenders will be guaranteed the fair market value of their house, which is more than they would receive at foreclosure sale, and without the lengthy delays and expenses associated with foreclosure. And loans can be modified quickly and effectively.
2. **Establish common-sense standards for sustainable mortgage origination.** Any solution to the foreclosure crisis also requires that we prevent such abuses from happening again, especially since so many people will need to refinance their current mortgages. In the fall, the House passed H.R. 3915 to do just that. While that legislation is a good start, it did not adequately hold Wall Street accountable for its role in this mess. To restore the world's confidence in our markets and recover a reasonable expectation of integrity to our mortgage financing system, we need policy action to realign the interests of people who buy homes, institutions that provide the loans, and the entities that invest in those mortgages.
3. **Expand the VA home loan program to address the current situation.** Right now, the VA typically does not refinance loans that were not originated as VA loans. It would be extremely useful to consider whether the FHASecure program, aimed at providing rescue loans to homeowners in trouble on their mortgages, could be replicated by the VA. To be most useful, this program would need to permit some level of delinquency on a current mortgage and to limit equity requirements. Furthermore, to encourage more veterans to use VA loans, Congress might consider capping loan fees at 1%, as proposed by Representative Filner in H.R. 4884.
4. **Assist veterans who are seeking loan modifications.** The VA occasionally assists veterans in negotiating with their lenders to modify a VA-backed loan. Policymakers in several federal and state venues have recognized the need for additional counseling and legal resources to assist homeowners facing foreclosure who seek modifications from the lenders. Congress should consider how the VA can expand its efforts to support veterans in working with private lenders as well.
5. **Consider extending period of post-service foreclosure protection.** Currently, under the Servicemembers Civil Relief Act, if a lender moves to foreclose on a servicemember's home during the term of service or within 90 days thereafter, a judge may stay the proceedings. Chairman Filner has introduced legislation (H.R. 4883) that would extend this period to a full year. Recent experience with loan modification suggests that 90 days may be insufficient for veterans to get their financial affairs in order and to explore options for saving their homes, especially as they often have many other pressing matters to attend to upon returning home. Congress should consider extending this period of protection.

Conclusion

The subprime lending system has failed our Nation's veterans along with millions of other middle-class families. Veterans put their lives on the line to protect our country's security and our way of life. Now, their families are on the verge of losing their homes and financial security, and we all will be worse off as a result.

As outlined here, policymakers have a number of tools at their disposal to mitigate the harm caused by this situation and prevent it from happening again in the future. We greatly appreciate the Subcommittee's interest in the foreclosure crisis, and we look forward to working with you to explore and implement the recommendations that we and others have suggested.

Prepared Statement of Larry Gilmore, Deputy Director, HOPE NOW Alliance

Madam Chairwoman, Ranking Member Boozman and Members of the Subcommittee, I am Larry Gilmore, Deputy Director of the HOPE NOW Alliance. I appreciate the opportunity to appear before you today on behalf of HOPE NOW to talk about the efforts to help veterans and all at-risk homeowners stay in their homes during this time of serious challenges in the housing market.

The HOPE NOW Alliance is a broad-based collaboration between credit and home ownership counselors, lenders, investors, mortgage market participants and trade associations. Since last October, the HOPE NOW Alliance has worked to dramatically expand and coordinate the efforts that individual companies and non-profits are making to help homeowners in difficulty. HOPE NOW has been strongly encouraged by Treasury Secretary Paulson and Housing & Urban Development Secretary Jackson and by Members of Congress and other leaders. HOPE NOW has established and is expanding a coordinated, national approach among servicers, investors,[1] non-profit housing counselors and other industry participants to enhance our ability to reach out to borrowers who may have or expect to have difficulty making their mortgage payments and to offer them workable options to avoid foreclosure. The HOPE NOW Alliance is achieving real results in reaching more at-risk borrowers and in providing positive solutions that avoid foreclosure.

Progress in Helping Struggling Homeowners

The members of the HOPE NOW Alliance recognize the urgency of this issue, and we are working to reach new milestones on a weekly basis. I am pleased to have the opportunity to share our progress with you, including our most recent data results.

First, the Alliance is continuing to expand and add companies and organizations who commit to specific efforts to reach and assist borrowers. As of February 25th, we have 27 loan servicers in the Alliance who represent over 90 percent of the subprime market. In addition, we have strong participation from respected non-profits, led by NeighborWorks America, the Homeownership Preservation Foundation, and the Housing Partnership Network, with their networks of trained counselors. We are continuing to expand our network of non-profits.

One of the Alliance's first steps was to demonstrate our commitment to results by adopting a Statement of Principles on helping distressed homeowners stay in their homes. These principles are helping ensure that all borrowers receive quality service and assistance when they contact their lender/servicer in the Alliance.

The following are the principles embraced by HOPE NOW servicers, which are consistent with calls for the industry to expedite solutions for borrower:

- HOPE NOW members agree to attempt to contact at-risk borrowers 120 days, at a minimum, prior to the initial Adjustable Rate Mortgage (ARM) reset on all 2/28 and 3/27 ARM loan products;
- HOPE NOW members agree to inform borrowers of the potential increase in payment and terms of the loan, in an effort to determine if the borrower may face financial difficulty in keeping their mortgage current;
- HOPE NOW members agree to establish a single port of entry for all participating counselors to use; and
- HOPE NOW members agree to make available dedicated e-mail and fax connections to support counselor and consumer contacts.

By establishing these principles, HOPE NOW members are improving the infrastructure needed to help more borrowers on a much larger scale. In addition to im-

[1] After a mortgage is made, the lender will often sell the loan to investors. A loan servicer acts as the intermediary between the borrower and the investor. The servicer's role is to collect payments, handle escrow accounts, forward principal and interest payments to the investor and deal with issues that arise from delinquency and foreclosure. A servicer is typically compensated 25 basis points (0.25%) of the loan balance for performing this service, or $250 on a $100,000 loan balance.

proving lender/servicer systems for working with counselors and borrowers, we are redoubling our efforts to reach out to at-risk borrowers.

One of the most significant on-going challenges we face in helping consumers is a persistent reluctance of struggling borrowers to contact their servicer for help. Historically, evidence has shown that about half of borrowers who go into foreclosure never contacted their servicer for help. Freddie Mac reported at the end of January that 57 percent of the Nation's late-paying borrowers still don't know that their lenders may offer alternatives to help avoid foreclosure.[2] We are working to drastically reduce that number and help as many troubled homeowners as possible avoid foreclosure.

In November, HOPE NOW servicer participants began a monthly direct mail outreach campaign to at-risk borrowers. This direct mail effort—on the HOPE NOW letterhead—is in addition to the thousands of letters and telephone contacts made by individual servicers to their own customers.

In our first direct mail effort in November, HOPE NOW members sent 232,850 letters to borrowers who are behind on their mortgage payments and who have not had contact with their servicer. The November letter provided a dedicated phone number for the individual borrower to use to call their own servicer for help. As a result of these letters, more than 16 percent of borrowers contacted their servicer, far more than the typical 2–3 percent response rate to a letter.

In December, HOPE NOW sent a second wave of direct mail outreach letters to 259,633 at-risk homeowners, providing individual servicer hotlines as well as the 888–995–HOPE Hotline provided by the Homeownership Preservation Foundation. As a result of these letters, more than 21 percent of borrowers contacted their servicer. The monthly direct mail efforts continued in January and February of this year, and to date, over one million letters have been sent to at-risk borrowers. We will report more results as data are compiled.

The Homeowner's HOPE Hotline is a key component of the outreach and assistance effort for at-risk homeowners. The hotline directly connects homeowners with trained counselors at non-profit counseling agencies that have been certified by the Department of Housing and Urban Development (HUD). This counseling service is completely free to borrowers and is offered in English and Spanish. The counselors have direct access to the lender/servicers through improved single points of entry that all HOPE NOW Alliance members have agreed to create.

The Homeowner's HOPE Hotline is having a dramatic and positive impact for at-risk homeowners. The HOPE NOW Alliance will continue to expand the Hotline's capacity and promote it to reach more at-risk borrowers.

- To date, the Homeownership Preservation Foundation Homeowner's HOPE Hotline has received 456,243 calls, with over 245,000 calls in 2007 alone;
- Calls are increasing monthly. In December 2007, there were 93,794 calls to the Hotline that produced 15,462 counseling sessions;
- 165,755 homeowners received counseling after calling the Hotline, 83,000 of which occurred in 2007;
- In January 2008, there were 82,569 calls that produced 19,558 counseling sessions.
- The Counseling sessions produce results. Through October 26, 2007, more than half of all homeowners counseled have been connected with their lender for assistance, and one quarter of all homeowners counseled in the fourth quarter of 2007 were referred to their lender for a recommended workout;
- Counseling sessions are rapidly increasing. Call volume has increased nearly 10fold between first quarter 2007 and fourth quarter 2007;
- Lender/servicers are urging borrowers to call for counseling. Homeowners primarily hear about the Homeowner's HOPE hotline from their lender;
- More homeowners with ARMs are calling—49 percent of callers in the fourth quarter of 2007 were ARM borrowers, up from 34 percent in the first quarter.

Publicity for the Homeowner's HOPE Hotline continues to increase and we hope more homeowners will learn about it. We are proud that the Homeowner's HOPE Hotline provides a resource for free, non-profit counseling to any homeowner, anywhere in the country. President Bush, Treasury Secretary Paulson and HUD Secretary Jackson have mentioned the Homeowner's HOPE Hotline several times and they have urged homeowners in trouble to seek help. Members of Congress have also highlighted the hotline. Thirty-eight Mayors from across the country recently created public service announcements for their local media markets urging borrowers to use the hotline. Anytime the Homeowner's HOPE Hotline is mentioned

[2] http://www.freddiemac.com/news/archives/corporate/2008/20080131_07ropersurvey.html.

by public officials or on television, calls to the hotline increase dramatically. We welcome that support and are continuing to work to expand the counseling network for the hotline.

Members of Congress, in an effort to help their constituents avoid foreclosure, have asked us on many occasions what they could do to help. The single most important thing Members and other community leaders can do to help people stay out of foreclosure is to urge homeowners to seek help and publicize HOPE NOW efforts, particularly the Homeowner's HOPE Hotline, 888–995–HOPE. We would like to work with the Veterans Affairs Committee to ensure that more veterans are aware of the HOPE hotline and other assistance from the HOPE NOW Alliance.

The Homeownership Preservation Foundation, the HOPE NOW Alliance member managing the telephone network, is continuing to add trained, experienced counselors to the program to handle the increasing call volume from concerned homeowners. Tremendous progress has been made in just the last few months. The hotline now has 400 trained counselors assisting borrowers, up from 64 at the beginning of 2007. The agencies providing counseling include Auriton Solutions, CCCS Atlanta, CCCS San Francisco, Novadebt, Springboard and Money Management International.

NeighborWorks America, known formally as the Neighborhood Reinvestment Corporation, is a Congressionally chartered non-profit organization with a national network of more than 240 community-based organizations in 50 states. NeighborWorks is a leader in the HOPE NOW Alliance, and with its partners, is actively providing in-person counseling services to consumers across the country. NeighborWorks has also been the leader in working with the Ad Council on the national advertising campaign for the Homeowners' HOPE hotline, which includes television, radio and print materials.

HOPE NOW is working to add more non-profit agencies to the effort. HOPE NOW is working with HUD and HUD counseling intermediaries to review ways to include additional grass-roots counseling groups. We are working to broaden the HOPE NOW effort to ensure it is a model that works broadly for industry, non-profits and consumers to maximize the ability to reach troubled borrowers.

Servicers' ability to reach borrowers, either directly or through an intermediary is the key to helping them stay in their homes. The solutions will vary with the circumstances of the borrower. Prudent and responsible loan modifications, repayment plans and other types of workout options are solutions that can both help borrowers keep their homes and minimize losses to investors. The HOPE NOW Alliance is committed to pursuing all viable solutions to help people stay in their homes.

HOPE NOW Multi-City Outreach Events

In addition to the direct mail campaign and promotion of the HOPE hotline to reach at-risk borrowers, HOPE NOW is initiating a series of events across the country to reach more at-risk borrowers and provide them with an opportunity to meet with their loan servicer and find solutions. The first HOPE NOW outreach events are next week in California: March 3rd in Riverside, March 5th in Anaheim, and March 7th in Stockton. The purpose of these events is to enable more borrowers to meet with their servicer or a certified home ownership counselor face-to-face to develop a workout solution that helps the borrowers stay in their home.

Tools for Helping Struggling Borrowers

The HOPE NOW mortgage servicers recognize that it makes good economic sense to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are very costly to the servicer, who must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, significant staff resources must be employed to contact the borrower, assess the situation, work on repayment plans and other loss mitigation solutions, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance and repayment plans are generally the first tool servicers employ to help borrowers. Servicers allow mortgagors to miss a payment, with the explicit understanding the payment(s) will be made up some time soon. If the situation is more involved than a short-term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended timeframe, but within the original term of the loan.

Loan modifications are the next level of loss mitigation options. A loan modification is a change in the underlying loan document. It might extend the term of the loan, change the interest rate, change repayment terms or make other alterations. Similarly, a servicer may attempt to refinance the delinquent borrower into a new loan. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because the current loan terms are not sustainable for that borrower.

HOPE NOW members have worked aggressively to make all of the available tools as efficient as possible. The American Securitization Forum (ASF) has created a framework that allows servicers to more readily modify certain at-risk loans that are securitized in the secondary market. This effort has received the backing of the Departments of the Treasury and HUD, many Members of Congress, the federal banking agencies and state and local officials.

The focus of the ASF framework is to identify categories of current subprime hybrid ARM borrowers who can be streamlined into refinance or modifications. We believe that the ASF-established framework will add to existing efforts to assist distressed borrowers. The key is to find solutions which help borrowers but do not violate the agreements with investors who now own the securities containing these loans.

The ASF has worked with servicers and investors to create and implement a process which identifies, in advance of loan resets, borrowers who would qualify for refinancing, loan modifications or other workout options. To ensure that investors accept and support far-reaching loan modification and other workout solutions, this process cannot violate pooling and servicing agreements with investors. The goal is to minimize the risk of legal action by investors against servicers who help borrowers.

The ASF framework covers securitized subprime adjustable rate mortgage loans, the so-called 2/28's and 3/27's that were originated between January 1, 2005 and July 31, 2007 with an initial interest rate that resets between January 1, 2008 and July 31, 2010. In other words, the framework is for loans that have just begun to adjust. The ASF framework will help provide solutions for homeowners with these subprime hybrid ARMs who qualify for three different types of help: refinancing, modification and other loss mitigation efforts.

- *Refinancing:* One segment of borrowers is comprised of those who are current, likely to remain current even after reset, or likely to be able to refinance into available mortgage products, including the Federal Housing Administration (FHA), FHA Secure or industry products. Generally, the servicer will determine whether loans may be eligible for refinancing into various available products based on readily available data such as LTV, loan amount, FICO and payment history. The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties whenever feasible. HOPE NOW will continue to work with the alliance to ensure that all servicers have access to products and programs generally available in the market to refinance eligible borrowers.
- *Loan Modifications:* A second segment of borrowers is comprised of those with good payment records who will not qualify for refinancing for any variety of reasons, such as a drop in home equity or insufficient credit score. These borrowers will be targeted for streamlined loan modifications if the loan is a primary residence (i.e., not an investment or vacation property) and meets additional criteria. Borrowers in this category will be offered a loan modification under which the interest rate will be kept at the existing rate of the loan for five years. This fast track option does not in any way preclude a servicer from conducting a more individual in-depth review, analysis and unique modification for a borrower to determine if a longer term modification would be appropriate.

  The fast track framework allows the servicer to make these decisions:

  - Whether the borrower is unable to pay under the original loan terms after the upcoming reset and default is reasonably foreseeable, based on the size of the payment increase, and the current income if the borrower did not pass the FICO improvement test;
  - Whether the borrower will be able to pay a modified loan based on payment history prior to the reset date;
  - Whether the borrower is willing to pay a modified loan; and
  - Whether the modification will maximize the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are not available and the borrower is able and willing to pay under the modified terms.

- *Loss Mitigation:* This third segment of borrowers is comprised of those for whom the loan is not current and who will not be able to refinance into any available product. These borrowers are significantly behind in their payments before the loan resets and their situations need to be evaluated individually. It is especially important for us to reach this group of borrowers through efforts such as the HOPE NOW direct mail campaign and through the national advertising campaign for the Homeowner's HOPE hotline. For loans in this category, the servicer will determine the appropriate workout and loss mitigation approach on a loan-by-loan basis. Referrals from counselors if the borrowers contact the Homeowners' HOPE hotline will also be important. Approaches for these borrowers may include loan modification (including longer term rate reductions, capitalization of arrearages and term extensions), forbearance, short sale, deeds in lieu of foreclosure or foreclosure. Because these borrowers are already behind in their payments, and may face challenges such as a loss of income or other issues, they require a more intensive analysis, including current debt and income analysis, to determine the appropriate loss mitigation approach.

Servicers, however, can only help borrowers who come forward for help. Borrowers must respond to servicers' notices and phone calls. That is why the outreach effort is so important. If borrowers do not respond, at some point the servicer has to assume the homeowner has no intention of paying off the obligation. It is also important to note that the options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means that you do not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans. According to data by the Mortgage Bankers Association, in the third quarter of 2007, 18 percent of foreclosure actions started was on non-owner occupied properties. Foreclosure starts for the same period for non-owner occupied properties in Arizona, Florida, Nevada and Ohio were at 22 percent.

HOPE NOW is seeking to help all borrowers at risk, not just subprime ARM borrowers eligible for fast track refinance or modifications. The ASF framework for a streamlined, scalable solution for current borrowers facing a reset allows servicers to give more detailed attention to at-risk, hard-to-reach, delinquent borrowers. Servicers will be able to work closely with credit counselors and/or homeowners to ensure all options are explored to avoid foreclosures. The scalable outreach and modification effort in no way precludes on-going workout solutions for the highest risk delinquent borrowers. By having this framework in place, human capital and other resources are able to focus on the cases that require the most attention.

Project Lifeline

HOPE NOW members are continuing to work to develop new methods and programs to assist at-risk homeowners. Project Lifeline is the latest effort to help the most at-risk borrowers—those borrowers who are 90 days or more late on their mortgage and face the greatest risk of losing their home. No later than March 31, all HOPE NOW servicers will adopt the principles of this effort to reach most at risk borrowers (90-day plus delinquent), work with agreed upon steps with borrowers and if appropriate, put a 30-day "pause" on foreclosures. The program will begin by servicers sending a letter to seriously delinquent homeowners. This program reaches most loans, Prime, Alt-A, Subprime, and second liens. The servicers will reach out to homeowners with the following straightforward steps that may qualify them for a loan modification:

1. Call your mortgage servicer.
2. Tell the servicer you received a letter, you want to stay in your home and you are willing to seek counseling, if necessary.
3. Provide updated financial information so the servicer can explore a suitable solution.
4. If appropriate, any pending foreclosure will be 'paused' for up to 30 days during the review process until a formal decision is made and a plan is created.
5. If a workout plan is established and the homeowner follows the plan for three consecutive months, their loan will be formally modified as they have demonstrated their ability to meet their requirements.

Measuring Our Results

The members of HOPE NOW recognize that results are the key to this national effort to assist at-risk homeowners. I am pleased to share with you the latest results from HOPE NOW servicers on their efforts in the second half of 2007. This latest HOPE NOW data, released on February 6th, shows that significantly more homeowners received assistance than previously estimated.

Fourteen HOPE NOW servicers responsible for more than 33.3 millions home loans (about 62 percent of both prime and subprime loans outstanding nationwide), as of September 2007, provided the data. The latest report shows that an estimated 869,000 homeowners were helped in the second half of 2007 through either a formal repayment plan (652,000) or a loan modification (217,000).

During the same period, 283,000 foreclosure sales were completed. Based on 1,446,000 average monthly delinquencies of 60 days or more past due during the second half of 2007, 45.3 percent received a formal repayment plan, 14.8 percent received a modification and 19.7 percent resulted in a completed foreclosure sale.

The data for the second half of 2007 reveal 324,000 prime borrowers and 545,000 subprime borrowers were helped:

- 20.7 percent of prime borrowers helped received a modification;
- 27.5 percent of subprime borrowers helped received a modification; and
- 34.8 percent of subprime borrowers helped during the fourth quarter received a modification; and
- 49.8% of those helped in January 2008 received a loan modification indicating a rapid increase in the use of modifications as a loss mitigation solution.

In addition, the study also collected information on foreclosure activity and trends. These data are revealing. While there appears to be a large number of foreclosures initiated by servicers, less than half of those initiated actually result in a completed sale. Frequently borrowers do not respond to their servicer's attempts to contact them until they receive their first legal action notice. HOPE NOW's borrower outreach initiatives are already increasing the number of borrowers who respond before a foreclosure action is initiated.

In addition to aggregate nationwide data, the report includes quarterly data for the 50 states and the District of Columbia.

The latest state level data from HOPE NOW servicers show that efforts to help borrowers are rapidly increasing. The trend in formal repayment plans is up in all states but more so in the states that experienced rapid and substantial increases in home prices. That is to be expected because of the more rapid increase in delinquencies in the states that experienced a rapid increase and then decline in housing prices. However, it is clear in all states that the upward trend in loan modifications completed is much greater than the upward trends in delinquencies and in formal repayment plans, which clearly indicates that servicers increasingly are working with borrowers to modify the terms of their loans. The upward trend in loan modifications is much more pronounced in the states that had substantial increases in home prices.

We believe the upward trend in loan modifications and repayment plans will continue and more homeowners will receive the help they need to stay in their homes.

We are tracking and measuring outcomes through HOPE NOW and other efforts. In addition to the data reported here, we are measuring trends in delinquencies and resolution outcomes (i.e. reinstatement, repayment plans, modifications, short sales, deeds in lieu of foreclosure, partial claims and foreclosure). We want to provide consistent and informative data reports based on common definitions and to provide information that provides insights into the nature and extent of the current mortgage crisis that will help in the development of workable solutions that avoid foreclosure whenever possible.

As we promised at the start of HOPE NOW, as our data collection initiatives mature and the data are validated, we are providing more detailed information nationally and on a state by state basis. As I noted, our alliance is growing weekly. Our participating servicers have been engaged in developing standard definitions for key loss mitigation data. The data collection effort is an enormous undertaking, which will take time to develop fully and perfectly. We are confident, however, that we will be able to deliver systematic information at the state level that will help measure what servicers are doing to resolve difficult situations and to assist homeowners.

Assisting Veterans and Military Personnel

HOPE NOW members are committed to assisting all homeowners in need. Any homeowner who is concerned about their mortgage situation can call the national HOPE hotline to speak to a non-profit counselor. We also urge homeowners to call their servicer directly and ask for assistance. In addition to the HOPE hotline, we are publicizing the 800-numbers for the customers of all our servicers.

HOPE NOW member organizations and companies are also involved in other specific programs to assist veterans and active duty military personnel.

The Homeownership Preservation Foundation, which manages the HOPE hotline, has supported U.S.A. Cares in assisting 154 families of active duty military personnel. They have made back mortgage payments to avoid foreclosure, and 130 loans have been reinstated and 24 are in repayment plans. For example, through this partnership, a member of the National Guard who went onto active duty in November and whose wife and father both fell ill within two months of each other leading to becoming 6 months behind in his mortgage payments, was able to secure funds from USA Cares and has fully reinstated his mortgage. Similarly, a retired Army veteran who suffered from Post Traumatic Stress Disorder had difficulties finding a job after returning home and who has a wife and a very young child, received assistance from USA Cares to become current on his mortgage and Veterans' Affairs was also able to help him secure a job.

Countrywide Financial is a corporate founding sponsor of Serving Those Who Serve. Working with Rebuilding Together, they rehabilitate homes for injured Iraq War veterans to make them more accessible for their particular disability. Their work focuses on helping veterans who suffer from one or any combination of four injuries including: loss of sight, loss of hearing, mobility impairments, and Traumatic Brain Injury.

Conclusion

The HOPE NOW Alliance and those working with it are committed to enhanced and on-going efforts to contact at-risk homeowners and to offer workable solutions. Our top priority is to keep people in their homes and to avoid foreclosures whenever possible. As I reported today, 869,000 homeowners were helped through modifications or work-outs in the second half of 2007 and the rate of loan modifications continues to increase. We are working to help many more at-risk homeowners.

We need the active involvement of all Members of Congress to alert constituents that help is available when they contact either their lender/servicers or a non-profit counselor through the Homeowner's HOPE Hotline.

The HOPE NOW Alliance will continue its work until the problems in the housing and mortgage markets abate. My testimony today includes initial, but real and significant results on the number of homeowners who have been helped. We will provide updates on our progress to Congress and other concerned policymakers in the coming weeks.

We want to work with the Committee and the Department of Veterans Affairs to ensure that veterans are aware of and can take advantage of the assistance offered by HOPE NOW.

Thank you for this opportunity to share this information on our efforts with the Subcommittee.

HOPE NOW Membership

Counselors

- ACORN Housing Corporation
- Catholic Charities USA
- Citizens' Housing and Planning Association, Inc.
- Consumer Credit Counseling Service of Atlanta
- HomeFree—USA
- Homeownership Preservation Foundation
- Housing Partnership Network
- Mission of Peace
- Mississippi Homebuyer Education Center—Initiative
- Mon Valley Initiative
- Money Management International, Inc.
- National Association of Real Estate Brokers—Investment Division, Inc.
- National Council of La Raza
- National Credit Union Foundation
- National Foundation for Credit Counseling, Inc.
- National Urban League
- NeighborWorks America
- Rural Community Assistance Co.
- Structured Employment Economic Development Co.
- West Tennessee Legal Services, Inc.

Servicers/Lenders/Mortgage Market Participants

- Assurant, Inc.
- Aurora Loan Services
- Avelo Mortgage, LLC.
- Bank of America
- Carrington Mortgage Services

- Chase
- Citigroup, Inc.
- Countrywide Financial Corporation
- EMC Mortgage, Inc.
- Fannie Mae
- First Horizon Home Loans and First Tennessee Home Loans
- Freddie Mac
- GMAC ResCap
- Home Loan Services, Inc. (d/b/a First Franklin Loan Services & NationPoint Loan Services)
- HomEq Servicing
- HSBC Finance
- Indymac Bank
- Litton Loan Servicing
- LoanCare Servicing Center, Inc.
- MERS
- National City Mortgage Corporation
- Nationstar Mortgage, LLC.
- Ocwen Loan Servicing, LLC.
- Option One Mortgage Corporation
- PMI Mortgage Insurance Co.
- Saxon Mortgage Services
- Select Portfolio Servicing, Inc.
- State Farm Insurance Companies
- Strategic Recovery Group, LLC.
- SunTrust Mortgage, Inc.
- Washington Mutual, Inc.
- Wells Fargo & Company
- Wilshire Credit Corporation

Trade Associations

- American Bankers Association
- American Financial Services Association
- American Securitization Forum
- Consumer Bankers Association
- Consumer Mortgage Coalition
- The Financial Services Roundtable
- The Housing Policy Council
- Mortgage Bankers Association
- Securities Industry and Financial Markets Association

Servicer Contact Numbers for Homeowners

Below are the customer contact telephone numbers of HOPE NOW servicer members. If you are a homeowner having trouble with your mortgage, please call your servicer's hotline for assistance (please have your account number ready when calling).

If you would like to talk to a HUD-approved home ownership counselor, please call the Homeowner's HOPE Hotline, 888–995–HOPE, operated by the Homeownership Preservation Foundation. Free counseling is available 24 hours a day, 7 days a week. You can also visit *www.995hope.com* for more assistance.

Servicer and Hotline

Aurora Loan Services—800–550–0509
Avelo Mortgage, LLC.—866–992–8356
Bank of America—800–846–2222
Carrington Mortgage Services—800–790–9502
CitiFinancial/Citi Trust Bank—800–422–1498
CitiMortgage/Loss Mitigation—866–272–4749
CitiResidential Customer Care—800–430–5262
Countrywide Home Loans—800–669–6650
EMC Mortgage, Inc.—877–362–6631
First Horizon Home Loans—800–364–7662
GMAC/Homecomings/ResCap—800–799–9250
Home Loan Services, Inc. (d/b/a First Franklin Loan Services and NationPoint Loan Services)—800–500–5022
HomEq Servicing—888–270–6663

HSBC Consumer Lending—800–333–5848
HSBC Mortgage Services—800–365–6730
HSBC Mortgage Corporation—888–648–3124
Indymac Bank—800–880–6848
JPMorgan Chase Prime Loans—800–446–8939
JPMorgan Chase Non-Prime—877–838–1882
JPMorgan Chase Home Equity—866–582–5208
JPMorgan Chase Default HPO Help Line—866–345–4676
Litton Loan Servicing—800–999–8501
National City Mortgage Corporation—800–523–8654
Nationstar Mortgage, LLC.—888–480–2432
Ocwen Loan Servicing, LLC.—877–596–8580
Option One Mortgage Corporation—888–275–2648
Saxon Mortgage Services—888–325–3502
Select Portfolio Servicing—888–818–6032
SunTrust Mortgage, Inc.—800–443–1032
Washington Mutual, Inc.—866–926–8937
Wells Fargo Home Mortgage—877–216–8448
Wells Fargo Financial—800–275–9254
Wilshire Credit Corporation—888–917–1050

HOPE NOW: Results in Helping Homeowners
As of February 25, 2008

- **An estimated 869,000 homeowners were helped to avoid foreclosure in 3rd and 4th quarters of 2007.**
  - This includes an estimated 652,000 formal repayment plans and an estimated 217,000 modifications.
- **Subprime modifications doubled in 4th quarter 2007 from 3rd quarter 2007.**
- **Since November 2007, HOPE NOW servicers have sent over one million outreach letters to at-risk borrowers who have not previously been in contact with their servicer.**
  - 16% responded in November.
  - 21% responded in December.
  - When servicers send similar letters to their borrowers, the normal response rate is 2–3%.
  - Prior to these letters, these borrowers had not responded to any outreach efforts.
- **27 servicers part of HOPE NOW as of February 2008.**
- **American Securitization Forum (ASF) guidance—member companies are** adopting and implementing the ASF framework for loan modifications.
- **Project Lifeline—Member companies are** adopting the principles of this effort to reach most at risk borrowers (90-day plus delinquent), work with agreed upon steps with borrower and if appropriate, put a 30-day "pause" on foreclosures.
- **Homeowner calls have increased to 4,500 per day through the Homeownership Preservation Foundation's Homeowner's HOPE Hotline.**
- **Over 37,000 counseling sessions completed through the Homeowner's HOPE Hotline in 4th quarter 2007.**
  - To date, the HOPE Hotline has received 456,243 calls which led to counseling for 165,755 homeowners. Nearly half of those counseled have avoided foreclosure by working out new loan terms or by selling their home.
- **As of February 2008, increased response capacity to 400 home ownership counselors through the Homeownership Preservation Foundation and intermediaries, 24 hours a day, 7 days a week.**

Prepared Statement of Judith A. Caden, Director, Loan Guaranty Service, Veterans Benefits Administration, U.S. Department of Veterans Affairs

Madam Chairwoman and members of the Committee, I appreciate the opportunity to appear before you today to discuss the subprime mortgage crisis and America's veterans.

The Subprime Crisis

"Subprime" is a generic term used to describe mortgage loans with interest rates higher than prime rates. The subprime loans that are causing the current crisis usually have several layers of risk associated with them. These layers of risk are generated by a combination of one or more factors, such as lack of income verification, lack of asset verification, lack of underwriting at a fully indexed rate, low borrower credit scores, large margins, low teaser rates, interest only payments, borrower option payments, and secondary liens. (Note: Industry often labels loans with some of these characteristics as Alt-A rather than subprime if borrowers have high credit scores.) VA guaranteed loans, on the other hand, have none of these characteristics and have carried an average borrower FICO credit rating of around 680, as compared to the subprime average of below 620.

In 2000, loans characterized as subprime represented a low percentage of all mortgage originations, and were made mostly to borrowers with low credit scores and small loan balances. By comparison, in 2006, subprime originations represented more than 20 percent of all mortgage originations, and borrowers, despite having slightly higher credit scores, carried much higher loan balances and much higher loan-to-value ratios.

Credit losses mounted from the record-setting losses of the subprime loans made in 2000. Secondary market investors recognized this risk and priced the potential of losing money on future investments to the point where originators of subprime mortgage loans could no longer afford to sell them. This lack of liquidity in the secondary market has had a tremendous impact on the ability and desire of lenders to originate subprime loans. It is the primary reason few institutions are willing to make them.

The VA-Guaranteed Home Loan Program

It is important to understand that the VA-guaranteed home loan program is not a part of the subprime mortgage market. VA-guaranteed home loans are not subprime products. Additionally, the average borrower using the VA-guaranteed home loan program does not have what would be considered a subprime credit score. To date, VA has not been affected by the current subprime turmoil as dramatically as lenders that have all or even some percentage of their portfolios concentrated in subprime loans.

The laws governing our program provide that VA-guaranteed home loans must be made in accordance with VA's credit underwriting standards, which are promulgated in VA regulations. Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses, and that the veteran is a satisfactory credit risk. VA's credit standards employ the use of debt-to-income ratios and residual income guidelines in determining the adequacy of the veteran's income. When evaluating borrower creditworthiness, however, VA's standards require lenders to evaluate all of the borrower's available credit data. In marginal cases, VA seeks to give veterans the benefit of the doubt with regard to credit and instructs lenders to examine compensating factors like the veteran's cash reserves, level of consumer debt, etc., when making an underwriting decision.

The VA program has fared well in recent years with regard to foreclosure rates. According to data from the Mortgage Bankers Association, between the third quarter of 2005 and the third quarter of 2007, VA's serious default rate declined, while all other mortgage types, including prime loans, rose.

That said, VA does operate in the broader mortgage marketplace and will be collaterally affected by the subprime turmoil currently affecting that market. This collateral effect will generally be the result of declining house prices.

Impact of Subprime Turmoil on VA Home Loan Borrowers

With additional foreclosed homes on the market and a glut of new construction available and weak demand, the inventory of unsold homes has risen. Concurrently, credit has tightened as investors, fearing the quality of subprime loans, withdraw funds from the mortgage market, causing even some well qualified buyers to experience difficulties in obtaining new mortgages. With supply now exceeding demand, prices have naturally declined.

In the current marketplace, there are fewer borrowers able or choosing to purchase homes and, therefore, fewer opportunities to sell homes. VA expects that its robust supplemental servicing program, which offers hope to many veterans with delinquent VA-guaranteed home loans, will be hampered by this situation. Most notably, the deflation in house prices eliminates certain foreclosure-avoidance tools that were previously available to us. The net result will be more foreclosures.

VA-Guaranteed Home Loan Protections

For veterans who obtained a VA-guaranteed home loan, VA can offer supplemental servicing assistance during times of financial hardship and default.

VA-guaranteed home loans are subject to certain regulatory requirements that allow us to help veterans retain ownership of their homes. The following briefly describes VA's supplemental servicing assistance to veterans in default on their VA-guaranteed home loans and the impact thereof.

VA Supplemental Servicing and Loss Mitigation

When VA receives notice that a veteran borrower has become seriously delinquent on his/her home loan, we take an active role in working to avoid foreclosure. VA's efforts include pursuing various options to cure the default, thereby allowing the veteran to retain ownership of his/her home. VA can intercede with the loan holder on the veteran's behalf. In the event the borrower can no longer maintain mortgage payments, VA encourages other alternatives to foreclosure to help mitigate the negative impact on the borrower.

In FY 2007, due in part to VA's loan servicing intervention efforts, foreclosure was avoided for more than 57 percent of the VA loans in serious default. Additionally, VA was able to intervene in 8,453 instances that resulted in successful loan reinstatement. As a result, VA avoided claim payments estimated at more than $181 million.

However, VA's supplemental servicing efforts will be significantly hampered by the effects of the depressed state of the subprime market and tight credit.

Specifically, house price deflation in certain areas will limit the options available to veterans hoping to avoid foreclosure.

During the most recent housing boom, house prices were such that a sale often netted the borrower an amount which would satisfy any outstanding mortgage debt. But in the current environment, house prices are deflated and many borrowers find themselves unable to sell at a price which would net an amount to satisfy the outstanding mortgage debt in time to avoid foreclosure. Secondly, as house prices and values decrease, so does a borrower's home equity. In many areas, borrowers now have less equity or no equity against which to borrow. In many areas home equity values have declined so substantially that this option is altogether eliminated.

VA Assistance for Veterans with Subprime Loans

For a veteran (or servicemember) who may have obtained a subprime loan, VA can offer general advice and guidance through our nine Regional Loan Centers. However, unlike the case of a veteran with a VA-guaranteed home loan, VA has no legal authority or standing to intervene on the subprime borrower's behalf.

Because VA only maintains home loan data on veterans who have taken advantage of the VA loan benefit, we are not aware of how many veterans may have mortgages that would be categorized as subprime. The Home Mortgage Disclosure Act does not require 'veteran status' to be collected as part of the loan applicant's data.

Regrettably, there are veterans who have subprime mortgages and who will be adversely affected by the subprime crisis. VA is prepared to offer as much assistance as possible to help veterans in this situation. Our VA Regional Loan Centers have Loan Service Representatives who can offer advice to all veterans who are experiencing home loan repayment difficulties, not just those veterans with VA-guaranteed loans.

VA is authorized to guarantee refinancing loans to veterans. However, if a veteran wishes to use his/her home loan benefit to refinance a subprime loan, the resulting loan-to-value ratio could not exceed 90 percent and the total dollar guaranty is limited to $36,000. This means that a veteran with no equity would be able to obtain a refinance loan for only 90 percent of the home's appraised value, and the maximum loan he/she could effectively obtain is $144,000.

VA Program Revisions with Safeguards

We are proud of the success of the VA home loan guaranty program in helping veterans obtain and retain homes. While the program has been expanded and modified over the years, it retains sound underwriting criteria.

Conclusion

VA expects that our program loan volume will increase. The lack of availability of mortgage credit, especially subprime products, in the conventional market will encourage veterans to obtain VA guaranteed loans. However, VA also expects that the supply glut in the marketplace and the resultant house price decreases will have a collateral effect on VA borrowers in default and that the number of foreclosures in our program will increase. VA stands ready to aid veterans in any way possible.

Madam Chairwoman, this concludes my testimony. I look forward to answering any questions you or the Committee members may have.

Statement of Todd Bowers, Director of Government Affairs, Iraq and Afghanistan Veterans of America

Madam Chairwoman, ranking member and distinguished members of the committee, on behalf of Iraq and Afghanistan Veterans of America, I thank you for the opportunity to testify today regarding the Subprime Mortgage Crisis and America's veterans. I respectfully request that my testimony today be submitted for the record. I also ask that the Committee note that my testimony today is in my civilian capacity as the Director of Government Affairs for Iraq and Afghanistan Veterans of America and does not necessarily represent the views of the United States Marine Corps Reserve.

In World War Two, it was the dream of millions of veterans to own their own homes. The veteran home-loan program made this possible for thousands of them. Today's combat veterans have the same dream, and the VA is still here to help them. The VA currently guarantees 2.2 million home loans, totaling $243 billion dollars. They guarantee about 11,109 new home loans every month, over half of which go to first-time home buyers. Simply put, the VA's home loan protections are still helping veterans achieve the American dream.

Like all Americans, however, today's veterans have been affected by the downturn in the economy and the mortgage crisis. According to a VA-commissioned 2007 study, 18% of the veterans who sought jobs within three years of discharge were unemployed. A quarter of those who did find jobs were earning less than $22,000 a year. In addition, the VA has already seen 1,500 homeless Iraq and Afghanistan veterans.

These statistics are shocking, and without quick action, we can expect them to worsen. I am pleased to see that Congress has taken initial steps to appropriately address this issue. We believe that the following two pieces of legislation will aid veterans in their transition:

H.R. 4884, The Veteran Home Loan Guaranty Improvement Act of 2008, will make home loans more accessible to veterans by easing restrictions on the home loan guaranty programs administered by the Department of Veterans Affairs (VA). The bill eliminates the equity requirements for refinancing in response to the declining home values which prohibit many veterans from qualifying for the benefit. The bill also reduces the VA guaranteed home loan funding fees to one percent and eliminates the funding fees for veterans seeking to refinance a home loan, among other things.

H.R. 4883 will prohibit foreclosure of property owned by a servicemember for one year following a period of military service.

I thank you for providing me the opportunity to testify before you this afternoon. I hope that the information I have provided you will effectively lay the ground work for the committee make significant changes to the current obstacles that our nation's newest veterans are facing.

Statement of Kieran P. Quinn, CMB, Chairman, Mortgage Bankers Association

Madam Chairwoman, Ranking Member Boozman and Members of the Subcommittee, I am Kieran P. Quinn, Chairman of the Mortgage Bankers Association (MBA).[1] I am pleased to have the opportunity to discuss the effects of the subprime mortgage situation on America's veterans, how we can work together to stabilize the

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand home ownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

mortgage market, help borrowers in trouble and prevent some of the current problems from occurring again.

MBA shares your concerns for helping veterans achieve the dream of home ownership in responsible and sustainable ways. While we at MBA do not have access to specific statistics about how the subprime market transition is impacting servicemembers or veterans, we believe it is valuable for you to know what the situation is in the market today and what mortgage companies are doing to address the needs of all consumers.

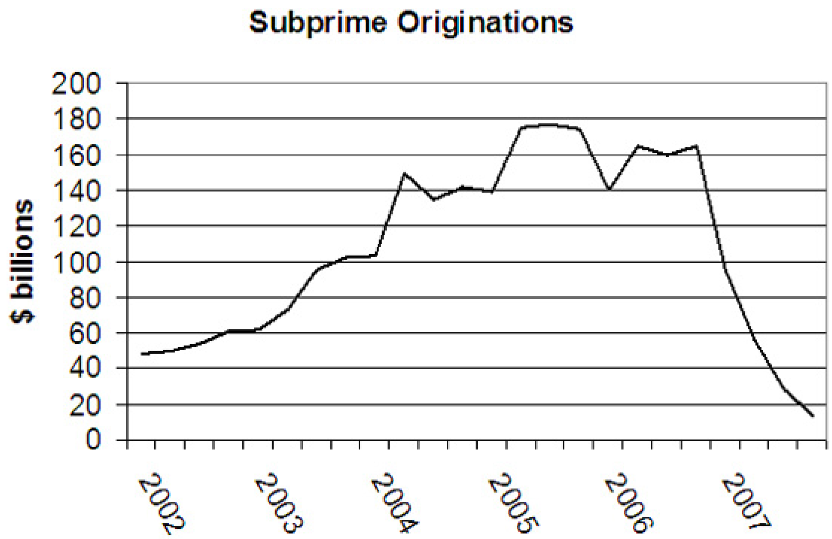
Current Market Conditions

Fundamentally, the demand for housing is driven by household formation and job creation. The single most important step Congress can take to support the housing market is to encourage long-term economic growth through sound fiscal and tax policy. Members of Congress should also recognize that housing and mortgage delinquencies react to economic conditions and are not a key driver of those conditions. States such as Ohio and Michigan have seen an exodus of jobs and population, stranding a significant amount of housing stock and lowering home prices in the region. States such as California, Florida, Arizona and Nevada experienced speculative home purchases that far outpaced the rate of household growth, causing home prices to retreat to levels of about two years ago. As long as economic growth continues, these Sunbelt states should be able to grow out of their problems. Other sections of the country face more long-term and intractable problems.

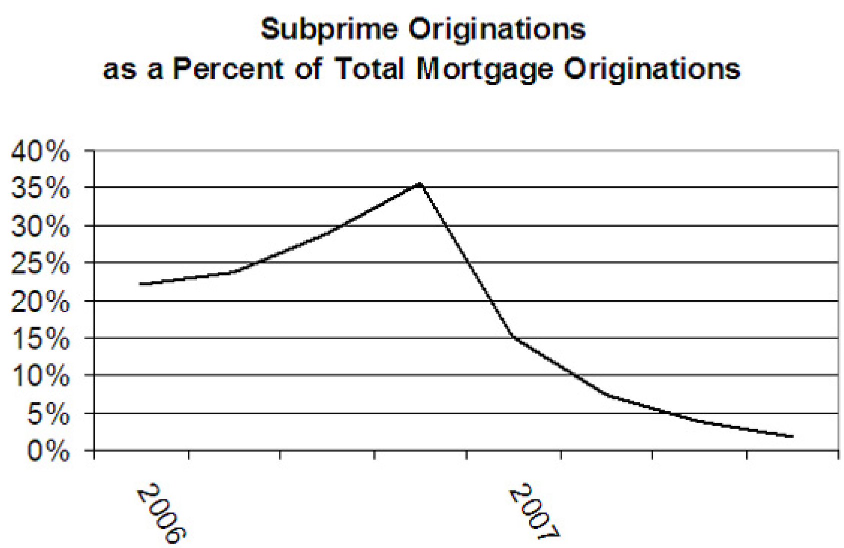
It is significant to note that subprime lending has already essentially stopped, due entirely to the reaction of the world capital markets to how these loans are performing. While quarterly originations of subprime loans hit a high of $177 billion in the third quarter of 2005, and were as high as $165 billion as recently as the fourth quarter of 2006, one year later they were down to $14 billion in the fourth quarter of 2007, according to the publication, "Inside B&C Lending." This is a 92-percent decline. As a percent of total mortgage originations, subprime loans were 36 percent of MBA's estimated total origination in the fourth quarter of 2006, and were 2 percent of mortgage originations by the end of 2007.

Historically, the major cause of delinquencies and foreclosures is job-related, as can be seen in the upper Midwest. However, in the last year, delinquency and foreclosure rates have increased due to upward rate adjustments on Adjustable Rate Mortgages (ARMs) combined with falling home prices. With the recent decline in interest rates, more homeowners are receiving favorable mortgage rates, either through lessening the burden on ARM adjustments or more favorable refinance opportunities. However, housing price declines make it harder for borrowers to qualify for certain mortgages, such as a loan taken out with a 10 percent downpayment (90 percent loan-to-value, or LTV), for example, may now be a 100 percent LTV loan due to a 10 percent house price decrease.

Given increased delinquency and foreclosure rates, lenders are taking significant action to help borrowers.



Source: Inside B&C Lending



Source: Inside B&C Lending and MBA Mortgage Finance Forecasts

HOPE NOW: Progress in Helping Struggling Homeowners

The HOPE NOW Alliance is a broad-based collaboration between credit and home ownership counselors, lenders, investors, mortgage market participants and trade associations, including MBA. The Secretaries of the U.S. Departments of the Treasury and Housing and Urban Development encouraged MBA to build on the efforts Members of Congress, State and local leaders and federal regulators urged us to undertake. HOPE NOW has established a coordinated, national approach among servicers, investors,[2] non-profit housing counselors and other industry participants to enhance our ability to reach out to borrowers who may have or expect to have difficulty making their mortgage payments and to offer them workable options to avoid foreclosure. The HOPE NOW Alliance is achieving real results in reaching at-risk borrowers and in providing positive solutions that avoid foreclosure.

The Alliance is continuing to expand and add members who commit to specific efforts to reach and assist borrowers. As of February 25th, 27 loan servicers, representing over 90 percent of the subprime market, were in the Alliance. In addition, we have strong participation from respected non-profits, led by NeighborWorks America and the Homeownership Preservation Foundation, with its network of trained telephone counselors. We are also expanding our network of non-profits every day.

One of the Alliance's first steps was to demonstrate a commitment to results by adopting a Statement of Principles to help distressed homeowners stay in their homes. These principles will help ensure all borrowers receive quality service and assistance when they contact their lender/servicer in the Alliance.

The following are the principles embraced by HOPE NOW servicers, which are consistent with calls for the industry to expedite solutions for borrowers:

- HOPE NOW members agree to attempt to contact at-risk borrowers 120 days, at a minimum, prior to the initial ARM reset on all 2/28 and 3/27 ARM loan products;
- HOPE NOW members agree to inform borrowers of the potential increase in payment and terms of the loan, in an effort to determine if the borrower may face financial difficulty in keeping their mortgage current;
- HOPE NOW members agree to establish a single port of entry for all participating counselors to use; and
- HOPE NOW members agree to make available dedicated e-mail and fax connections to support counselor and consumer contacts.

By establishing these principles, HOPE NOW members are improving the infrastructure needed to help more borrowers on a much larger scale. In addition to improving lender/servicer systems for working with counselors and borrowers, we must continue to increase our efforts to reach out to at-risk borrowers.

The most significant barrier to helping consumers is a persistent reluctance of struggling borrowers to respond to servicers' efforts to offer help. Historically, about half of borrowers who go into foreclosure never contact their servicer for help or reply to outreach efforts. Freddie Mac reported at the end of January that 57 percent of the Nation's late-paying borrowers still do not know their lenders may offer alternatives to help avoid foreclosure.[3] MBA is working to drastically reduce that percentage and help as many troubled homeowners as possible avoid foreclosure.

In November, HOPE NOW servicer participants began a monthly direct mail outreach campaign to at-risk borrowers. This direct mail effort—on the HOPE NOW letterhead—is in addition to the thousands of letters and telephone contacts made by individual servicers to their own customers. In the first direct mail effort in November, HOPE NOW members sent more than 215,000 letters to borrowers who are behind on their mortgage payments and who have not had contact with their servicer. The November letter provided a dedicated phone number for the individual borrower to use to call their own servicer for help. As a result of these letters, more than 16 percent of borrowers contacted their servicer, far more than the normal 2–3 percent.

In December, HOPE NOW began a second wave of direct mail outreach to 250,000 at-risk homeowners, providing individual servicer hotlines as well as the 888–995–HOPE Hotline hosted by the Homeownership Preservation Foundation. A third direct mail effort was launched on January 22nd. HOPE NOW will report the results as data are compiled.

The Homeowner's HOPE Hotline is a key component of the outreach and assistance effort for at-risk homeowners. The hotline directly connects homeowners with trained counselors at U.S. Department of Housing and Urban Development (HUD)-certified non-profit counseling agencies. This counseling service is completely free and is offered in English and Spanish. The counselors have direct access to the lend-

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[2] After a mortgage is made, the lender will often sell the loan to investors. A loan servicer acts as the intermediary between the borrower and the investor. The servicer's role is to collect payments, handle escrow accounts, forward principal and interest payments to the investor and deal with issues that arise from delinquency and foreclosure. A servicer is typically compensated 25 basis points (0.25%) of the loan balance for performing this service, or $250 on a $100,000 loan balance.

[3] http://www.freddiemac.com/news/archives/corporate/2008/20080131_07ropersurvey.html

er/servicers through improved single points of entry all HOPE NOW Alliance members agreed to create.

The Homeowner's HOPE Hotline is having a dramatic and positive impact for at-risk homeowners. The HOPE NOW Alliance will continue to expand the Hotline's capacity and promote it to reach more at-risk borrowers. Some basic statistics about Hotline activity in recent months includes:

- Since the Homeowner's HOPE Hotline's inception in 2003, it has received over 323,904 calls, over 245,000 calls received in 2007;
- 124,357 homeowners received counseling after calling the Hotline, 83,000 occurred in 2007 and almost 20,000 in January 2008;
- Calls are increasing monthly. In December 2007, there were 93,794 calls to the Hotline that produced 15,462 counseling sessions;
- In January 2008, there were 82,569 calls that produced 19,558 counseling sessions;
- The counseling sessions produced results. Through October 26, 2007, more than half of all homeowners counseled have been connected with their lender for assistance, and one quarter of all homeowners counseled in the fourth quarter of 2007 were referred to their lender for a recommended workout;
- Counseling sessions are rapidly increasing. Call volume increased nearly 10-fold between first quarter 2007 and fourth quarter 2007;
- Lenders/servicers are urging borrowers to call for counseling. Homeowners primarily hear about the Homeowner's HOPE hotline from their lender;
- More homeowners with ARMs are calling—49 percent of callers in the fourth quarter of 2007 were ARM borrowers, up from 34 percent in the first quarter.

Publicity for the Homeowner's HOPE Hotline continues to increase. We are proud that the Homeowner's HOPE Hotline provides a resource for free, non-profit counseling to any homeowner, anywhere in the country. President Bush, Treasury Secretary Paulson and HUD Secretary Jackson have mentioned the Homeowner's HOPE Hotline several times in public statements and have urged homeowners in trouble to seek help. Members of Congress have also highlighted the hotline. Thirty-eight Mayors from across the country recently created public service announcements for their local media markets urging borrowers to use the hotline. NeighborWorks is also working with the Ad Council on the national advertising campaign for the Homeowners' HOPE hotline, which includes television, radio and print materials. Any time the Homeowner's HOPE Hotline is mentioned by public officials or on television, calls to the hotline increase dramatically. MBA welcomes that support and continues to work to expand the counseling network for the hotline.

Members of Congress, in an effort to help their constituents avoid foreclosure, have asked on many occasions what they could do to help. The single most important thing Members and other community leaders can do to help people stay out of foreclosure is to publicize the HOPE NOW efforts, particularly the Homeowner's HOPE Hotline, 888–995–HOPE.

The Homeownership Preservation Foundation, the HOPE NOW Alliance member managing the telephone network, continues to add trained, experienced counselors to the program to handle the increasing call volume from concerned homeowners. Tremendous progress has been made in just the last few months. The hotline now has 400 trained counselors assisting borrowers, up from 64 at the beginning of 2007.

NeighborWorks America, known formally as the Neighborhood Reinvestment Corporation, is a Congressionally chartered non-profit organization with a national network of more than 240 community-based organizations in 50 states. NeighborWorks is a leader in the HOPE NOW Alliance, and with its partners, is actively providing in-person counseling services to consumers across the country.

HOPE NOW is working to add more non-profit agencies to the effort. In December, NeighborWorks and other HOPE NOW Alliance members met with HUD and other HUD counseling intermediaries to review ways to include additional grass-roots counseling groups. MBA is working to broaden the HOPE NOW effort to ensure it is a model that works broadly for consumers, industry and non-profits to maximize the ability to reach troubled borrowers.

Servicers' ability to reach borrowers, either directly or through an intermediary, is the key to helping them stay in their homes. The solutions will vary with each individual borrower's circumstances. Prudent and responsible loan modifications, repayment plans and other types of workout options are solutions to help borrowers keep their homes and minimize losses to investors. The HOPE NOW Alliance is committed to pursuing all viable solutions to help people stay in their homes.

Tools for Helping Struggling Borrowers

It makes good economic sense for mortgage servicers to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are very costly to the servicer. Servicers must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, significant staff resources must be employed to contact borrowers, assess the situation, work on repayment plans and other loss mitigation solutions, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance plans are generally the first tool servicers employ to help borrowers. Servicers allow mortgagors to miss a payment, with the explicit understanding the payment(s) will be made up some time soon. If the situation is more involved than a short-term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended timeframe.

Loan modifications are the next level of loss mitigation options. A loan modification is a change in the underlying loan document. It might extend the course of the loan, change the rate, change repayment terms or make other alterations. Similarly, a servicer may attempt to refinance the delinquent borrower into a new loan. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because the current loan terms are not sustainable for that borrower.

HOPE NOW members have worked aggressively to make all of the available tools as efficient as possible. Lenders and servicers worked diligently with the American Securitization Forum (ASF) to create a framework to more readily modify certain at-risk loans securitized in the secondary market. This effort has received the backing of the U.S. Departments of the Treasury and HUD, many Members of Congress, the federal banking agencies and state and local officials.

The focus of the effort has been to identify categories of current subprime hybrid ARM borrowers who can be streamlined into refinance or modifications. MBA believes the ASF-established framework will add to existing efforts to assist distressed borrowers. The key is to find solutions which help borrowers but do not violate the agreements with investors who now own the securities containing these loans.

The ASF has worked with servicers and investors to implement a system which identifies, in advance of loan resets, borrowers who would qualify for refinancing, loan modifications or other workout options. To ensure investors accept and support far-reaching loan modification and other workout solutions, this system cannot violate pooling and servicing agreements with investors. The goal is to minimize the risk of legal action by investors against servicers who help borrowers.

The ASF framework covers securitized subprime adjustable rate mortgage loans, the 2/28's and 3/27's originated between January 1, 2005 and July 31, 2007 with an initial interest rate that resets between January 1, 2008 and July 31, 2010. In other words, the framework is for loans that have just begun to adjust. The ASF framework will help provide solutions for homeowners with these subprime hybrid ARMs who qualify for three different types of help: refinancing, modification and other loss mitigation efforts.

- *Refinancing:* One segment of borrowers is comprised of those who are current, likely to remain current even after reset, or likely to be able to refinance into available mortgage products, including the Federal Housing Administration (FHA), FHA Secure or industry products. Generally, the servicer will determine whether loans may be eligible for refinancing into various available products based on readily available data such as LTV, loan amount, credit score and payment history. The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties whenever feasible. HOPE NOW will continue to work with the alliance to ensure all servicers have access to products and programs generally available in the market to refinance eligible borrowers.
- *Loan Modifications:* A second segment of borrowers is comprised of those with good payment records who will not qualify for refinancing for any variety of reasons, such as a drop in home equity or insufficient credit score. These borrowers will be targeted for streamlined loan modifications if the loan is a primary residence (i.e., not an investment or vacation property) and meets additional criteria. Borrowers in this category will be offered a loan modification under which the interest rate will be kept at the existing rate of the loan for five years. This fast track option does not in any way preclude a servicer from conducting a

more individual in-depth review, analysis and unique modification for a borrower to determine if a longer term modification would be appropriate.

The fast track framework allows the servicer to make these decisions:

- Whether the borrower is unable to pay under the original loan terms after the upcoming reset and default is reasonably foreseeable, based on the size of the payment increase, and the current income if the borrower did not pass the credit score improvement test;
- Whether the borrower will be able to pay a modified loan based on payment history prior to the reset date;
- Whether the borrower is willing to pay a modified loan; and
- Whether the modification will maximize the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are not available and the borrower is able and willing to pay under the modified terms.

- *Loss Mitigation:* This third segment of borrowers is comprised of those for whom the loan is not current and will be unable to refinance into any available product. These borrowers are significantly behind in their payments before the loan resets and their situations need to be individually evaluated. It is especially important for us to reach this group of borrowers through efforts such as the HOPE NOW direct mail campaign and through the national advertising campaign for the Homeowner's HOPE hotline. For loans in this category, the servicer will determine the appropriate workout and loss mitigation approach on a loan-by-loan basis. Referrals from counselors if the borrowers contact the Homeowners' HOPE Hotline will also be important. Approaches for these borrowers may include loan modification (including longer term-rate reductions, capitalization of arrearages and term extensions), forbearance, short sale, deeds in lieu of foreclosure or foreclosure. Because these borrowers are already behind in their payments, and may face challenges such as a loss of income or other issues, they require a more intensive analysis, including current debt and income analysis, to determine the appropriate loss mitigation approach.

Servicers, however, can only help borrowers who come forward for help. Borrowers must respond to servicers' notices and phone calls. At some point, the servicer has to assume the homeowner has no intention of paying off the obligation. It is also important to note the options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of the American economy relies on the willingness of people to take risks, but risk means you do not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans. In the third quarter of 2007, 18 percent of foreclosure actions started were on non-owner occupied properties. Foreclosure starts for the same period for non-owner occupied properties in Arizona, Florida, Nevada and Ohio were at 22 percent.

HOPE NOW helps all borrowers, not just subprime ARM borrowers eligible for fast track refinance or modifications. The ASF framework for a streamlined, scalable solution for current borrowers facing a reset allows servicers to give more detailed attention to at-risk, hard-to-reach, delinquent borrowers. Servicers will be able to work closely with credit counselors and/or homeowners to ensure all options are explored to avoid foreclosures. The scalable outreach and modification effort in no way precludes on-going workout solutions for the highest risk delinquent borrowers. By having this framework in place, human capital and other resources are able to focus on the cases that require the most attention.

Measuring Results

MBA recognizes results are the key to this national effort to assist at-risk homeowners. The latest results from HOPE NOW servicers on their foreclosure prevention efforts in the second half of 2007 are attached. This latest HOPE NOW data, released on February 6th, shows significantly more homeowners received assistance than previously estimated.

Fourteen HOPE NOW servicers responsible for more than 33.3 million home loans (about 62 percent of both prime and subprime loans outstanding nationwide), as of September 2007, provided the data. The latest report shows an estimated 869,000 homeowners were helped in the second half of 2007 through either formal repayment plans (652,000) or loan modifications (217,000).

During the same period, 283,000 foreclosure sales were completed. Based on 1,446,000 average monthly delinquencies of 60 days or more past due during the second half of 2007, 45.3 percent received a formal repayment plan, 14.8 percent received a modification and 19.7 percent resulted in a completed foreclosure sale.

The data for the second half of 2007 reveal 324,000 prime borrowers and 545,000 subprime borrowers were helped:

- 20.7 percent of prime borrowers received a modification;
- 27.5 percent of subprime borrowers received a modification; and
- 34.8 percent of subprime borrowers, during the fourth quarter, received a modification, indicating a rapid increase in the use of modifications as a loss mitigation solution.

In addition, information was collected on foreclosure activity and trends. These statistics are revealing. While there appears to be a large number of foreclosures initiated by servicers, only one-third of foreclosures initiated actually result in a completed sale. Frequently, borrowers do not respond to servicers' attempts to contact them until they receive their first legal action notice. HOPE NOW's borrower outreach initiatives are already increasing the number of borrowers who respond before a foreclosure action is initiated.

The latest state-level data from HOPE NOW servicers show that efforts to help borrowers are rapidly increasing. The trend in formal repayment plans is up in all states but more so in the states that experienced rapid and substantial increases, and now declines, in home prices. That is to be expected because of the more rapid increase in delinquencies in those states. However, it is clear in all states the upward trend in loan modifications completed is much greater than the upward trends in delinquencies and in formal repayment plans, which clearly indicates servicers increasingly are working with borrowers to modify the terms of their loans. The upward trend in loan modifications is much more pronounced in the states with substantial increases in home prices. We believe the upward trend in loan modifications and repayment plans will continue and more homeowners will receive the help they need to stay in their homes.

As you can see, we are tracking and measuring outcomes through HOPE NOW and other efforts. In addition to the data reported here, we are measuring trends in delinquencies and resolution outcomes (i.e. reinstatement, repayment plans, modifications, short sales, deeds in lieu of foreclosure, partial claims and foreclosure). We want to provide consistent and informative data reports based on common definitions and to provide insights into the nature and extent of the current mortgage crisis that will help in the development of workable solutions that avoid foreclosure whenever possible.

As promised at the start of HOPE NOW, as data collection initiatives mature and the data are validated, MBA is providing more detailed information nationally and on a state-by-state basis. As noted, the Alliance is growing weekly. Participating servicers have been engaged in developing standard definitions for key loss mitigation data. The data collection effort is an enormous undertaking, which will take time to fully develop and perfect. We are confident, however, to be able to deliver information at the state level to help measure what servicers are doing to resolve difficult situations and to assist homeowners.

Misinterpretation of Key Report Fuels Public Concern

On January 17, MBA released a study of actions lenders took to assist borrowers in the third quarter of 2007. The paper also discussed something known in the industry as the "Moody's 1% Number." In September 2007, Moody's released a study suggesting the mortgage industry had only assisted one percent of the people who needed help. A later report in December showed an increase of this number to 3.5 percent.[4] In that same report Moody's made a much-overlooked but critical statement: "The ratio of loans that were modified or on a workout plan as a percentage of seriously delinquent loans active as of September 30th (60+ days), a meaningful barometer of the extent to which servicers are undertaking loss mitigation activity, was 24 percent." Servicers had undertaken loss mitigation activity for nearly one in four distressed borrowers and this was before any of the streamlined modifications had begun or the HOPE NOW efforts had really expanded.

Despite this important statement, some continue to focus on the 3.5 percent number when Moody's itself has made it clear the 24 percent number is the "meaningful" indicator. This is the case because not every subprime ARM borrower needs

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[4] Various groups have used the 3.5 percent figure as a political rally cry despite the fact that this admittedly flawed indicator represents a tripling of loan modification activity since the September report.

help; in the third quarter of 2007, according to MBA's National Delinquency Survey, approximately 70 percent of subprime ARM borrowers were paying on time. The December 2007 Moody's report itself reveals that more than half of the loans evaluated prepaid or refinanced before resets occurred. This population does not need loss mitigation assistance. Unfortunately this important fact is often overlooked and consistently underreported by the media.

Efforts to Serve and Assist Veterans and Servicemembers

Qualifying veterans and servicemembers have access to favorable loan terms through the Department of Veterans Affairs (VA) loan program. This program offers veterans and servicemembers 100 percent financing in exchange for a small funding fee (e.g. guaranty fee) which can be financed into the mortgage. The federal government provides this help to veterans and servicemembers not by actually making the loan, but by providing a guarantee that protects the lender against losses in the event of foreclosure. The guarantee is a form of credit enhancement that allows lenders to provide 100 percent financing.

Servicemembers who are in active duty status also have critical protections available to them under the Servicemembers Civil Relief Act (SCRA).[5] In particular, interest rates for mortgages taken out prior to active duty status are reduced or capped at six percent while the servicemember is on active duty. The interest rate differential between the note rate and the six percent cap is not deferred, but forgiven.

Moreover, SCRA prohibits foreclosure and eviction actions during the servicemember's period of active duty plus an additional three months. These are significant protections that recognize the importance of our servicemembers' efforts in defending our country. These benefits are unique to active duty military personnel.

Legislative Efforts to Address Market Conditions

Congress has acted robustly to address challenges in the mortgage market. This hearing, along with over a dozen others in various Committees, has illuminated how the mortgage market works, recent failings in market operations and how Congress can address the issues. Congress has also worked with the Executive branch and industry in creating and supporting the HOPE NOW initiative, which I discussed earlier.

MBA continues to believe transparency in the mortgage process needs to be improved to help borrowers understand, shop for and choose the loan to best meet their needs. We also believe a uniform national mortgage consumer protection standard for all home buyers will simplify the process for borrowers and protect them, facilitate better enforcement against predatory practices and assist the smooth flow of global capital into the mortgage market.

Since last February, it has become clear that industry participants and policy makers needed to respond to the credit crunch and market conditions. In December, Congress passed important legislation extending the mortgage insurance deduction and providing tax relief for forgiven mortgage debt. Also last year, HUD launched the *FHASecure* program to help borrowers who have made their payments before a rate reset refinance into a FHA-insured loan.

Fiscal and monetary policy must also respond to the current weakness in the overall economy. Congress recently passed an economic stimulus which will help the market in two ways. First, it will stimulate the economy directly through payments to consumers and indirectly through tax changes. It will also help by temporarily raising the loan limits for investment by Fannie Mae, Freddie Mac and for FHA loans. This will result in a more stable housing system, particularly addressing the situation in high-cost states like California. Further, Congress should make clear what the rules of the game are, so the current market upheaval is not exacerbated by a rapid change in regulation. These include passage of a uniform national mortgage lending standard, regulatory reform of the housing government sponsored enterprises (Fannie Mae and Freddie Mac) and FHA modernization.

Efforts that would serve to increase prices or push market participants out of the housing finance system, such as efforts to encourage more consumers to file for bankruptcy, should be avoided. In order for the market to change course, certainty must be realized by consumers, lenders and investors. With the possibility of major investor liability still on the horizon, secondary market participants and mortgage lenders will remain apprehensive of lending to all but borrowers with perfect credit. The longer these fears remain, the longer the national housing market will take to rebound.

[5] 50 U.S.C. App. 501 et seq.

Conclusions

MBA is pleased to have this opportunity to discuss the situation in the mortgage market and how we can help stabilize the market, assist those who are in trouble and how we can prevent today's problems from recurring.

In the midst of the concern for the market, it is important to keep in mind the benefits of home ownership. Homeownership makes American communities stronger, by giving families ownership interest in what is happening around them. Crime goes down and educational achievement increases. Owning your own home is still the best way to build, grow and maintain wealth in America today. As Congress wrestles with ways to address the market, we ask that the goal be to increase home ownership—in responsible and sustainable ways—and that Congress refrain from efforts that will make it harder for American families to achieve the dream of home ownership.

Thank you for the opportunity to present our testimony on this important issue.

Statement of Justin M. Brown, Legislative Associate, National Legislative Service, Veterans of Foreign Wars of the United States

MADAM CHAIRWOMAN AND MEMBERS OF THIS SUBCOMMITTEE:

On behalf of the 2.3 million members of the Veterans of Foreign Wars of the United States and our Auxiliaries, I would like to thank you for the opportunity to testify before this distinguished body. The subprime mortgage crisis is an issue that is affecting the entirety of our Nation. We appreciate this Committee's rigor in recognizing the affects it will have upon American veterans. The thought of America's heroes in the streets due to their use of a bad financial tool makes us all shudder. It is of the utmost importance, that if nothing else, we learn from our mistakes and insure this never happens again.

Unfortunately, we have no veteran specific information on veterans' exposure to the subprime mortgage market because it is not tracked. It is important to note that Department of Veterans Affairs (VA) home loan guarantees did not apply to subprime loans and are not being directly affected by the subprime mortgage crisis. However, veterans have used multiple financial tools to purchase their homes, including subprime mortgages. We do have some opinions as to why some veterans may be finding themselves faced with a subprime mortgage foreclosure: the veteran was working with predatory lenders, the veteran did not have access to prime loans, the veteran lacked knowledge or qualification for a VA home loan, the veteran lived in a large urban area in which housing averages exceeded the VA home loan cap, or the veteran had a bad or lower credit score due to deployments, or any combination of the above.

The VA home loan process is very lengthy, and costly, to both lenders and veterans. This bureaucratic red-tape may have become an incentive for lenders and real-estate agents to discourage VA home loans and may have led to veterans using subprime mortgages. Also, VA home loans are capped at a level cost prohibitive to certain geographic regions. The unreasonable VA loan cap in expensive urban districts may have led several veterans to subprime loans in those areas. In comparison to VA home loan guarantees, Federal Housing Authority home loan caps vary by state and county allowing prospective mortgagees more flexibility.

We strongly recommend that measures be introduced to strengthen and expand the use of the VA home loan guarantee program for veterans. In the housing market crunch, veterans are likely to rely more heavily on VA home loans as access to capital becomes more difficult and guaranteed loans become more attractive to lenders.

Our primary recommendations for the VA home loan guarantee program are: raise the maximum cap of VA home loans specific to the needs and averages of individual communities, decrease the completion time of a VA guaranteed home loan (thereby decreasing the likelihood of lenders to encourage alternative less attractive mortgage options), repeal the funding fee to obtain a VA loan guarantee, and increase outreach and access to VA home loan specific information.

The Veterans of Foreign Wars are appalled that there are individuals in our country who targeted veterans and others for substandard loans knowing they would likely default after the initial rates were raised. Those individuals have done their country, and the men and women who served it so proudly, a great disservice.

Let us all work hard for our future and those affected by this terrible tragedy. We are a great Nation and our people deserve better.

Madam Chairwoman, Ranking Member Boozman, and members of this Subcommittee I thank you for the opportunity to testify and am happy to answer any questions you may have.