S. HRG. 113–577

# INEQUALITY, OPPORTUNITY, AND THE HOUSING MARKET

## HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

OF THE

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

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING ONGOING CHALLENGES AND DISPARITIES IN THE HOUSING MARKET AND HOUSING FINANCE SYSTEM

DECEMBER 9, 2014

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# C O N T E N T S

## TUESDAY, DECEMBER 9, 2014



## WITNESSES

# INEQUALITY, OPPORTUNITY, AND THE HOUSING MARKET

**TUESDAY, DECEMBER 9, 2014**

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

The Subcommittee met at 11:20 a.m., in room 538, Dirksen Senate Office Building, Hon. Robert Menendez, Chairman of the Subcommittee, presiding.

## OPENING STATEMENT OF CHAIRMAN ROBERT MENENDEZ

Chairman MENENDEZ. This hearing will come to order. Let me apologize to our witnesses and to our audience. We had votes taking place, so we are starting a little later.

The housing market was at the epicenter of the financial crisis and the Great Recession that followed. Lenders entered into risky and unsafe mortgages with bars which were packaged and sold to investors, all with a view that housing prices would keep bubbling upward. When prices stopped rising and the bubble popped, the devastation was broad for families, businesses, communities, and our financial system and economy.

Today, the housing market, much like our economy, is rebounding, but important challenges still remain. The number of households in foreclosure has fallen from its peak, but it still exceeds 600,000 nationwide. The number of homeowners in negative equity is also falling as prices have rebounded, but over five million homeowners across our country still owe more on their mortgages than the value of their homes.

The national numbers, moreover, do not always tell the complete story, as experiences vary considerably across geographic areas, demographic groups, and market segments. In my home State of New Jersey, for example, nearly 6 percent of homeowners with a mortgage are in the foreclosure process, the highest rate in the Nation.

In communities with high concentration of foreclosed properties or distressed borrowers, the consequences can be devastating and the economic recovery slow. Families looking to become homeowners or move up in the market also face challenges. During the boom years, lenders made and securitized risky loans that borrowers could not afford. But now, it seems that borrowers of more modest means, instead of receiving modest, responsible loans, are having a hard time getting a mortgage at all. First-time home buyers in underserved communities, in particular, are feeling the impact.

Today's hearing will examine challenges such as these that still face us in the housing market. I look forward to hearing from our witnesses regarding the factors that may be contributing to each as well as potential solutions.

Are there any other Senators who wish to offer an opening statement? If not, then let me introduce our witnesses.

Wayne Meyer is the President of New Jersey Community Capital, a community development financial institution based in New Brunswick, New Jersey, whose work is well known in our State, and I want to thank you for making the trip from New Jersey for our hearing today.

Mabél Guzmán is the 2014 Chair of the Conventional Financing Committee of the National Association of Realtors and former President of the Chicago Association of Realtors, and she is testifying today on behalf of the National Association of Realtors. We welcome you.

Julia Gordon is the Director of Housing Finance and Policy at the Center for American Progress, where she works on the future of housing finance, foreclosure prevention, access to sustainable mortgages and affordable rental housing, and other housing-related policies. We thank you for coming.

And, finally, Deborah Goldberg is the Special Project Director at the National Fair Housing Alliance, a national organization dedicated to ending discrimination in the housing market. She plays a lead role in the Alliance's public policy work on foreclosure prevention, mortgage lending, and financial regulatory and housing finance reform. We thank you for being back to the Committee, as well.

So, let me just advise you all, your full statements will be entered into the record, without objection. I would ask you to summarize your statement for about 5 minutes or so, so that we could enter into a dialogue at the end of your collective testimony.

And with that, Mr. Meyer, we will start with you.

**STATEMENT OF WAYNE T. MEYER, PRESIDENT, NEW JERSEY COMMUNITY CAPITAL**

Mr. MEYER. Thank you, Senator Menendez and Members of the Subcommittee, for this opportunity to speak with you today. My name is Wayne Meyer and I am the President of New Jersey Community Capital, which is the largest nonprofit community development financial institution, or CDFI, in the State of New Jersey. I would like to share with you several approaches that my organization has been taking to prevent and mitigate foreclosures and to stabilize distressed housing markets in New Jersey.

First, I would like to briefly discuss challenges facing our State, because while the housing market has begun to turn the corner in some places, New Jersey is still very much in a housing crisis. The data bears this out. As of June 2014, 5.7 percent of homes in New Jersey were in foreclosure and 9.3 percent more were seriously delinquent, the highest rate in the Nation. Twelve-point-eight percent of mortgaged homes in the State had negative equity, comprising 240,000 homes threatened by foreclosure and abandonment. Concurrently, mortgage credit has been extremely inaccessible for even stable, moderate-income New Jersey homebuyers.

Finally, New Jersey has the fourth-highest rental costs of any State, and these costs are rising, even as wages for the bottom 50 percent of New Jersey earners has declined by a dollar an hour in the past year. As a result, many lower-income families are spending half their income on rental housing, which is simply unacceptable.

For New Jersey Community Capital, an equitable housing market has been and remains a fundamental pillar for stabilizing neighborhoods and increasing the well-being and economic mobility of lower-income families. From our perspective, without economic mobility, there is no progress.

In my written testimony, I have discussed four solutions that New Jersey Community Capital has developed to combat New Jersey's persistent housing crisis. They center around our lending strategies, our Mortgage Loan Purchase Program, our real estate development arm and strategies, as well as mortgage lending. I believe that our holistic approach is one that, with the right support and partnerships, could be effective in many distressed communities around the country. In the interest of time, I would like to really highlight two of those particular programs that we believe are really important in addressing ongoing housing obstacles and creating opportunities to jump-start the housing market.

The first is around lending. In New Jersey, we have witnessed an increasing shortage of capital from financial institutions to lend to nonprofit community development organizations and others who wish to acquire, redevelop, and put back into productive use vacant and abandoned housing. Every year, New Jersey Community Capital invests millions of dollars into the creation and preservation of hundreds of for-sell and rental affordable housing units in a very difficult financial climate. Since the advent of the economic crisis, we find that CDFIs like NJCC have taken on even a larger role in lending in this certain area.

Furthermore, there has been a lack of access to mortgage credit. So, in response, New Jersey Community Capital is partnering with the State's largest credit union to create a Credit Union Service Organization which will provide CRA-qualifying mortgage credit and credit counseling to qualifying prospective low- and moderate-income homebuyers that cannot access mortgages in their traditional market.

Second, I would like to talk, if I may, about our ReStart Mortgage Loan Purchase Program. Senator Menendez, at a field hearing you held in New Jersey in 2012, when you held the field hearing in New Jersey, I talked about the need for us to be able to acquire mortgages while people were still in their homes, to get ahead of the problem, to be in the front end to make sure we can preserve home ownership. Over the last 2 years, New Jersey Community Capital has acquired 800 mortgages through FHA's Distressed Asset Stabilization Program in New Jersey, and our goal is simple. It is to keep families in their homes through principal reduction, bringing the mortgage down to the current value of the house and ensuring that the borrower's monthly payment does not exceed 35 percent of their income. We provide all of our homeowners with high-touch financial counseling through partnerships with local approved HUD organizations.

Last, we have found in these pools that approximately 45 percent of the properties are vacant or tenant-occupied. We view these situations as opportunities to repurpose distressed properties into new affordable housing opportunities. It is especially valuable in today's housing market, in which Government housing subsidies are so limited, that we can pass on our savings on the mortgage purchases both to homeowners and to new affordable housing. To date, we have kept 250 homeowners in their homes and provided over $20 million in principal reduction, and there has not been one re-default on any of those mortgages.

Briefly, I would just like to talk about what we see as several low- or no-cost approaches that can be taken to advance the steps to recovery in New Jersey and elsewhere. The first is increasing nonprofit access to nonperforming mortgages and REO properties through the FHA Distressed Asset Stabilization Program and the FHFA program. New Jersey Community Capital has relied on the FHA program to acquire 800 mortgages, but more and more for-profit entities are winning these pools. To date, they have won 88 percent of what the FHA considers to be Neighborhood Stabilization Outcome pools, and we believe that this has to change.

Some of our solutions to this challenge include increasing direct sales of mortgage pools from FHA to nonprofits in NSO areas, awarding extra points to NSO bidders committed to social outcomes, and allowing nonprofits the first option to bid on NSO pools or other sets of targeted pools. We believe that FHFA should follow the lead of the FHA DASP program and incorporate the NSOs in their GSE auctions.

Finally, I would like to talk about the continuing support of principal reductions as an effective foreclosure prevention strategy. We believe that many of our homeowners are so severely underwater that the only way to make sure that they stay in their home is through principal reduction. So, we advocate for increasing access to funding sources similar to the hardest-hit funds, potentially including Department of Justice settlement funds, a source that can carry a program like ours to thousands more homeowners.

Thank you, Senator.

Chairman MENENDEZ. Thank you.

Ms. Guzmán.

## STATEMENT OF MABÉL GUZMÁN, 2014 CHAIR, CONVENTIONAL FINANCE AND POLICY COMMITTEE, NATIONAL ASSOCIATION OF REALTORS

Ms. GUZMÁN. Thank you, Chairman Menendez and Members of the Subcommittee, for the opportunity to testify on behalf of the National Association of Realtors. My name is Mabél Guzmán and I am a broker at @properties in Chicago, Illinois, and I am the 2014 Chair of the National Association of Realtors Conventional Finance and Policy Committee. I am very passionate about the role of real estate in public policy, so much so that I took time away from my business to be here today.

In my 17 years as a Realtor, this is thus far the most difficult market for homebuyers I have seen. In many respects, the U.S.

housing market is headed down the wrong path. We believe this is due to six major factors.

First, our economy is still recovering. Employment and incomes are improving, but many earners still struggle with cash for downpayments and many homes are quickly snagged by investors paying cash, leaving little inventory for first-time buyers.

Second, fees are hurting consumers. The overall cost of loans are at historic highs. The guarantee fees and loan level pricing adjustments charged by GSEs are hurting consumers. These policies result in billions of dollars of profits for the GSEs, but have had a significantly negative impact on mortgage lending.

Third, despite a healthy portfolio, FHA premiums are very high and they require borrowers to pay mortgage insurance for the life of the loan with no opportunity to cancel. Quite simply, this hamstrings consumer buying power.

I had the pleasure to work with the Vasquez family, first-time homebuyers, and they wanted to use FHA as an option to purchase and they could not because the fees were exorbitant and too expensive. They had two options, either not to buy and wait a year to do so and save more money, which was not an option because the trends in our city are that prices would have been 10 percent higher and they would have been priced out of the market. The other option was to do a conventional mortgage, which they ended up doing, but they pulled from their reserves to be able to make that 5 percent downpayment. Then there was the issue of the closing costs. By using those reserves, they had less money to be able to pay for closing costs. So, I was able to negotiate with a seller that was willing to contribute 3 percent toward their closing costs, but that took over five offers to make that happen. So, through the 6-month process, we were able to have success, and now they are happy homeowners.

Fourth, there are significant barriers to condominium ownership. We need changes to rules regarding owner occupancy ratios, project approval processes, and commercial space. Condominiums often represent the most affordable options for first-time homebuyers.

I worked with a young man named Andrew Wikell [phonetic]. It took 3 years to find him a condominium under $200,000 in the city of Chicago, and we kept expanding our search. For him, it was the owner occupancy ratio. If a building had 55 percent tenants or nonowner occupied, it would not—he would not be able to get any financing on it. Though it was 55 percent nonowner occupied, within those units, anywhere from 5 percent to 15 and at times 20 percent had no mortgage, so they had no risk of default. We felt that it really should have been moved out of that ratio and put into owner-occupied status because the risk of default did not exist.

Second, on commercial spaces, only allowing 20 percent is very onerous. Developers are creating transient-friendly buildings, additionally lifestyle centers, where the owner can come down, get a cup of coffee, do their dry cleaning, make a copy, even sit down and have a glass of wine. By reducing that to 20 percent, it has a double-negative. Number one, they have no potion to buy into that building which gives them so many amenities outside their other properties that they could choose, but second, it reduces commercial space, which creates small businesses an opportunity to open in that building and create jobs. So, it is a job killer at the same time.

Fifth, the underwriting process needs to be improved. FHA and GSEs have made concessions with respect to lender liability. Now, lenders need to improve the quality of their underwriting and halt preventable mistakes. In addition, Congress and the Administration can improve current credit conditions by addressing the 3 percent cap on fees and points.

And, finally, foreclosure and short sales remain problematic for thousands of American families. The GSE and FHA alternative asset disposition programs actually reduce home purchase opportunities for owner occupants. Foreclosure prevention efforts need to be increased before loans are sold off to investors. In addition, NAR urges Congress to extend mortgage debt forgiveness to distressed homeowners who should not have to pay phantom income tax after enduring the stress and loss of their home in a short sale. Therefore, we need to provide more certainty in the short sale process, as well. We support Senator Brown's bill, S. 361, to provide a certain answer to distressed homeowners.

I worked with a client. We started the short sale process and we waited 1 year for an approval so that she can realize that short sale, and it never happened. Her loan was sold. The new investor who purchased that did not want to realize a short sale and foreclosed on the client, now adding another unit of foreclosure into the market as well as destabilizing a condominium property.

Until we address these issues, our national return to prosperity will be jeopardized. Out of the nine previous recessions, seven of the recoveries were led by housing.

On behalf of the one million members of the National Association of Realtors, thank you for this opportunity to testify and I look forward to your questions.

Chairman MENENDEZ. Thank you.

Ms. Gordon.

**STATEMENT OF JULIA GORDON, DIRECTOR OF HOUSING FINANCE AND POLICY, CENTER FOR AMERICAN PROGRESS**

Ms. GORDON. Good morning, Chairman Menendez and Senator Warren. My name is Julia Gordon and I direct the Housing Finance Team at the Center for American Progress. Thank you so much for convening this hearing on the critical topic of inequality of opportunity in the housing market.

Today, our Nation's housing recovery is neither strong nor equitably distributed, as Ms. Guzmán has described. Not only has the mortgage market shrunk nationally, but many communities, and especially communities of color, lag far behind other parts of the country, with hard-hit neighborhoods continuing to suffer the ongoing effects of multiple foreclosures, negative equity, vacant homes, and blight. And, as more families become renters rather than owners, rents have risen to the point where more than half of all renters spend more than 30 percent of their gross income on rent, which is considered the upper limit of rental affordability.

Most people of color remain shut out of the conventional mortgage market, with more than 70 percent of African Americans and about two-thirds of all Latinos having FHA and other Government programs as their only option. And, while less than 20 percent of all homeowners nationally still owe more on their mortgage than it is worth—than their home is worth, in the hardest-hit zip codes in the Nation, as many as three-quarters of all homeowners are still underwater, and in two-thirds of these zip codes, African Americans and Latinos account for at least half the population.

Ironically, even as home prices experienced historic declines over the past 6 years, the tightness in the credit market meant that for too many households, especially families of color and lower-wealth families, they miss what could otherwise have been an ideal opportunity to access affordable and sustainable home ownership, and in many of these communities that already lost significant wealth due to the foreclosures, wealth continues to be exported outside the community as it flows to landlords who do not live there.

It is not too late to turn this situation around, but we must focus our efforts on enabling more families to join the ranks of home ownership. At the same time, we must ensure that expansion of access not lead to any of the predatory and abusive market practices that led to the crisis. So, I do urge you as you hear calls to exempt more market participants from the Dodd-Frank mortgage protections, that we think very carefully about that. We believe that access can be increased significantly under the current rules.

So, while there is no one silver bullet, there are many dials and levers we think we can move to increase access without opening the door to predatory or unsafe lending. First and foremost, Congress should complete comprehensive reform of the housing finance system. Uncertainty concerning the fate of Fannie and Freddie continues to weigh heavily on the market. S. 1217, the legislation passed by this Committee, provided a very useful framework, but did not sufficiently place the goal of access to affordable, sustainable credit at the center of the new system's purpose.

Until that effort is completed, FHFA and FHA have a great deal of power to make positive change. Just yesterday, FHFA released the news that Fannie and Freddie will offer a low-downpayment product for first-time homebuyers, a sorely needed first step in opening the conventional market to lower-wealth borrowers.

We further recommend that companies update the credit score model used by their automated underwriting systems to improve the reliability of scores and the availability of scores for tens of millions of consumers, especially consumers of color.

Additionally, FHFA should set strong housing goals and duty to serve requirements that push the enterprises to lead the primary market instead of lagging it, as they have been doing. They should pool for risk and set pricing based on what is needed to cover expected losses rather than continuing what has been a failed attempt to revive the private label market using unnecessarily high fees.

To help struggling communities, FHFA should provide troubled borrowers with principal reduction modifications, which are the most successful form of assistance. It should also instruct Fannie and Freddie to consider direct purchase of forced place hazard insurance to protect both consumers and taxpayers from the kickbacks and inflated costs associated with mortgage servicers purchasing that insurance.

FHFA should direct Fannie and Freddie to begin contributing immediately to the Housing Trust Fund and Capital Magnet Fund, which will help provide affordable rental housing for extremely low-income families.

As for FHA, which is now on track to fully replenish its reserves by 2016, we recommend revisiting the impact that premiums are having on access to credit and considering whether some reductions could provide sufficient additional volume to offset any cost to the fund.

Both FHFA and FHA should ensure that any bulk sales of distressed mortgages promote both home retention and neighborhood stability. If designed responsibly, we believe these sales can offer better loan modifications, support neighborhood revitalization, and limit losses to taxpayers. But, if loans are simply passed off to the highest bidder without any protections, we will have missed an extraordinary opportunity.

To further the work of fixing the broken mortgage servicing system, FHFA and FHA should join with CFPB and other prudential regulators to improve servicing rules further, revisit soon the issue of servicer compensation, and find a way to require sustainable modifications to homeowners after HAMP expires.

Finally, as Ms. Guzmán mentioned, Congress must extend the Mortgage Debt Relief Act, at least through the end of 2015.

Thank you again for inviting me to talk today. Together, we can work to create a more robust, fairer housing market that drives economic growth and promotes opportunities for America's families.

Chairman MENENDEZ. Thank you.

Ms. Goldberg.

**STATEMENT OF DEBORAH GOLDBERG, SPECIAL PROJECT DIRECTOR, NATIONAL FAIR HOUSING ALLIANCE**

Ms. GOLDBERG. Thank you, Mr. Chairman. Good morning. Good morning, Members of the Subcommittee. Thank you for the opportunity to testify here today. My name is Debby Goldberg. I am a Special Project Director at the National Fair Housing Alliance, or NFHA. NFHA works with its 220 members in 37 States and the District to provide equal access to housing for millions of people.

My written testimony touches on a number of topics, but my testimony here this morning will focus on the broken system for maintaining and marketing foreclosed properties, particularly in communities of color, and the long-term impact of these problems.

Home ownership has long been a key to opportunity in this country, a path into the middle class. It has provided millions of families the means to create economic stability and build wealth. But, households of color have not experienced the benefits of home ownership to the same degree as their White counterparts, and for many households of color, home ownership is a thing of the past. Since 2008, five million families who were homeowners have lost their homes to foreclosure, and communities of color have been particularly hard hit.

In April 2009, NFHA began an investigation into the marketing and maintenance of foreclosed properties, or REOs. In partnership with 17 of our members, we have inspected 3,726 foreclosed properties in 29 metro areas and 22 States. Some of these are in predominately White neighborhoods, others in predominately Black and/or Hispanic neighborhoods. Many of these are stable communities where the rate of home ownership is high. At each house, our investigators evaluate more than 30 aspects of maintenance and marketing, including curb appeal, structural integrity, signage, indications of water damage, and the condition of the paint, siding, gutters, and downspouts.

We have found that REOs in White neighborhoods were well cared for and well maintained, well marketed. They were more likely to have neatly manicured lawns, securely locked doors, and attractive professional "for sale" signs out front. Someone driving down the street would be unlikely ever to know that the property was for sale because of a foreclosure.

In contrast, REOs in communities of color were more likely to have overgrown yards, trash on the premises, unsecured doors, and broken or boarded windows. They appeared abandoned, blighted, and unappealing to potential homebuyers, even though they were located in stable neighborhoods where the surrounding homes were well maintained.

Further, these maintenance deficiencies were cumulative. That is, REOs in communities of color were more likely to have a greater number of deficiencies than those in White communities. These cumulative deficiencies lead to a host of problems. They can cause health problems, both physical and mental. They attract vagrants and criminal activity and may be fire and safety hazards. They also contribute to violent crime in a community. Research shows that for every 1 percent increase in the foreclosure rate in a census tract, violent crimes increase by 2.33 percent. All of these problems place an increased burden on municipal fire, police, health care, and other resources.

At the same time, these poorly maintained REOs bring down property values, resulting in lower tax revenues for municipalities, even as they must expend more resources to cope with the problems created by the REOs. We have also found that poorly maintained REOs linger on the market longer before being sold and are more likely to be sold to investors, transferring wealth out of the community.

Managing REOs differently based on the racial composition of the neighborhood in which they are located is a violation of the Federal Fair Housing Act. The Federal agencies responsible for overseeing the activities of banks, the GSEs, and other investors have both the authority and the obligation to ensure that they do not violate the Fair Housing Act in their maintenance and marketing of REO properties. Effective oversight can help stem the kind of problems our investigations uncovered. To date, only the Federal Reserve Board has taken action in this area.

In our report, we outline a series of recommendations for addressing these problems and ensuring that communities of color have an opportunity to share in the economic recovery. One of these is for Congress to play an active role in oversight, both to shine a spotlight on the problems where they exist and to hold accountable Federal agencies with the responsibility to help prevent and solve these problems.

Further, we believe it is critical to create a path back to home ownership for families harmed by the foreclosure crisis and have described some of the steps necessary to do this. So many of these families are families of color, and they will constitute half of the potential homebuyers over the next decade. Helping them exercise that potential is not only the right thing to do, it is an economic imperative for our Nation.

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

Chairman MENENDEZ. Thank you all for your testimony. There is a lot of ground to cover here, so let me start.

Several of you have discussed how mortgage borrowers' credit scores have tightened sharply in recent years, and not only compared to the precrisis boom years, but also tighter than the more normal period before the boom. During the run-up to the crisis, we saw many instances of homeowners who once would have received modest, affordable loans instead receiving much riskier loans than they could possibly afford. And now it seems the response has been, instead of going back to matching the creditworthy borrower at the lower end of the distribution with affordable loans, these borrowers are being cut out of the market entirely.

So, my question for any or all of you is what factors do you think are driving that trend? To what extent are the broader economic factors as opposed to tighter mortgage lending standards affecting this? And, to the extent that creditworthy borrowers are having a tougher time right now getting a mortgage, how has the impact differed across different populations or segments of the market? Who has felt it the most? So, one is why is it happening? Two, what are the factors? Are there factors beyond just having the pendulum swing the opposite way, and who is getting the worst of it?

Ms. Guzmán.

Ms. GUZMÁN. Yes. With regard to what is happening, is currently, banks have credit overlays. CFPB put out actually very rational rules that mitigate risk to any qualified borrower, but banking comes in. If there is a 41 percent DTI, debt-to-income ratio, which is the CFPB rule, they will say they need 43 percent. So, that eliminates 10 percent right there.

Then, if they look at a credit score, 650 maybe being the average on a consumer, they will say, well, we need 680 or 700. That eliminates another subsection right there. And, credit—that number has nothing to do with risk. It is, rather, they have a lot of revolving debt or not. Many consumers actually prefer to pay cash, and we are looking at FICO 9, which is one of the new models that would actually help and introduce more borrowers into the market.

The credit overlays do need to be removed, or buffers, as they say, because we have already gone through a sense of reform, you could say, with the CFPB. And, by the elimination of that, you would still have good creditworthy borrowers, rational lending, and you would see a reintroduction of opening that pool and access to more borrowers into the American dream.

Chairman MENENDEZ. Does anyone else want to opine? Ms. Gordon.

Ms. GORDON. If I could pick up on the fact that the lenders have these overlays and talk about why they have the overlays, it would be hard for us to know exactly why, because every time we talk to lenders about it, we hear a different story, depending on what problem we are working to solve.

For a long time, the concern had to do with the representation of warranty framework or the indemnification framework, lenders concerned about being forced to buy back their loans. Both FHA and FHFA have been doing their best to provide lenders with more certainty in that area. But, as soon as you hear more certainty in that area, you hear the lenders talk about other regulatory risks. You hear they talk about the DOJ settlements.

There are a whole variety of reasons lenders have been putting forward about why they are not lending and it is very difficult to tell exactly what policymakers can do to change the fact that, at the moment, some of the biggest lenders, some of the biggest banks, simply do not appear to really want to ramp up their mortgage businesses, which is why I do think it is really important for us to focus on alternative mortgage channels, to focus on credit unions, CDFIs, smaller institutions. While, typically, the answer to that is, well, you can never scale that up to the point where it matters, I think that we would be doing ourselves a disservice if we did not really try to scale the efforts of the more mission-based organizations that have a desire and willingness to be in the mortgage business and to serve the communities that we are talking about.

And, in terms of who is being left out the most, you know, low-wealth borrowers, but in particular, borrowers of color are being very, very deeply hurt, and I want to strongly support what the CFPB is trying to do in terms of collecting more and better HMDA data. We really need that data to understand what is going on. I would also urge CFPB to add a few more data fields and think about how we can also be keeping track of things like housing counseling and loan modifications, as well as the origination data.

Chairman MENENDEZ. I have several other questions. I only got to one. You all expounded significantly on it. But, in deference to my colleagues, I am going to come back a little later.

Senator Warren.

Senator WARREN. Thank you, Mr. Chairman, and thank you all for being here today. Thank you for calling this hearing.

You know, home ownership remains the principal way for most families to build economic security. But, access to mortgage credit is very tight. Only about half as many new mortgages were approved in 2012 as back in 2001, well before lending standards were loosened up in the run-up to the financial crisis.

Now, Fannie and Freddie are responsible for a huge portion of the secondary mortgage market and that means their standards have a major influence on what mortgages are actually offered in the primary market. Since the crash of 2008, trouble with a mortgage or short-term job loss has left millions of Americans with dings on their credit scores, and moderate-income families, African American and Hispanic families, have been hit especially hard.

But, instead of taking that into account in loosening credit score standards, Fannie and Freddie have gone in the other direction. In 2012, the average credit score associated with a mortgage purchased by Fannie or Freddie was over 760. That is more than 50 points higher than the average credit score associated with mortgages they purchased back in the early 2000s, and more than 50 points higher than the average credit score of the average American. To be blunt, Fannie and Freddie have put home ownership out of the reach of millions of creditworthy families.

So, Ms. Gordon, I just wanted to start with you. Do you agree that Fannie and Freddie's credit standards have played a key role in keeping many Americans out of home ownership?

Ms. GORDON. Well, the answer is yes, but it is not just their credit standards per se. The whole direction of Fannie and Freddie's policies since the conservatorship has been extremely conservative and not aimed at performing their chartered mission of serving all markets all times.

Senator WARREN. Fair enough. I just wanted to focus in, though, in particular, on credit scores. It is an easy piece to get a hold of and an easy piece to talk with Fannie and Freddie about. We have got other aspects, I promise, we will——

Ms. GORDON. Sure. Absolutely, on the credit scores. I mean, it is partly because of the overlays, partly because they are using the old FICO model, and, you know, with a heavy reliance on automated systems as opposed to manual underwriting, they have some important exemptions from some of the QM standards but often are not able to use the compensating factors or do not want to use them.

Senator WARREN. Well, that is right, and the data would suggest they are not using them——

Ms. GORDON. Right.

Senator WARREN. ——right? And, Ms. Guzmán, you are out there doing real estate. Would you agree with that?

Ms. GUZMÁN. Absolutely.

Senator WARREN. OK.

Ms. GUZMÁN. Absolutely. When we look at the HMDA filings in 2006, 56.8 percent of African American and Black borrowers had an Experion credit score of 650 or less. When we are looking at FICO 9, this will result in increased acceptance of mortgage applicants. But, we also believe VantageScore is another model that they need to be using. First of all, again, that number, 650 or 675, does not indicate risk. It just means how much credit they have available to them.

Senator WARREN. Right.

Ms. GUZMÁN. With VantageScore, it takes into account rental payments, utility payments, and maybe even possibly, with many Latinos in our market, they send their children to parochial school. That is a big nut they have to pay on education every month. They should be using other methodology and have innovation within the organization to actually look at this and say, yeah, we need to now expand the way we give credit or how we determine who is a creditworthy borrower.

Senator WARREN. Good. I think that is really valuable, and offering a lot of approaches that Fannie and Freddie could be using. You know, with Fannie and Freddie keeping credit so tight, especially at a time when housing is more affordable than it has been before, then it is bad for families, it is bad for the housing market, and it is bad for the economy across the board.

So, I want to ask about one other thing, and that is since the Government's Home Affordable Mortgage Program, HAMP, began in 2009, more than 1.3 million homeowners have received a loan modification, and many of these modifications reduced the interest rates, which, in turn, lowered the homeowners monthly payments and helped people stay in their homes. About 90 percent of these modifications were designed so that interest rates would begin resetting and gradually increasing after 5 years.

The first reset started last year, and according to an analysis of Treasury data by the Special Inspector General for TARP, after all of these resets are completed, the median monthly mortgage payment will increase by more than 20 percent for these families. Monthly payment increases will be even higher for those who needed the most help and, thus, received the steepest initial discounts in their interest rates.

Now, researchers at Urban Institute's Housing Finance Policy Center have estimated that the impact of these resets will hit hardest in 2016 and 2017, and that as a result, we may see redefaults of about 10 percent among this group. That translates to about 100,000 families defaulting in the next couple of years.

So, Mr. Meyer, I wanted to start with you. I was pleased to see that last week, Treasury announced plans to enhance the existing HAMP modification to avoid some of the problems that these resets will cause. Has New Jersey Community Capital looked at ways to help these families stay in their homes if they default again?

Mr. MEYER. Yes, Senator. Thank you. We believe that it is important to engage with principal forgiveness and to make sure that the mortgage is right-sized to give the homeowner the best chance of success. But, a really important part, an important component of our program is a really high-touch financial counseling component, and it is not just to develop a mortgage resolution plan to keep the homeowner in their home, but it is also to support the homeowner on a go-forward basis. So, our counselors are staying with the homeowner after the mortgage is modified for a period of 12 to 18 months to make sure that they stay on track. And, although our track record right now is 2 years, we have modified hundreds of mortgages and have not yet had one redefault.

Senator WARREN. Good for you. Thank you, Mr. Meyer.

I am going to follow the good example set by the Chair and quit there, but I do want to come back at some point to what Treasury should be doing about this on the modifications, as well. Thank you.

Chairman MENENDEZ. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair, and thank you all for your concern and interest day to day in this challenge of reestablishing home ownership as a major driver of wealth for middle-class families.

Ms. Gordon, I thought I would ask you a question, and it is a little unfair, because I have not briefed you in advance, but are you familiar with IDA programs, Individual Development Account programs? This is something that I became interested in in Oregon. I started the first IDA program that was west of the Mississippi, essentially in which low-income families, if they save toward home ownership, they get a matching grant under the program to enable them to buy a house, pay closing costs, downpayment, and so forth. And, it has had a very strong success rate in home ownership. I also worked previously with Habitat for Humanity, where we worked with very low-income families to buy homes.

And, the reason I raise this is when we look at the home mortgage interest deduction, it is our major home ownership program, but it does not extend to low-income families, and let me give an example of that. You buy a $200,000 house. You pay 4 percent interest—that is $8,000 of interest—at the beginning of the mortgage. It gets less over time. And, yet, the standard deduction currently is $12,400. So, you do not get one dime of help.

And, one of the things that I have put forward periodically is the idea of adding on to the home mortgage interest deduction and with a grant program for those who do not take advantage of it. For example, if we were to have—we could kind of create a systematic IDA, still requiring matching funds if a homeowner was to take advantage of it for closing and downpayment, but take a value equivalent, kind of the value that they would have if they could have utilized the home mortgage interest deduction at a middle-class tax rate and give it as an annual grant or tax credit.

Is that something you have taken a look at? This is where it is unfair, but the general idea—do you see where I am headed with the suggestion—to enable home ownership——

Ms. GORDON. Right.

Senator MERKLEY. ——not taking away anything from anyone else, but to help empower home ownership among lower-income families.

Ms. GORDON. I do see where you are headed and I think it is a very interesting idea to talk about. I do have to say that we have recommended actually converting the mortgage interest deduction into a credit so that we solve the problem of this enormous subsidy. I mean, the amount we spend on the mortgage interest deduction every year is bigger than the entire HUD budget, which is, you know, incredible when you think about it, and it really is benefiting those in the upper parts of the income scale. And, so, we do think converting it to a credit and capping it would help direct that subsidy to the people who need it the most.

But, knowing that reform of that particular deduction is challenging, to say the least, and that comprehensive tax reform may be on the table, but will also be challenging to accomplish, you know, thinking about ways to tax advantage programs that help lower-income borrowers get into housing is very important and I would love to talk to you more about that.

Senator MERKLEY. Thank you, because I think we spent about $70 billion on the mortgage interest deduction.

Ms. GORDON. Yeah. Yeah.

Senator MERKLEY. It would take just a few billion dollars to provide these credits at the lower end. So, I like to think of it as "yes plus" if you will, the possibility.

I also wanted to—does anyone else want to make any comments on that?

Ms. GOLDBERG. I would add just one thing, which is that I think it is a very interesting idea, as well, and agree that the way we handle the mortgage interest deduction definitely disfavors people with modest means, which often means people of color.

But, I also want to say that I think it is important for us not to fixate on downpayment. The downpayment is a huge hurdle for people of modest means to get into home ownership, and the truth is that if we look back beyond this most recent period of trouble in the mortgage market, we find that we actually know how to make low downpayment loans that are very sustainable, affordable and sustainable. If you do it right, with the right product, it helps to have housing counseling along with it, and we have a long history, actually, of being able to make low downpayment loans to low- and moderate-income people that are extremely successful, and we need to remember that history and revive that approach. Then, the IDA program will get you a lot farther and there will be fewer people who need that kind of help to get over the hurdle of getting into home ownership.

Senator MERKLEY. Yes, fair point, Deborah. But, even with low downpayment loans, the downpayment and the closing costs together can still be a substantial hurdle to undertake.

Ms. GOLDBERG. That is right.

Senator MERKLEY. But, the type of thing I was just describing does not help just with the downpayment. It helps on an annual basis when you do not utilize the mortgage interest deduction as an alternative——

Ms. GOLDBERG. The ongoing cost——

Senator MERKLEY. As ongoing costs, yes. And, so, it mimics the effect of the mortgage interest deduction, if you will.

I am out of time. So many questions, so little time. Thank you all very much.

Chairman MENENDEZ. Well, we are going to have another round, so if you want to stick around, you will maybe have—if your schedule permits. But, let me—and I know Senator Reed is going to be returning shortly. He has a very significant interest.

Let me—there is so much here. First of all, Ms. Goldberg, I am glad you raised the history of the low downpayment program and its efficacy and its success. I think it is going to be under siege in the next Congress, so we are going to have to remind people about the facts, not the creation of the image, and that is going to be a challenge.

I want to get, since part of the focus of why I wanted this hearing, in addition to where we are at and what our challenges are, is also to drive here a point that I think is very real, and that is, certainly for many families, the whole essence of home, in addition to being the place that we nurture our families and raise them, represents the most significant, or in some cases the only source of savings. And, for half of American families, for example, home equity accounts for at least 60 percent of their net worth, including nearly 70 percent for the typical Latino family and about 60 percent for African American families, and almost 80 percent for families in the bottom 25th percent of income earners.

So, with those numbers in mind, what is the implication of the current credit conditions for savings, wealth building, and income mobility? It seems to me that that is rather challenging. And, one of the things that we just—I think I perceive from this last election is despite every major macroeconomic indicator, you know, the 6 consecutive years of private job sector growth, the lowest unemployment in 6 years, the lowest deficit in 6 years, the lowest deficit as a percent of the economy by 40 years, the low gas prices, I mean, I could go on and on and on, but what is the reality for most families, is that incomes have been stagnant. If you add to that, then, the inability to have the single most significant source of asset and wealth to be stuck or not attainable, then you are creating an even more caste set of circumstances in our society. So, I would like to hear some of you address that, anyone who wishes to.

Ms. GOLDBERG. Sure. Yes, it is absolutely true. Particularly for families of color, home equity has tended to be the largest single asset that they have. It is an asset that can be passed intergenerationally and that has been used very powerfully in many moderate-income neighborhoods around the country. Those neighborhoods were particularly devastated by the foreclosure crisis. They were the first neighborhoods targeted. They were equity stripped before we even invented some of the toxic products that eventually took down the whole superstructure. It has left people of color in a very bad position in terms of wealth. I mean, if Whites lost about a quarter of their net worth over the course of the crisis, African Americans and Latinos lost 50 or 60 percent of their net worth. It is really—it is really frightening and the disparity is huge.

You know, also, going forward in the mortgage market, the majority of family formation is going to be people of color, and if we want to have a healthy mortgage market, if the White baby boomers want to someday sell their houses, we are going to have to find a way for people of color who are now even lower wealth than they were before the crisis to be able to come in and buy these houses.

And, honestly, I think this is a national emergency and that we need to think very creatively and boldly about how we solve this problem.

Chairman MENENDEZ. And, as some of you others answer, I wonder if you have any policy considerations for how we improve access to affordable home ownership for creditworthy borrowers. I do not want to lose sight that we are still looking for creditworthy borrowers. Ms. Guzmán and then Mr. Meyer.

Ms. GUZMÁN. Well, absolutely. I was—I participated in the Neighborhood Stabilization Program, which targeted 25 communities in the city of Chicago, and predominately communities of color that were hardest high by foreclosures. A lot of those properties were bought through that program, and the first initial round was $55 million and Realtors played a big role helping the NSP recipient to actually buy a lot of those properties and then reintegrate them into the market. Additionally, they set up programs where first-time borrowers would have counseling. And, additionally, they would help them with closing costs. But, at the end, there were 2,000 units that were purchased. It is now a national model.

And, on the competitive bid for the NSP on the second round, it was $98 million was awarded to the city because of the success of the program, and it continues to grow. Four thousand units of housing were created, 75 percent rental, because, again, the market was in freefall. But, many communities were stabilized, and mostly in communities of color.

It is wealth building. It is a wealth builder. It changes the dynamic of a family. To have prosperity, economic self-reliance, we really do need to reintroduce these borrowers back into their communities to create that stabilization and also economic prosperity for themselves.

Chairman MENENDEZ. Mr. Meyer.

Mr. MEYER. I agree that wealth building is such a challenge, and Senator, I may even take it a step further. In a lot of the neighborhoods where we work, more than 50 percent of the renters pay more than 50 percent of their income toward housing, which leaves them with very little other room for food, for health, for education. So, it is not just about wealth building. It is also about being able to put your housing costs into line with your income.

So, what Ms. Guzmán's point was around, the NSP program, I agree, that was a significant program. But, we are in an age of limited, shrinking Government resources. So, in New Jersey, for example, we receive $65 million of NSP monies. I think we did maybe a little less than 300 units with these funds, which is not a lot. And one of the policy changes we can make is to increase access to FHA mortgages, because through that alone, we have bought 800 mortgages at a discount. So we are able to repurpose 300 of these properties that are vacant or tenant-occupied for just a fraction of the cost of doing 300 units through NSP. I think that is a significant consideration.

So, then the challenge becomes how do we put into the hands of nonprofits and others the inventory of assets that can create these opportunities for low- and moderate-income families rather than only selling them into private equity firms. I think DASP is a great opportunity to do that. I really do believe that. And, I think this opportunity is going to pass us if we do not act quickly on it.

Chairman MENENDEZ. In this regard—and I want to turn back to Senator Warren, but just to keep this train of thought while we have it—Ms. Gordon, in your testimony, you discussed the FHFA's recent announcement about allowing Fannie and Freddie to resume backing well underwritten loans with downpayments as low as 3 percent in cases where borrowers can demonstrate their creditworthiness and ability to repay and with other compensating factors. What is the track record for well underwritten loans with lower downpayments with other compensating factors?

Ms. GORDON. The track record is good. I mean, at Fannie and Freddie themselves, the difference in performance between a 3-percent down and a 5-percent down is almost indistinguishable, and we have worked with the Center for Community Self-Help—I actually used to work there—where we had a portfolio of many, many thousands of mortgages that were low-downpayments mortgages made to families with nontraditional credit histories or thin files and that were properly underwritten and were safe, sustainable 30-year fixed-rate mortgages, and we actually had a grant to follow very closely the performance of those mortgages and so we have been tracking them carefully throughout the crisis, and that portfolio of loans, which, really, many people might have looked at and said, really, do you want to make these loans, they have performed better than any other cohort of loans except for the very prime fixed-rate mortgages. They have performed better than adjustable rate prime. They have performed better than any all day or subprime categories.

Chairman MENENDEZ. So, these were not the drivers of the crisis.

Ms. GORDON. These were not the drivers of the crisis.

Chairman MENENDEZ. I ask, because we are going to hear the opposite of that.

Senator Warren.

Senator WARREN. Well, what does it mean when you say you are going to hear the opposite?

Chairman MENENDEZ. No, no——

[Laughter.]

Chairman MENENDEZ. No, no, we are comrades in arms on here.

Senator WARREN. We certainly are on this one.

So, I want to actually, though, ask you about another part of this. I want to raise another issue, and that is when a Fannie- or Freddie-owned mortgage goes into default, Fannie or Freddie buys the property and then resells it, and last year alone, Fannie sold more than $2.8 billion worth of property. So, when these notes are sold to homeowners rather than to investors or absentee landlords, families do better, neighborhoods do better.

So, FHFA has a First Look policy that gives families and individuals first crack at buying these repossessed properties before the bidding is opened up to investors, but the policy is not working. The houses are priced so high during the First Look period—significantly above market value, according to many reports that we hear—that regular buyers do not really have a shot at this. The prices come down only later, when investors are moving in.

So, I thought I would start with you again, Ms. Guzmán. As a Realtor, you have firsthand experience with the difficulties that borrowers are facing in today's housing market. How do you think Fannie and Freddie could better ensure that these notes end up in the hands of owner-occupants?

Ms. GUZMÁN. Well, it is beyond the First Look. I mean, getting the First Look and then being able to submit an offer right away, also, in a timely response on that offer, is completely different than the First Look, let the clock run out 10 days later, then it is a multiple-bidding process. That seems—you know, they say they want to support owner occupancy, but we find that it really kind of confounds everything.

As I said, working with several buyers, it has been a multiple offer process. You know, they are writing five, six offers just to get into housing. The Vasquez family, I mean, with their three children, it ended up that we did not even get into a Fannie Mae property. We actually worked with a private seller and it worked out just fine.

But, the First Look, it has to be more than First Look. It has to be First Look, first bid.

Senator WARREN. Good.

Ms. GUZMÁN. Give them a crack, and then after that, if it does not succeed, then, fine. Then go ahead and reintroduce it to the public and let the private market go at it. But, it has to be First Look, first bid.

Senator WARREN. Good. Thank you.

Anybody else want to add on the First Look? Ms. Goldberg.

Ms. GOLDBERG. So, our recommendation would be to extend the First Look period longer, but also, that any time the price drops, there should be a new First Look period——

Senator WARREN. Oh, interesting.

Ms. GOLDBERG. ——so that, once again, people who want to live in the home as opposed to use it as an investment have an opportunity to take a shot at it.

And, in addition, we would recommend that we remove the incentives for the preference for cash offers. We understand that a lot of times the real estate agents who list these properties are paid incentives to move things quickly. This means that when they get two offers, one of which requires the buyer to get a mortgage and the other one of which is a cash offer, if they're going to get a bigger commission if they move the property quickly, then they're going to go for the cash offer that can settle immediately without having to worry about whether and when the mortgage is going to come through.

When it comes to both foreclosed properties and nonperforming loans that are under the control of either Government agencies, such as HUD, or Government-controlled entities, such as the GSEs, we need to be looking at these as resources to help stabilize communities. That means our approach to disposing of these assets needs to be mindful of both the bottom line for the agencies involved and also the bigger neighborhood stabilization efforts that are really needed. Those help shore up all the other mortgages and all the other properties in those same neighborhoods.

So, we should make some changes to the First Look process so that we do not create incentives for investors and cash offers to get a preference. We actually have a settlement with Wells Fargo as a result of some of our REO work and a complaint that we filed with HUD under the Fair Housing Act. That settlement includes provisions addressing the First Look process. It mandates that any time there is a cash offer to buy a Wells REO and at the same time there is an offer from a prospective owner occupant that is as good or better but requires financing, the noncash offer must get preference. We would recommend that this be instituted across the board in First Look programs.

Senator WARREN. Thank you——

Ms. GUZMÁN. I need to respond to that.

Senator WARREN. I will let Ms. Guzmán respond, and then Mr. Meyer.

Ms. GUZMÁN. I think it is ultimately, when offers come in and they are cash and/or if they are financed, we always recommend the financed deal, because, actually, it is a better price. So, we do not actually lean toward the cash investor ever. We want it to be——

Senator WARREN. You mean, we, the real estate——

Ms. GUZMÁN. We, the real estate, the Realtors——

Senator WARREN. The Realtors——

Ms. GUZMÁN. I have represented REO properties for Bank of America and I have friends who worked on Fannie Mae properties, as well, and what it comes down to is that the investor—that person on the end that you do not see is making a decision to go with cash, even though we believe that the financed deal is a better deal. It is a better price. But, they do not want to wait. They do not want to wait. They would rather go ahead, especially, in many cases, just go with cash, because they figure it is going to be a clean deal and that is it.

Senator WARREN. Same outcome.

Ms. GUZMÁN. Yes.

Senator WARREN. Mr. Meyer.

Mr. MEYER. Senator, we have a fair amount of experience with the First Look Program, both with Fannie Mae and also through the National Community Stabilization Trust, and our experience is that they need more time. It would be helpful. But, we also advocate for a last look, because all too often, the price does come down and then the homes ends up in the hands of an investor. But the homeowner or nonprofit could have purchased it first if they had more time to do so.

And, I have an example of that. About 2 years ago, I was working with Fannie Mae on a bulk transaction where we were going to buy 40 properties in a very targeted neighborhood and we thought it was an opportunity for us to really increase home ownership and also build neighborhoods. We could not get to an agreement on price. At the end of the day, they ended up selling it for less. You know, they ended up breaking it up and selling it into the market, but the price kept dropping and dropping and dropping. And, of course, nothing good happens when these properties sit on the market vacant. So I urge the consideration of a "last look" where homeowners and nonprofits have a final opportunity to buy before the properties end up in the hands of investors.

I think another area where we can have success—and I really do believe this—we entered into a direct sale of nonperforming mortgages from FHA—it was to help with Sandy recovery. We purchased 517 mortgages. We paid a premium. The Office of Management and Budget calculated that premium. But, it was worth it for us to be able to get control of those assets and be able to repurpose them for the community stabilization outcomes we thought important: number one, keeping family in their home, and number two, when houses were vacant, to to offer them as affordable housing opportunities.

I would urge that this direct sale approach continue to be developed, both at FHA and FHFA, and that they tighten the neighborhood stabilization outcomes to make sure that these properties do end up being used for community stabilization purposes.

Senator WARREN. Well, I want to thank you all for these comments. They are very helpful.

You know, I just think it is very important that the First Look Program actually work to help keep homeowners in homes and to help stabilize communities, not, as you say, a box to be checked off before the property gets shipped over to investors. So, thank you. It is really important. And, I appreciate all the ideas you have got for how it is that this program could be changed to make it more effective for families and more effective for communities. Thank you.

Thank you, Mr. Chairman.

Chairman MENENDEZ. Thank you.

One last question. Ms. Goldberg, you know, I guess maybe I know this or knew it, but hearing it from you is really bothersome to me, and that is the question of the differences on how foreclosed homes are treated in different communities. And, if a foreclosed property is less well managed in communities that are already facing challenges, does that not create a self-fulfilling prophecy that it is going to make it harder for it to recover at the end of the day?

Ms. GOLDBERG. That is right, and it has a tremendous impact not only on the people who lost their homes, obviously, but on all the surrounding properties and then on the larger community and the resources available to the city to provide the kinds of services that are needed.

You know, it has been estimated that the foreclosure crisis and the loss in value of property as a result is going to lead to about $2.2 million in wealth drained out of communities across the country, and half of that, $1.1 trillion—did I say trillion? I meant trillion. One-point-one trillion——

Chairman MENENDEZ. Around here, millions, you know, get lost, so——

Ms. GOLDBERG. Yeah——

[Laughter.]

Ms. GOLDBERG. One-point-one trillion is expected to be drained from communities of color. So, the way these properties are managed and maintained and marketed is a huge piece of that. And making the First Look program work for prospective owner occupants is important, as well, because one of the things we found in our investigation is that certain neighborhoods become targeted by the owners of the REOs—whoever those may be, whether that is a bank or a GSE or some other investor—they become targeted as investor communities and then they put less money into fixing that house up and maintaining that house. And, so, then it adds to your self-fulfilling prophecy because those homes then become less attractive to a homeowner who is going to have to put a bundle of money into it to make it the kind of house they want to live in.

And, so, dealing with these problems, creating the kinds of standards that we really need for marketing and for maintenance of these properties, making sure that the companies that are hired to do that work on the ground have the qualifications, making sure that the Federal agencies who oversee this whole process take that responsibility seriously and conduct that oversight, conduct enforcement where it is needed, that is a big piece of solving the puzzle, as well.

Chairman MENENDEZ. So, this was your entity's own investigation.

Ms. GOLDBERG. That is right. We worked with 17 of our members across the country, but, yes.

Chairman MENENDEZ. Well, and you also said that this was a violation of the Fair Housing——

Ms. GOLDBERG. That is right. So, that gives us another tool for addressing the problem.

Chairman MENENDEZ. Well, maybe we need an Inspector General's report.

It is unimaginable to me that with challenges already existing in communities like this, that there would be added with another challenge in which their properties would become less marketable at the end of the day as a result of a purposeful neglect, because you have to think of it as purposeful at the end of the day. It is obviously a judgment by those who own the REOs to treat them in a different way.

Ms. GOLDBERG. That is right.

Chairman MENENDEZ. If that is the findings, then we need to act upon that. That is very insightful.

Well, with the thanks of the Committee for all of your insight, this record is going to be open for 7 days. I feel that there may be questions coming to you, so we would ask you to answer them as expeditiously as possible so we can complete the record.

And, with that, this hearing is adjourned.

[Whereupon, at 12:28 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

## PREPARED STATEMENT OF WAYNE T. MEYER

PRESIDENT, NEW JERSEY COMMUNITY CAPITAL

DECEMBER 9, 2014

### Introduction

Senator Menendez and Members of the Subcommittee, thank you for this opportunity to speak with you about New Jersey Community Capital's efforts to advance the housing and foreclosure recovery. I am honored that our experience may be of value in your consideration of solutions for communities across the Nation that continue to struggle with the devastation of the foreclosure crisis.

My name is Wayne Meyer, and I am the President of New Jersey Community Capital, which is the largest nonprofit community development financial institution, or CDFI, in the State of New Jersey. I would like to share with you several approaches that my organization has been taking to prevent and mitigate foreclosures and to stabilize distressed housing markets in New Jersey. But first, I think it is important to discuss the challenges facing our State, because while the housing market has begun to turn the corner in some places, New Jersey is still very much in a housing crisis.

### Challenges

*Ongoing Foreclosures*

As of June 2014, 5.7 percent of homes in New Jersey were in foreclosure and 9.3 percent more were seriously delinquent.[1] Those are the highest rates in the Nation. 12.8 percent of mortgaged homes in the State had negative equity—that equals 240,000 additional homes still threatened by foreclosure and abandonment.[2] Moreover, foreclosures are actually increasing in New Jersey due to its prolonged foreclosure process: in October 2014, foreclosure auctions across the State were 118 percent higher than in the prior year, the third highest jump in the Nation.[3]

These numbers reflect dire outcomes, especially in low-income areas: hundreds of thousands of families facing the severe negative outcomes of debt and displacement; communities facing high vacancies and declining property values and their dire consequences on public health and safety; and a State facing major budget deficits in large part due to the crisis, which affects all of its residents.

*Barriers to Stable Housing*

It is also worth noting the barriers faced by many lower-income families trying to recover from the crisis and to regain housing stability. First, mortgage credit has become increasingly inaccessible: over the last 2 years, almost 98 percent of new mortgages have been extended to buyers with credit scores over 640, which is out of reach to even most financially stable moderate-income families, and while Fannie Mae and Freddie Mac's new guidelines will relax mortgage credit standards, the impact of these changes will take time to take effect.[4] In New Jersey, the number of available home purchase loans decreased by 55.1 percent from 2001 to 2012, the second largest decline in the country.[5] So stable home ownership is less and less of an option for recovering families.

At the same time, New Jersey has the fourth highest rental costs of any State, and these costs are rising,[6] even as wages for the bottom 50 percent of New Jersey wage earners has declined by a dollar per hour in the past year.[7] As a result, many more lower-income families are spending over 50 percent of their income on rental housing, in turn causing even greater economic and housing insecurity, with impacts that span generations. This cycle is hurting families across the State today, and without effective interventions, they will hurt thousands of additional families as foreclosures continue to release debt-ridden households into a high-cost rental market with extremely insufficient affordable housing options.

### Solutions

For New Jersey Community Capital, an equitable and healthy housing market has always been and remains a fundamental pillar for stabilizing neighborhoods

[1] CoreLogic. National Foreclosure Report, June 2014.
[2] CoreLogic. Equity Report, Second Quarter 2014.
[3] RealtyTrac. U.S. Foreclosure Market Report, October 2014.
[4] Joe Light, "Mortgage Lenders Set To Relax Standards", *Wall Street Journal,* Nov. 28, 2014.
[5] Laurie S. Goodman, Jun Zhu, and Taz George, "Where Have All the Loans Gone? The Impact of Credit Availability on Mortgage Volume", *Journal of Structured Finance* 20, No. 2 (2014).
[6] National Low-Income Housing Coalition. Out of Reach 2014, 2014 State Summary.
[7] Legal Services of New Jersey. Assessing New Jersey's Progress in Combatting Poverty, September 2014.

and increasing the well-being and economic mobility of lower income families. As first and foremost a community development lender, we annually invest millions of dollars into the creation and preservation of hundreds of affordable housing units, both for sale and rental. In a difficult financial climate, we have diversified funding sources and created new medium-term lending products to continue to provide flexible capital for this purpose.

But we know that this is not enough—development capital by itself does not prevent foreclosures or make mortgage credit more accessible, nor does our lending activity begin to approach the scale necessary to meet New Jersey's growing unmet affordable rental housing needs. So we have taken up the task of innovating additional solutions to stabilizing New Jersey's housing markets.

*ReStart*

The first of these solutions is a program we call ReStart. In 2012, we leveraged major investments from several financial partners to acquire two "NSO targeted" pools of nonperforming mortgages through the FHA's Distressed Asset Stabilization Program, a total of 261 mortgages in the areas of Newark, NJ, and Tampa, FL. A year later, we partnered with private investors to directly purchase a pool of 517 additional nonperforming FHA mortgages in the nine New Jersey counties most impacted by Superstorm Sandy. Cumulatively, the total unpaid principal balance on these mortgages was over $190 million.

We were the only nonprofit to successfully win bids for multiple DASP mortgage pools, and the only thus far to complete a direct purchase from FHA. We are also the loss mitigation manager for a private purchaser of DASP pools in both Florida and North Carolina. We are using the provision of Hardest Hit Funds from each State and our existing mortgage resolution infrastructure to manage and resolve all occupied homes under the mortgages in their pools, a total of more than 300 homes that will be stabilized.

Through ReStart, we are striving to produce 100 percent positive outcomes for homeowners and properties under the mortgages we acquire or manage. We first look to provide principal reductions to the distressed homeowners still occupying the homes, preventing their foreclosure and displacement. We are generally able to reduce the mortgages to 100 percent of current market value, with mortgage payments at under 35 percent of monthly income. We also provide these homeowners with high-touch financial counseling through local HUD-approved agencies, ensuring that they are stabilized for the long-term. So far, we have provided over 250 successful principal reductions, totaling over $18 million in forgiven principal, to families in need.

Mortgage modifications are just one component of the ReStart program, and not every home is owner-occupied, and not every occupant is in a position to sustain ownership. For homeowners who cannot or choose not to pursue a mortgage modification, we offer deeds-in-lieu of foreclosure and transitional assistance to help them attain new affordable housing. And for units that either were vacant or tenant-occupied—which account for about 45 percent of the units under mortgages we acquired—or become vacant over the course of the program, we are working with local community developers and contractors to rehabilitate them into new quality affordable housing opportunities.

*CAPC*

Our second major community stabilization innovation is Community Asset Preservation Corporation, or CAPC, which we incorporated as a real estate affiliate in 2009. The foreclosure crisis has almost entirely impacted one-to-four-family homes, but in the State of New Jersey, there has been a dearth of affordable housing developers with the capacity to compete with speculators to acquire these abandoned real-estate-owned homes at a scale large enough to begin to reverse trends of neighborhood decline.

Over the last 5 years, CAPC has used its capacity and expertise to acquire over 320 housing units, the vast majority of which have been clusters of single-family properties, and it has partnered with local community developers in order to return them to productive affordable housing. CAPC has also developed the capacity to manage many of these properties as rental housing, which is a critical and otherwise unmet function that both ensures the productive occupancy of these units and meets the needs of the growing number of low-to-moderate income renters in New Jersey.

CAPC will be serving a critical role in ReStart by acquiring and fostering the redevelopment of a number of the vacant ReStart properties. CAPC has also partnered with the City of Newark to serve as the lead redeveloper for 156 vacant properties that are primarily clustered in four distressed neighborhoods that the

City is targeting for revitalization. CAPC is continuing to work with local partners to redevelop and reoccupy these units. It has also begun a series of trainings to help local contractors build their capacity to partner on this effort and in other local redevelopments, and it has committed to providing the majority of the construction jobs through this program to local workers.

*Mortgage Bank*

Our next major step is the collaborative expansion of a Credit Union Service Organization (CUSO) to provide direct access to stable mortgage credit and credit counseling to qualifying prospective low- to moderate-income homebuyers that cannot access mortgages in the traditional market. We are currently developing a partnership with a major New Jersey-based credit union to build this platform.

The CUSO will originate and service CRA-qualifying mortgages for potential low-to-moderate income buyers of formerly abandoned properties that we have redeveloped into affordable housing through ReStart or CAPC or have financed through our loan products, as well as buyers of other affordable for-sale homes across New Jersey. Each of these buyers will be required to complete credit counseling through an NJCC-approved agency, which NJCC will compensate for services, and therefore the buyers will be pre-approved for the available mortgage products. NJCC and its partners will also provide eligible homebuyers with access to downpayment assistance programs and other subsidies. We believe we can launch this critical effort within the next year.

**Needs**

Between our flexible lending products and the programs I have outlined for you today, New Jersey Community Capital is seeking to foster the comprehensive stabilization of New Jersey's distressed families and communities: not only providing financing for rental housing, but directly developing and managing it on a large scale; not only preserving home ownership, but creating new pathways to it. And we believe that these are models that could be replicated in distressed communities across the country.

But for these efforts to operate on the scale necessary to really bring New Jersey another step closer to recovering from its persistent foreclosure crisis, they require partnerships and resources from Federal and State government and from private financial institutions. Decision makers in each sector can together provide large-scale access to distressed mortgages and vacant properties and can make available substantial financial resources that will produce both social outcomes and substantial direct and indirect returns on investment. Today, I would like to suggest several low-cost or no-cost approaches that Federal legislators and agencies could take to advance these steps to recovery, in New Jersey and elsewhere.

*Improving Access to Nonperforming Mortgages*

To expand ReStart to more homeowners and more vacant properties, NJCC has relied on access to discounted pools of nonperforming FHA mortgages offered through DASP program auctions. The DASP program has been a huge and vital resource in our efforts to scale up our foreclosure recovery efforts. The program has preserved homes, minimized foreclosures, protected property values, and promoted broad-based community stability, and from our perspective, it is one of the last remaining foreclosure recovery programs to preserve and create home ownership for low- to moderate-income communities at significant numbers.

However, this program has become increasingly dominated by profit-driven private investors, which have won bids on 98 percent of DASP loans, including 88 percent in designated Neighborhood Stabilization Outcomes (NSO) pools. We believe that it is critical that FHA refine the DASP auctions to make them more accessible to nonprofits and community-based organizations. Thus far, studies of the program have shown that nonprofits and community-based organizations have produced far more positive outcomes for homeowners and for communities.

There are several straightforward solutions to this challenge. FHA could complete more direct sales of these mortgages to nonprofits, especially in NSO areas, where positive neighborhood outcomes such as foreclosure prevention and affordable housing creation are of especially high importance. Also, FHA could tighten NSO requirements by awarding additional points to those committed to social outcomes, or it could set aside certain mortgage pools on which socially motivated nonprofits would have the first option to bid. Finally, FHA could heighten minimum NSO outcomes, such as requiring that a certain portion of vacant properties be redeveloped and sold or rented as affordable housing.

*Continuing Programs To Finance Principal Reductions*

Studies have shown that principal reductions are more effective than almost any other foreclosure prevention strategy, especially when paired with counseling. And these modifications benefit everyone involved: the homeowners, the neighborhoods, the mortgagees, and the local and State governments. But funds that are critical for producing affordable principal reductions have been difficult to access, and even more so now that Hardest Hit Funds are no longer available. We hope that similar funds can be made available for affordable principal reductions in places like New Jersey where the foreclosure crisis is still ongoing, including Department of Justice Settlement Funds. If more available, these funds could carry a program like ReStart to thousands more distressed homeowners.

An alternative approach would be to incentivize financial institutions to partner with nonprofits to directly provide principal reductions to distressed homeowners under mortgages they are servicing. We are currently working with one major financial institution to directly acquire over 500 mortgages located in communities we serve, but this transaction is just one of many that could occur if greater incentives were in place. These incentives could take the form of CRA credits or a number of other benefits.

We also believe that similar incentives—CRA credits perhaps being the best example—could spur financial institutions to increase access to stable mortgage credit for qualifying low-to-moderate-income families who are truly ready for home ownership. This could include the purchase of nonperforming mortgages that are modified and stabilized through programs like ReStart, as well as mortgages that have been seasoned though a program like our developing CUSO and would attain long-term success by being transferred into the conventional mortgage market.

*Expanding the CDFI Bond Guarantee Program*

Lastly, while we have used our existing resources and creativity to expand our provision of capital for affordable rental housing development, we simply do not have sufficient access to long term capital that is truly necessary for large-scale rental housing investments. The CDFI Bond Guarantee Program has the potential to be a truly momentous program in transforming the ability of CDFIs like ours to foster the large-scale creation of affordable rental housing, an especially severe need in places like New Jersey. The extension and expansion of this program will be transformative for the communities we serve.

**Conclusion**

In conclusion, I would once again like to thank the Members of the Subcommittee for their time and attention to this critical issue of saving our neighborhoods from the detrimental impact of foreclosures. And I would like to acknowledge Senator Menendez' leadership in helping residents of our at-risk communities across our State. I hope this conversation can continue, as I believe that, with the right set of policies and programs, we can truly stabilize our distressed communities, to the benefit of everyone.

**PREPARED STATEMENT OF MABÉL GUZMÁN**

2014 CHAIR, CONVENTIONAL FINANCE AND POLICY COMMITTEE, NATIONAL ASSOCIATION OF REALTORS

DECEMBER 9, 2014

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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO

THE UNITED STATES SENATE COMMITTEE ON BANKING HOUSING AND URBAN AFFAIRS COMMITTEE SUBCOMMITTEE ON HOUSING TRANSPORTATION AND COMMUNITY DEVELOPMENT

HEARING REGARDING

INEQUALITY OPPORTUNITY AND THE HOUSING MARKET

DECEMBER 9, 2014

## INTRODUCTION

Chairman Menendez, Ranking Member Moran, and members of the Subcommittee; my name is Mabél Guzmán. I am the broker for @properties in Chicago, Illinois. I have a long history of advocacy for housing needs, and received the 2014 Presidential Medallion for Outstanding Service from the Illinois Association of REALTORS®. I serve as the 2014 Chair of the National Association of REALTORS® Conventional Finance and Lending Committee. I am here to testify on behalf of the one million members of the National Association of REALTORS®. I thank you for the opportunity to present our views on "Inequality and Opportunity in the Housing Market."

## TIGHT CREDIT HAS CREATED INEQUALITY & INHIBITS OPPORTUNITY IN THE HOUSING MARKET

Access to affordable credit remains a huge problem for prospective homebuyers, those wishing to refinance, and our economy overall. The homeownership rate has fallen almost to levels last seen in 1990. Today, the number of homes purchased annually remains less than half of what was purchased prior to the real estate bubble and subsequent collapse. The number of first-time buyers entering the market is at the lowest point since 1987, despite historically low mortgage rates.

Some may question whether Americans still believe in the American Dream or whether homeownership is no longer desirable; however, according to a survey[1] by Neighborworks America released in October 2014, 88 percent of adults maintain a positive view of homeownership. Younger Americans also support homeownership. A recent report by *The Demand Institute* demonstrates that homeownership still matters. In fact, 75 percent of Millennials believe home ownership is an important long-term goal and 73 percent believe ownership is an excellent investment.[2]

Americans have not changed their belief that owning a home is important. What has changed is access to affordable mortgage credit. Credit remains tight as lenders remain leery of taking on risk. There are 6 major factors that are currently impacting access to credit:

1) **The national economy is still in recovery and the supply of both credit and homes remains tight.** Housing demand has lagged historic levels due to sluggish growth in employment and incomes combined with lender overlays on loans financed by the U.S. government. The result is constrained access to credit for minorities, young buyers, and low and moderate earners.

2) **High guarantee fees and loan level pricing adjustments charged by the Government Sponsored Enterprises (GSEs) are still hurting consumers.** Though it is prudent to protect taxpayers against further losses and bailouts of the GSEs, the Federal Housing Finance Authority (FHFA) must use restraint. Encouraging policies or economic models that significantly overcharge consumers may well result in billions of dollars of profits for the GSEs, but will also have a significantly negative impact on mortgage lending.

[1] Neighborworks America, *American at Home Survey*, October 21, 2014

[2] The Demand Institute, *Millennials and Their Homes: Still Seeking the American Dream*, September 16, 2014

3) **Excessive Federal Housing Authority (FHA) premiums are negatively impacting housing markets.** While NAR supports FHA's efforts to shore up its emergency reserve fund, our membership believes FHA's actions have come at the expense of FHA borrowers. Despite a healthy portfolio, FHA is charging borrowers historically high rates and requiring them to pay mortgage insurance for the life of the loan, with no opportunity to cancel that mortgage insurance other than to refinance into a non-FHA product.

4) **FHA and GSE condominium restrictions are preventing homeownership opportunities.** Changes to rules regarding owner occupancy ratios, project approval process, delinquent dues, and commercial space are necessary to remove onerous barriers preventing consumers from the ownership of condominiums, which often are the most affordable options for first-time homebuyers.

5) **Housing policies add to lending concerns.** Although recent steps taken by FHFA to provide more clarity with regard to representations and warranties, as well as restoring the GSE's longstanding practice of purchasing loans with 3 percent downpayments, are positive, it is imperative that lenders improve the quality of their underwriting and halt preventable mistakes during this process. Furthermore, just as the FHA has done encouraging work on compare ratios, NAR believes Congress and the Administration can help to further improve current credit conditions by addressing the 3 percent cap on fees and points.

6) **Foreclosure and short sales remain problematic for thousands of American families.** For this reason, NAR urges Congress to pass an extension of , "The Mortgage Forgiveness Tax Relief Act," which would extend mortgage debt forgiveness to distressed homeowners and provide more certainty to the short sale process. Also, NAR remains concerned about the GSE and FHA alternative asset disposition programs that actually reduce home purchase opportunities for owner occupants.

## A NATIONAL ECONOMY STILL IN RECOVERY

Homeownership is an important source of wealth creation for American families. Homeowners have always enjoyed more net worth than renters; in the recovery from the great recession, the wealth of owners grew by $20,900 from 2010 to 2013 as compared to just $300 for renters. The median net worth of a homeowner in 2013 was $195,400 versus $5,400 for renters. Federal Reserve economists have noted the power of a mortgage as a means of forced savings.

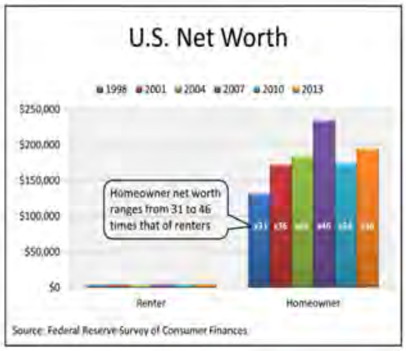



**Exhibit 1**

At the same time, however, the share of first-time home buyers fell to a 27-year low in 2013 of 33 percent, down from 38 percent in 2012 and a recent high of 50 percent in 2010. As depicted below, the decline in homeownership between 2004 and 2013 was disproportionately borne by African Americans and buyers aged 44 and under. As homeownership is one of the main vehicles for building wealth over one's lifetime, the decline in homeownership will have a lasting effect on access to education, healthcare, and retirement for these groups.

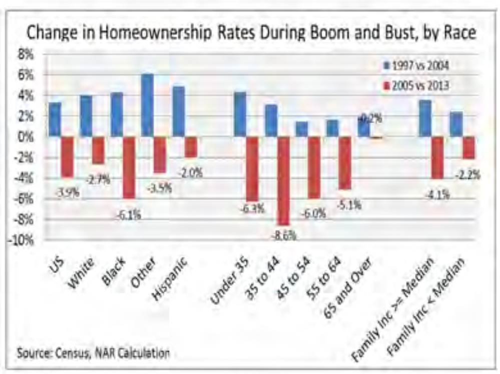



**Exhibit 2**

Rents have increased steadily in recent years as a result of tight credit and a bourgeoning renter population, and are expected to rise at annual rates of roughly 4 percent in each of the coming two years. Rising rents eat into savings that could fund a down payment, as well as savings for other life events like having a family and retirement. This trend could drive an expansion of the wealth gap.

Several factors are impacting the market today; these include: the supply of credit, the supply of homes, and consumer demand.

**SUPPLY OF CREDIT STILL LAGGING**

The average successful mortgage applicant's FICO score remains well above the historic average. While the FHA, Department of Veterans Affairs (VA), and Rural Housing Service (RHS) all provide access to low down payment loans, lenders have restricted that access to borrowers with higher credit scores and lower Debt-to-Income ratios (DTIs).

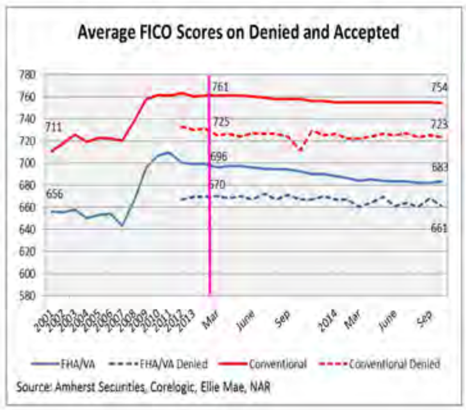



**Exhibit 3**

The impact of tight credit is felt even more by minority groups. The denial rate of African American credit qualified borrowers is more than double that of whites (see Exhibit 4 below). The ratio is nearly the same for Hispanics.

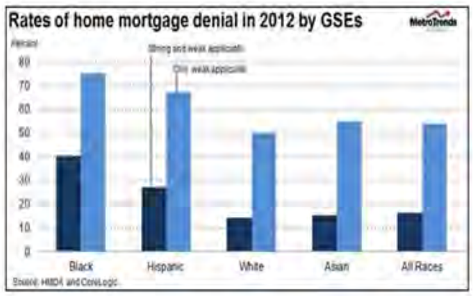



**Exhibit 4**[3]

Furthermore, while the rejection rates for all borrowers were higher in 2013 compared to 2004, the change in rejection rates over this period for African American, Hispanic White, and other minorities were elevated relative to non-Hispanic Whites.

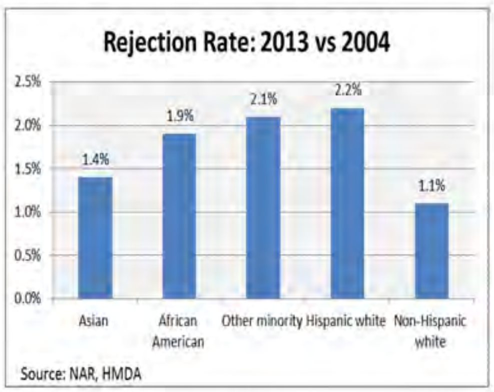



**Exhibit 5**

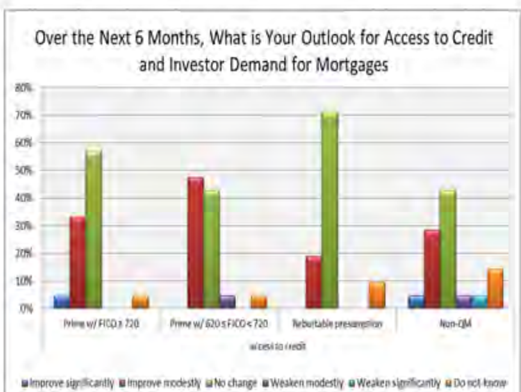
While lenders have expressed concern about regulatory uncertainty, the final Qualified Mortgage (QM) and Qualified Residential Mortgage (QRM) rules are both favorable and the CFPB has acted to ameliorate some frictions. Moreover, NAR applauds the six financial regulators that finalized the Risk Retention rule earlier this year which includes a broad definition of QRM that aligns with the Qualified Mortgage standard implemented earlier this year.

[3] http://blog.metrotrends.org/2014/06/gses-serve-minority-borrowers/

REALTORS® are confident that the new QRM rule will encourage sound and financially prudent mortgage financing by lenders, while also ensuring responsible homebuyers have access to safe and affordable credit. The synchronization of the QRM rule with the QM rule will provide lenders with much needed clarity and consistency as they apply the new standards to loan applications while also providing a framework to bring more competition to the secondary mortgage market.

The new QRM rule is also a healthy step towards a more robust securities market that will reduce the government's footprint and creates more opportunities for private capital to participate. Importantly, the final rule relies on sound and responsible underwriting rather than on an onerous downpayment requirement to qualify as a QRM loan.

Additionally, lenders surveyed have indicated optimism about an expansion of credit in the near-prime segment and a modest improvement for sub-prime borrowers (Exhibit 6).



Source: NAR

**Exhibit 6**

Lender confidence has not been shared by entry-level consumers, though. Research by the Federal Reserve indicates that borrowers with FICO scores below 680 expect to be rejected for credit at higher rates in 2014 and plan to apply at lower rates for credit as a result. The opposite is true for most other groups except high FICO borrowers who have had advantageous conditions for several years. The impact of tight credit has impacted lower credit borrowers' willingness to even apply for credit.


**Exhibit 7**

African American and Hispanic borrowers make up a disproportionate share of borrowers with FICOs less than 650. According to the 2013 Federal Reserve analysis of HMDA filings, in 2006, 56.8 percent of African American or Black borrowers had an Experian credit score of 650 or less, as compared to 37.5 percent for White Hispanic and 19.1 percent for White, Non-Hispanic. As depicted below, the distributions of credit scores by race vary significantly. Furthermore, the share of rejections due to credit score in 2013 was significantly higher for African Americans (30.0 percent) and other minorities (27.7 percent) than non-Hispanic Whites (22.5 percent).


**Exhibit 8**

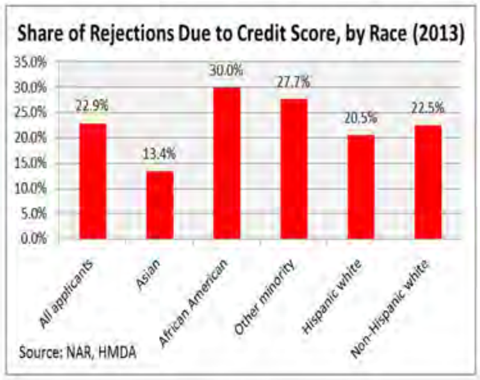



**Exhibit 9**

According to a recent NAR survey, roughly 60 percent of lenders believe FICO's latest credit score model, called FICO 9, will result in the increased acceptance of mortgage applications. Specifically, the company's latest version of its score will no longer weigh medical debts, which account for about half of all unpaid collections on consumers' credit reports, as heavily as it did in previous iterations. The newer FICO scores will also ignore any overdue payments that have already been made; previously, the scores factored paid and unpaid collections equally, though amounts under $100 were ignored.

REALTORS® welcome FICO's changes and believe they will ultimately make a real difference in the lives of millions of Americans, who have been shut out of the housing market or forced to pay higher mortgage interest rates because of flawed credit scores. Our members do understand that for consumers to see any benefit, however, lenders have to adopt the new scoring techniques. In the past, mortgage lenders have been slower to adopt new scores because Fannie Mae and Freddie Mac still used older models in their own underwriting software. NAR urges the GSEs to expand the use of other credit score models such as VantageScore, which rolled out a new scoring model in March 2013 that excludes all paid collections. This model also uses utility and rental payments, which are advantageous to potential buyers without considerable credit card balances or car loan debt, helping low income and first time buyers achieve homeownership.

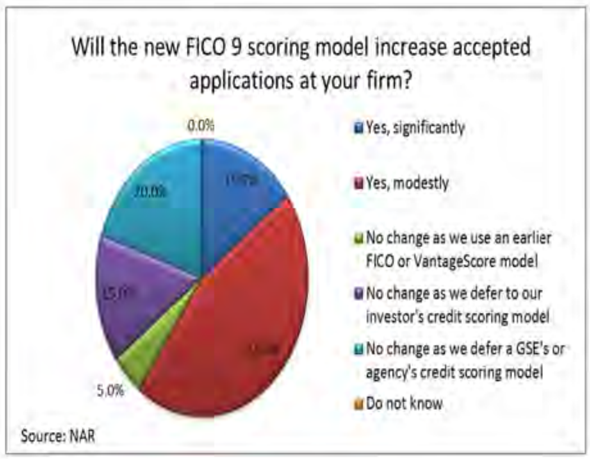



**Exhibit 10**

**HOUSING SUPPLY REMAINS TIGHT**

The months' supply of homes has been under the neutral 6 months' mark for more than two years, attesting to the tightness of inventories. While the national average was 5.1 months' in October 2014, the supply of homes in the $250,000 price range or less where entry-level buyers typically participate was much lower. Investor demand focused on this price point helped to absorb any excess inventory following the recession, but traditional sellers and builders have been slow to replenish the supply as the market recovered.


**Exhibit 11**

Single family housing starts were just 621,000 in 2013 and have only averaged slightly better in 2014, well below the historic average of nearly 1.1 million per year. Total construction starts, including single family and multi-family, were 930,000 in 2013 and have been modestly higher in 2014, but again well below the historical average of nearly 1.5 million per year.


**Exhibit 12**

Furthermore, the sales price of new homes remains significantly higher than those of existing homes pointing to the lack of affordable housing in the new construction portion of the market. While the spread has eased from a peak of 30 percent of the median new home sale price, it remains significantly above its level in the early

2000s. Some might argue that the median existing sale price includes distressed sales, but the spread did not decline in lock-step as the distressed share fell from 34 percent in October of 2011 to 9 percent in October of 2014. The spread has eased in 2014, but remains more than twice its pre-crisis level.

Without an increase in construction, the months' supply of homes could slip below 5 months, which could in turn drive strong price appreciation. Combined with an expected increase in mortgage rates, a rapid increase in home prices could weigh on affordability and stymie nascent first-time buyer confidence.

## HOUSING DEMAND FACES HEADWINDS

As the economy improved over the last two years, job prospects for young workers have as well. Nearly 1.2 million more persons between the ages of 25 and 34 were employed in October 2014 as compared to October 2012; this age group makes up nearly 60 percent of first-time homebuyers according to NAR's *Profile of Home Buyers and Sellers*. This survey also indicates that the majority of borrowers build up their down payment within the 24 month period in advance of their purchase. These trends bode well for 2015 as jobs provide the income and confidence to build up a down payment and make a home purchase.

However, headwinds for these young, aspiring home buyers remain. Of those buyers who had trouble saving for a down payment, nearly half of homebuyers indicate that student debt delayed their ability to save, according to NAR's 2014 *Profile of Home Buyers and Sellers*. Research by economists at the New York Federal Reserve indicates that students in states where the average student is more "heavily reliant on student debt while in school are significantly and substantially more likely to move home to parents when living independently, and are significantly and substantially less likely to move away from parents when living at home".[4] Furthermore, these same economists found a long-term pattern of increased residence of young adults with parents due to rising student debt burdens.

Repeat owners and potential trade-up buyers have had their own issues with which to contend. As of the second quarter of 2014, 5.3 million homeowners still owed more on their home than it was valued. This was a significant improvement of nearly 6.8 million fewer underwater borrowers than in the 4th quarter of 2012. Unfortunately, the severity of negative equity is greater for owners in the entry-level price range. Negative equity stymies the trade-up process, preventing entry-level homes from re-entering the market, but it also constrains the supply. As prices appreciate, these owners will gain the equity to trade up.

Former owners who went through short sales or foreclosures may now have access to financing through the FHA or the Government Sponsored Enterprises (GSEs). However, Federal Reserve economists found that 6 years after going delinquent, the FICO scores for these homeowners had only recovered 90 to 95 percent.[5] These borrowers may have access to credit, but they face higher pricing and manual underwriting by the FHA, GSEs, and Private Mortgage Insurers (PMIs). The higher pricing affects their ability to comply with the 3 percent cap and 43 percent back-end DTI requirements of the QM rule.

Not all homeowners can wait for prices to go up; many are in distress. Roughly 920,000 homeowners were seriously delinquent on their mortgage in the 3rd quarter of 2014 and another 980,000 were in some stage of foreclosure. If Congress is unable to extend the current tax treatment of mortgage debt forgiveness relief, these households will face an even greater debt load, further compounding their impaired credit issues and reducing the likelihood of their participation in the housing market and the economy. The potential impact of a failure to extend this provision of current tax law is illustrated by the sharp drop in the share of short sales in the latter half of 2013 that occurred in anticipation of the elimination of the more favorable treatment of mortgage debt forgiveness given the long timelines needed to complete the short sale process.

Summarizing, weak employment and income growth combined with lender overlays on loans financed by the US government or through Fannie Mae or Freddie Mac have constrained access to credit and the housing recovery for minorities, young buyers, and low and moderate earners. In short, these groups are missing out on the strongest affordability conditions in decades and this pattern may persist going forward.

## HIGH GSE GUARANTEE FEES & LOAN LEVEL PRICING ADJUSTMENTS STILL HURTING CONSUMERS

In addition to national economic factors, high guarantee fees (g-fees) and loan level pricing adjustments (LLPAs) charged by the GSEs are negatively impacting the housing recovery. These Enterprises buy single-

[4] http://www.newyorkfed.org/research/staff_reports/sr700.pdf

[5] http://www.federalreserve.gov/pubs/bulletin/2013/pdf/2012_HMDA.pdf

family mortgages from mortgage companies, commercial banks, credit unions, and other financial institutions. A key revenue component for the GSEs is a g-fee received for guaranteeing the payment of principal and interest on their mortgage backed securities (MBS). The g-fee is a significant factor in determining profits earned from this credit guarantee. The g-fee covers projected credit losses from borrower defaults over the life of the loans, administrative costs, and a return on capital. FHFA's announcement on December 9, 2013, will result in g-fees that are more than double the level of fees in 2007.

In March 2008, the GSEs implemented two new fees. The first was an upfront adverse market fee of 25 basis points that was intended to protect against the heightened credit risk posed by deteriorating housing market conditions. At the time, the adverse market fee was equivalent to an ongoing guarantee fee of approximately five basis points. The second new fee was loan level pricing adjustments (LLPAs), which are additional fees based on loan-to-value (LTV) ratios, credit scores, and other risk factors. Both of these charges, like the g-fee, are passed onto borrowers, typically in the form of higher mortgage rates, since borrowers often use available cash to contribute toward down payment rather than towards additional fees.

In addition to the LLPAs, ongoing g-fees are included in the interest rate charged to the borrower, while borrowers with LTVs higher than 80 percent will often contribute hundreds of dollars a month toward mortgage insurance premiums that protect the GSEs for losses well beyond that. As an example, Exhibit 13 shows the additional fees borrowers at different down payment levels are required to pay to the GSEs.

| LLPAs and AMDC Paid Upfront on $200,000 Home | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | < 60.00% | 60.01 – 70.00% | 70.01– 75.00% | 75.01 – 80.00% | 80.01 – 85.00% | 85.01 – 90.00% | 90.01 – 95.00% | 95.01 – 97.00% |
| > 740 | $0 | $325 | $363 | $775 | $825 | $875 | $925 | $960 |
| 720 – 739 | $0 | $325 | $725 | $1,163 | $1,238 | $1,313 | $1,388 | $1,440 |
| 700 – 719 | $0 | $975 | $1,450 | $1,938 | $2,063 | $2,188 | $2,313 | $2,400 |
| 680 – 699 | $300 | $975 | $2,175 | $3,100 | $2,888 | $2,625 | $2,775 | $2,400 |
| 660 – 679 | $300 | $1,625 | $3,263 | $4,263 | $4,950 | $4,375 | $4,625 | $3,840 |
| 640 – 659 | $900 | $1,950 | $3,988 | $5,038 | $5,775 | $5,250 | $5,550 | $4,800 |
| 620 – 639 | $900 | $2,275 | $4,713 | $5,038 | $5,775 | $6,125 | $6,475 | $6,240 |
| < 620 (1) | $900 | $2,275 | $4,713 | $5,038 | $5,775 | $6,125 | $6,475 | $6,720 |
| Source: FNMA, NAR | | | | | | | | |

**Exhibit 13**

Accordingly, a borrower with a down payment slightly under 10 percent will pay for credit protection to the GSEs in the form of $2,313 in upfront fees (if they are able to) and ongoing monthly guarantee and credit insurance costs that represent 18.9 percent of their monthly mortgage payment as shown in Exhibit 14. To provide context, the borrower in this example is paying for mortgage insurance coverage up to 30 percent in losses, which exceeds the charter requirement for 20 percent protection, based on the purchase price or the appraised value of the house.

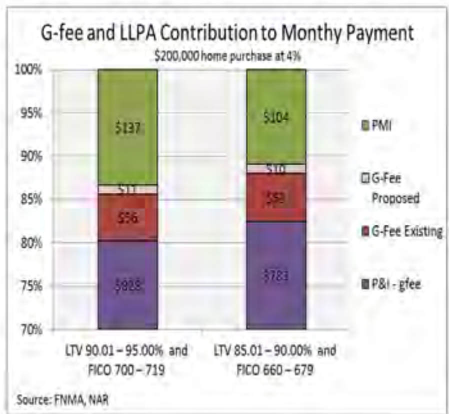



**Exhibit 14**

On December 13, 2013, as part of a yearly analysis of g-fees, FHFA indicated that, at its direction, Freddie Mac and Fannie Mae implemented new costing models in 2012 that resulted in sizeable increases in the GSEs' estimates of the cost of guaranteeing single-family mortgages. Though these changes don't reflect the reduced credit losses the GSEs experienced throughout 2013, FHFA indicated that it believed that the estimates more fully reflected the credit risk posed by the loans, thus substantiating continued increases to g-fees. It should be noted, that the same report indicated that the GSEs were guaranteeing a substantially lower amount of "high-risk" loans and that over 87 percent of loans originated were from borrowers with credit scores greater than or equal to 720, contradicting the idea that the estimated increase in costs were based on risk, rather than prescriptive policy measures to try to make high private market rates appear competitive.

Another flaw with the GSEs' models is that they do not take into account the new regulatory framework under the Consumer Financial Protection Bureau's Ability-to-Repay rule that prevents the highest risk loans from being originated. In addition, the cost models also don't factor improvements in mortgage servicing which will reduce losses should borrowers fall behind on payments. Instead, both of the GSEs are attempting to achieve a significant target rate of return to guarantee mortgages – well over and above projected losses. NAR's interpretation of this decision is that these fees are excessive and forcing taxpayers to pay substantially higher rates for their mortgages than the actual risk that they pose. As FHFA notes in its Request for Input, the GSEs' return on capital is positive in all borrower loan-to-value and credit score risk buckets, and the "cost" expressed is not actually a cost, it merely reflects a profit that is less than the targeted rate.

Continued increases in g-fees and upfront borrower costs will extend a trend of reduced access to mortgage credit, which is counter to a principal duty of the FHFA Director under the Housing and Economic Recovery Act of 2008 (HERA). Continuing to increase the fee will mean that larger numbers of consumers, many of them first time homebuyers, will be forced to pay substantially higher mortgage rates, or be left with limited housing finance options. NAR believes borrowers who are either purchasing a home or refinancing their existing mortgage using conventional financing are being charged excessive fees due to policy goals that go beyond protecting taxpayers from GSE losses.

NAR is especially concerned with the disparate impact the changes will have on first time homebuyers and other traditionally underserved borrowers. These families are more likely to bear the brunt of these fees typically due to credit histories that do not reflect payments toward housing expenses and smaller down payments than made by other borrowers.

FHFA seems to believe that by raising costs for loans purchased or guaranteed by the GSEs, they can lure private sector capital back to the mortgage market. However, we believe this policy does not account for the aversion to, and lack of trust in, issuers of private mortgage backed securities that many investors still harbor since suffering tremendous losses during the recent housing crisis. This lack of trust remains and is hard to quantify. When increasing fees, the GSEs must include performance measures to ensure they are meeting the goal of increasing private sector participation. In addition, the Agency should examine other factors that are holding back the private market in conjunction with the Treasury Department. The National Association of REALTORS® believes that future data will show that the effect of raising fees will simply be increased costs to home buying taxpayers who can afford to become homeowners, and that the true effect will be redirection of more mortgage loans to FHA without a robust private sector return.

Though many have commented that prior to the 2008 financial crisis the GSEs underestimated projected losses, FHFA's announcement of December 9, 2013 will result in more than a doubling of the guarantee fee since 2007. This is a result of credit risk models that don't factor regulatory changes made after the financial crisis such as the Ability-to-Repay rule and improvements in mortgage servicing standards. These rules restrict many of the loans and practices that were responsible for the substantial losses the GSEs experienced.

The excessiveness of these continued fee increase will harm the nation's housing recovery. First time homebuyers and other traditionally underserved borrowers are more likely to make smaller downpayments have been disproportionately affected by the upfront LLPA fees. Given the need to encourage borrowers to return to the housing market, unnecessarily increasing borrowing costs for this class of homebuyers is irresponsible housing policy and impacts borrowers who are essential to our housing recovery. .

## EXCESSIVE FHA PREMIUMS NEGATIVELY IMPACTING HOUSING MARKET

Along with excessive fees charged by the GSEs, current FHA mortgage insurance premiums have made it more difficult for many Americans to achieve the dream of homeownership. In 2014, FHA fees make up nearly 25 percent of a monthly mortgage payment. On a $150,000 loan at 4.5 percent interest, the mortgage payment is 13 percent higher today than it was in 2008 (See Exhibit 15).

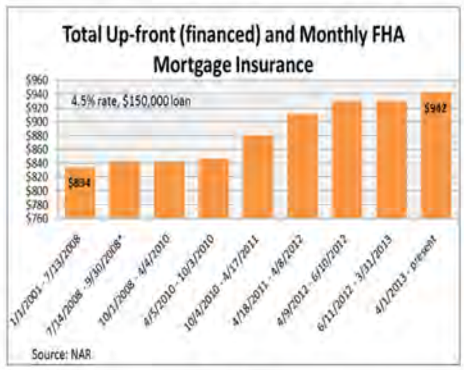



**Exhibit 15**

Now that the MMI Fund is on a path to recovery, NAR has strongly urged FHA to lower the annual mortgage insurance premiums and eliminate the requirement that mortgage insurance r for the life of the loan. These changes will slow the rate of prepayments that are having a negative effect on the fund. According to HUD's data, full payoffs, with no subsequent refinance with FHA, were 81 percent of FHA's prepayments.[6] In 2012, only 50 percent of FHA prepayments were full payoffs. Prepayments in FY 2013 were at their highest level since the end of FY 2004.

The MMI Fund is currently capitalized at $4.8 billion. In just two years, the fund has gained $21 billion. This is remarkable progress considering in FY 2012, FHA had to take a draw on the Treasury due to significant losses experienced as a result of the housing collapse for the first time in its 80 year history,. The housing crisis was the worst in our nation's history since the Great Depression. FHA took losses, because doing so helped keep our economy afloat during this crisis. FHA prevented an even greater economic collapse by continuing to lend mortgage money, stabilizing housing prices, and keep housing markets flowing. Mark Zandi of Moody's has reported *"If FHA lending had not expanded after private mortgage lending collapsed, the housing market would have cratered, taking the economy with it."*[7] Moody's has estimated that without FHA, housing prices would have dropped an additional 25 percent, and American families would have lost more than $3 trillion of home wealth.

Now that the FHA fund is healthy, FHA is trying to rebuild its emergency reserves as quickly as possible. NAR supports this effort, but rebuilding capital reserves takes time. FHA's underwriting is stronger than ever. Higher risk borrowers are required to make significant downpayments, and some even must go through strenuous manual underwriting processes. FHA's average borrower today has a credit score of more than 680. The average borrower rejected for an FHA mortgage has a credit score of 661. Despite these strong borrower characteristics, FHA is charging borrowers historically high rates and requiring them to pay mortgage insurance for the life of the loan, with no opportunity to cancel other than to refinance into a non-

[6] U. S. Department of Housing and Urban Development (HUD) Office of Risk Management and Regulatory Affairs, Office of Evaluation, Reporting and Analysis Division, *FHA Production Report*, December 2013.

[7] Zandi, Mark, Obama Policies Ended Housing Free Fall, *The Washington Post*, September 28, 2012.

FHA product. NAR believes this is simply disenfranchising the typical FHA borrower, and preventing a significant portion of qualified borrowers from buying a home.

In 2014, the mortgage insurance premium of 1.35 percent is 80 basis points higher than the rate of 0.55 percent in 2010. The 80 additional basis points pushed an estimated 1.45 million to 1.65 million renters over a sustainable debt-to-income level for purchase of a home in 2013 (see Exhibit 16). Of these impacted renters, as many as 125,000 to 375,000 would have purchased a home in 2013 had they not been priced out of the market.

| Premium Rates and the Impact on Renters | | | |
|---|---|---|---|
| Year | MIP | Change in MIP from 2010 | Renters Impacted |
| 10/4/2010 - 4/17/2011 | 90 | 35 | 550,000 to 750,000 |
| 4/18/2011 - 4/8/2012 | 115 | 60 | 1,000,000 to 1,250,000 |
| 4/9/2012 - 6/10/2012 | 125 | 70 | 1,200,000 to 1,400,000 |
| 6/11/2012 - 3/31/2013 | 125 | 70 | 1,250,000 to 1,450,000 |
| 4/1/2013 - present | 135 | 80 | 1,450,000 to 1,650,000 |

<u>**Exhibit 16**</u>[8]

Many of the potential home buyers who are priced out of FHA cannot migrate to private mortgage insurance (PMI). PMI premiums are currently 1.1 percent annually for a borrower with a downpayment between 3 percent and 5 percent and a FICO score of 720 or higher[9]. The rate rises to 1.31 percent if the FICO is between 680 and 719, and 1.48 percent if the FICO is between 620 and 679; private mortgage insurance in not available for loans with FICOs below 620. Combined with the higher funding cost of roughly 25 basis points for a GSE execution, only borrowers with the highest credit scores could afford to migrate to GSE financing (e.g. 1.31 percent + 0.25 percent = 1.56 percent, 21 basis points higher for conventional than FHA). Likewise, for a larger downpayment between 5 and 10 percent with a FICO below 680, the cost of PMI is 1.15 percent, still more expensive than FHA when the 25 basis point difference in funding costs is included.

Many first-time home buyers, who are priced out of FHA and unable to migrate to private mortgage insurance, are likely to be under the age of 44. Since 2008, income growth has been slowest among Millennials, ages 33 and younger, and Generation Xers, ages 34-44 (see Exhibit 17). Of these younger buyers, over 40 percent are minorities. If most of the people buying homes in the next two decades are now under the age of 44, then more than one in four homebuyers will be Hispanic or Asian.[10]

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[8] NAR, Census and Genworth Data

[9] Genworth Financial data on PMI.

[10] The Changing Face of America (2011, August) *National Association of REALTORS® Global Perspectives Newsletter*. Retrieved from http://www.realtor.org/sites/default/files/global-perspectives-2011-08-US-demographic-shift-full-issue.pdf

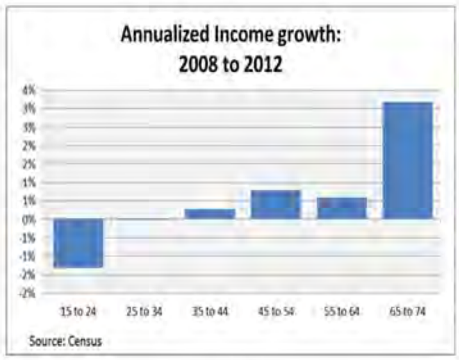


**Exhibit 17**

FHA has played an important role in helping first-time and minority borrowers become homeowners. In 2014, 81 percent of all FHA loans went to first-time homebuyers.[11] Moreover, nearly half of African American and Hispanic families who purchased a home, did so with FHA mortgage insurance (see Exhibit 18). Providing access to credit for these homebuyers is a critical means of building wealth. A recent research paper by the Joint Center for Housing Studies at Harvard concludes that even after the decline in housing prices and the increase of foreclosures beginning in 2007, homeownership continues to be a significant source of household wealth, particularly for lower-income and minority households.[12] The study notes that,

> *"efforts to save for a down payment lead to a large jump in wealth that is then further supported by at least modest appreciation and some pay down of principal over time. Renters may have the opportunity to accrue savings and invest them in higher yielding opportunities but lack strong incentives and effective mechanisms for carrying through on this opportunity…and those who made a failed transition from owning to renting are no worse off financially than those who remained renters over the whole period."*[13]

[11] Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund, Fiscal Year 2014, November 17, 2014.

[12] Christopher Herbert, Daniel McCue, and Rocio Sanchez-Moyano. "Is Homeownership Still an Effective Means of Building Wealth for Low-income and Minority Households? (Was it Ever?),"49, Joint Center for Housing Studies, Harvard University, September 2013.

[13] Ibid, 26-27.

**Home Purchase Loans and Racial Shares Across Market Segments in 2013[a]**

| Race or Ethnicity | Number of Loans | 2013 Market Segments (Shares in Rows Add to 100%) | | | |
|---|---|---|---|---|---|
| | | Conventional | FHA | FSA/RHS[b] | VA |
| All Borrowers | 2,748,237 | 62.9 | 23.4 | 4.8 | 9.0 |
| American Indian or Alaska Native | 9,262 | 47.5 | 34.5 | 5.9 | 12.1 |
| Asian or Hawaiian/Pacific Islander | 158,741 | 82.4 | 13.7 | 0.8 | 3.1 |
| Black or African American | 130,534 | 32.4 | 46.3 | 4.5 | 16.8 |
| Hispanic or Latino | 220,070 | 39.7 | 47.9 | 4.6 | 7.7 |
| White | 1,949,002 | 65.4 | 20.4 | 5.5 | 8.7 |
| Not Disclosed[c] | 200,846 | 69.5 | 18.8 | 1.8 | 10.0 |
| Joint[c] | 79,782 | 59.9 | 22.1 | 2.7 | 15.4 |

**Exhibit 18[14]**

The 2014 FHA Actuarial report believes FHA will achieve a 4.5 percent capital reserve (more than double the required level) in just 4 years. But at what cost? FHA's mission is to provide mortgage access to the underserved. Increasing the emergency reserves at this rate, is limiting mortgage access to hundreds of thousands of qualified families. FHA is healthy, and strongly capitalized. We strongly urge FHA to lower premiums, and resume its goal of providing safe, affordable mortgage financing to qualified American families who want and deserve their piece of the American dream. .

## CONDO RESTRICTIONS PREVENTING HOMEOWNERSHIP OPPORTUNITIES

FHA and the GSEs have significant restrictions on the purchase of condominiums. However, condominiums often represent the most affordable options for first-time homebuyers. NAR supports developing policies that will give current homeowners and potential buyers of condos access to more flexible and affordable financing opportunities and a wider choice of approved condo developments. Specifically, we have four areas of concern.

1. Owner occupancy – The GSEs do not place limits on the owner-occupancy of a condominium project if the borrower is buying it as a primary residence. FHA requires that a condominium property be at least 50 percent owner occupied. FHA's ratio greatly limits the number of condominium buildings available to credit-worthy borrowers. This policy is also self-fulfilling. If a building has less than the 50 percent owner-occupancy ratio, sellers of units have fewer buyers who are eligible, leading them to rent out their unit rather than sell. This makes it difficult for many buildings to achieve the 50 percent requirement. NAR strongly urges FHA to eliminate this requirement to open up more properties for FHA eligible buyers.

2. Project Approval Process – Both FHA and the GSEs require the entire condominium project to be approved prior to a buyer purchasing a unit. The GSEs allow lenders to approve a project, but they

[14] Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund, Fiscal Year 2014, November 17, 2014.

do not publish the approved list, making it difficult for prospective purchasers to know if a building is approved. FHA, on the other hand, does publish a list of approved properties, but its certification requirements to obtain approval are much more challenging. The process is costly and time-consuming, and difficult for the often volunteer boards of condominium buildings. Only about 10 percent of all condominium properties nationwide have FHA approval.[15] NAR strongly urges FHA to reduce the burdens associated with project certification. NAR also recommends that the spot loan approval process be reinstated to allow purchases in some buildings that do not have FHA certification.

3. Delinquent Dues – Following the housing crisis, a number of condominium and homeowner associations have units that are behind in paying their dues. Both FHA and the GSEs restrict approval of properties where more than 15 percent of the units have delinquent dues. While NAR appreciates the need to make sure properties are properly capitalized with appropriate reserves, dues payment should not be a sole determinant. Some associations may have compensated for delinquencies by building reserves or taking other steps to ensure that delinquencies are not impacting their financial stability. This requirement should NOT be a determining factor, but instead be a part of an overall review of a property's finances.

4. Commercial Space – Multi-use properties and new "town center" developments are very popular, and lauded by HUD as creating benefits for communities in providing easy access to amenities and transportation. Yet, condominium associations with commercial space are restricted from approval by both the GSEs and FHA. The GSEs limit commercial space to 20 percent, but provide waivers. FHA's limit is 25 percent, also with allowable waivers. The current policy hinders efforts to build neighborhoods that have a mix of residential housing and businesses with access to public transit. The Association urges FHA and the GSEs to lift these restrictions.

There are additional concerns related to condo rules including investor ownership, concentration limits, and pre-sale requirements that also should be changed. REALTORS® were pleased to see a recent notice by Fannie Mae, loosening some restrictions. We look forward to the publishing of FHA's upcoming condo rule and are hopeful that it will loosen many of the current restrictions.

Condominium unit mortgages are among the strongest performing in the FHA portfolio. According to FHA data from 2014, the combined serious delinquency and claims rate for new condominium projects is 0.96 percent and 0.76 percent for existing projects.[16] Condominiums are often the most affordable option for first time homebuyers, or older homeowners who wish to downsize. We strongly believe that qualified homebuyers should not be prevented from this option, simply due to mortgage restrictions.

## HOUSING POLICIES ADD TO LENDING CONCERNS

Lenders remain wary of mortgage markets, and continue to only provide access to those with pristine credit and flawless work history. Just last month, former Federal Reserve Chairman Bernanke disclosed that he had

[15] FHA Approved Condominium Map, Retrieved July 21, 2015, from FHA Review by a) v(s. http://www.fhaapprovedcondomap.com/

[16] Serious Delinquent/Claim Comparison, Retrieved December 1, 2014, from Neighborhood Watch, Early Warning System https://entp.hud.gov/sfnw/public/

been denied the opportunity to refinance his home. The average FICO score on conventional, purchase mortgages fell slightly in recent months, from 761 to 754 – still at historically high levels. This partially reflects the increased willingness of private mortgage insurers to back high FICO, high LTV mortgages. The average accepted FICO on FHA purchase production has fallen slightly as well, while the average FICO for a rejected loan in both spaces has increased. This pattern suggests a shift in production from the FHA to the GSEs, but not an expansion of the credit box. Specifically, the average FICO scores for accepted applications of both conventional and FHA production remain roughly 30 to 40 points higher than in 2001, a period predating the loosening of underwriting standards.

While the credit box remains very tight, NAR is encouraged by the actions of FHFA in the area of representation and warrants as well as for their work on guidelines for the GSEs to resume their longstanding practice of purchasing mortgages with downpayments of 3 percent. FHA has also begun to look at compare ratios, which should help expand access. Finally, we urge Congress to pass legislation fixing the 3 percent cap on fees, so that consumers have more options for financing.

**A BETTER REPRESENTATION & WARRANTIES FRAMEWORK**

Since the financial crisis, lenders have also expressed concern about representations and warranties, which provide the necessary assurances which permit the GSEs to purchase loans in an efficient and responsible manner without checking each loan individually or being at each closing. They also provide Fannie Mae and Freddie Mac with remedies to address circumstances where lenders do not meet the GSEs' purchase guidelines.

It is clear that the Representation and Warranty Framework (Framework) did not provide enough clarity to empower lenders to understand when the GSEs would exercise their remedy to require repurchase of a loan. This has contributed to lenders imposing credit overlays that drive up lending costs and also restrict lending to borrowers with less than perfect credit scores.

The new FHFA framework will provide clarity on specific Life-of-Loan exclusions from repurchase relief. Life-of-Loan exclusions are intended to protect the GSEs from instances of fraud or other significant noncompliance, and as a result, they allow the GSEs to require lenders to repurchase loans at any point during the term of the loan. The banking industry has conveyed that the current Life-of-Loan exclusions are open-ended and make it challenging for a lender to predict when, or if, Fannie Mae or Freddie Mac will apply one of them.

Moreover, by specifically defining the Life-of-Loan exclusions, lenders will know what they are and when they apply to loans that have otherwise obtained repurchase relief. Also, for loans that have already earned repurchase relief, FHFA plans to clarify that only Life-of-Loan exclusions can trigger a repurchase under the Framework, which REALTORS® believe will reduce confusion and risks to lenders. Finally, under the new Framework, the GSEs will retain their ability to conduct quality control reviews at any time, which is essential to their ongoing safety and soundness.

**RESTORING 97 PERCENT LTV LOANS A POSITIVE STEP**

In addition to FHFA's plan to improve representations and warranties, NAR supports the Agency's work to allow the GSEs to resume their longstanding practice of purchasing 97 percent LTV mortgages. When coupled with high quality underwriting, these loans have a history of performing well. Mortgages with high quality underwriting and low downpayments provide an important option for many creditworthy borrowers, especially first-time homebuyers, who will have access to affordable homeownership in a sensible and responsible manner.

While this action along with improvements to representations and warranties will help improve the lending environment, NAR strongly believes that lenders must do their part and ensure loans are prudently underwritten. Additionally, it is imperative these financial institutions improve the quality of their underwriting and halt preventable mistakes during this process, which ultimately has hurt potential borrowers and taxpayers.

Furthermore, NAR believes Congress and the Administration can help to further improve current credit conditions by addressing the 3 percent cap on fees and points.

**3 PERCENT CAP ON POINTS & FEES NEEDS TO BE FIXED**

In June 2014, the House of Representatives passed H.R. 3211, "The Mortgage Choice Act". It was passed again as part of a broader package (H.R. 5461) in September, 2014. H.R. 3211 and its Senate companion, S. 1577, are bipartisan compromises that reduce discrimination against mortgage firms with affiliates in the calculation of fees and points in the Dodd-Frank Ability to Repay/Qualified Mortgage (QM) rule. The QM rule sets the standard for mortgages by providing significant compliance certainty to QM loans that do not have risky features and meet certain requirements. A key requirement is that points and fees for a QM may not exceed 3 percent of the loan amount. The inherent discrimination of this rule arises from the fact that under current law and rules, what constitutes a "fee" or a "point" varies greatly depending upon who is making the loan and what arrangements are made by consumers to obtain closing services. As a result of these definitions, many loan originators affiliated with other settlement service providers are not be able to make QM loans to a significant segment of otherwise qualified borrowers.

The discrimination in the calculation of fees and points is being felt by consumers who are seeing reduced choices and added obstacles in their transactions. A Spring 2014 NAR survey of affiliated mortgage lenders revealed almost half experienced problems due to the 3 percent cap and in almost half those instances, consumer either were not able to complete the transaction or not able to complete the transaction with their preferred settlement services provider. Where services were outsourced and charges known to the lender, nearly half of loans (43.8) reported higher fees as compared to the same (12.5) or unknown (43.8).

Now that the House has passed H.R. 3211, we believe it is now time for the Senate to act during the lame duck session and pass S. 1577, which has the support of several notable sponsors including: Senators Manchin (D-WV), Johanns (R-NE), Levin (D-MI), Kirk (R-IL), Stabenow (D-MI), Toomey (R-PA), Klobuchar (D-MN), Portman (R-OH) and Isakson (R-GA).

**FHA COMPARE RATIOS ARE A GOOD START**

Lender overlays are a significant issue for borrowers attempting to use the FHA program. One reason for lender overlays is that FHA reviews and audits all lenders under the same protocol. This means that lenders who take the time and effort to carefully underwrite borrowers and approve with lower credit scores are treated the same as those lenders who only lend to those with a credit score over 700.

NAR is pleased that FHA is beginning to review compare ratios for lenders, but thinks they can do more. FHA currently compares a lender's early seriously delinquent (SDQ) performance for single family loans in a geographic area to other mortgagees in the same area. FHA's new proposal will add a supplemental analysis that will assess lender performance based on the lender's national default rate within three credit bands (below 640, 640 to 680 and above 680) and compare it to an FHA target rate of 1.6 percent. If a lender's SDQ rate is less than 125 percent of the target rate, FHA has indicated that "this may be a consideration to not take further action under the Initiative." NAR believes that the benefit of the Supplemental Performance Metric needs to be more definitive. If a lender has a supplemental metric ratio below the acceptable compare ratio (proposed 125 percent), NAR would like to see more certainty that the lender will not be subject to termination. Only then do we believe that lenders will feel more comfort in lending to borrowers with lower credit scores.

In addition, we believe the 125 percent target is too narrow. In its other Credit Watch calculations, FHA uses an SDQ rate of 150 percent of the industry average for Lender Insurance sanctions and 200 percent for Credit Watch penalties. We are concerned that 125 percent may provide too narrow of a tolerance particularly for smaller lenders where 5 to 10 additional early defaults could cause a significant swing in its compare ratio. Consequently, lenders may be compelled to manage their performance at much lower default rates, which will not encourage lending to qualified borrowers across the credit spectrum. .

## FORECLOSURES & SHORT SALES REMAIN PROBLEMMATIC

Along with the issues discussed above, NAR believes that there remain a number of issues related to foreclosure and short sales processes that the Subcommittee should also review.

### HOMEOWNERS ARE SUFFERING WITHOUT MORTGAGE CANCELLATION TAX RELIEF FIX

Over the past year, many families have decided not to go through with short sales or seek workouts because of uncertainty over a possible tax burden they could not pay. The income tax exemption on mortgage debt forgiven in a short sale or a workout for principal residences expired at the end of 2013. Unless remedied, homeowners who did participate in a workout or short sale will have to pay tax on "phantom income" from forgiven debt. This is not only unfair but harms families, neighborhoods and communities. The lapse of this provision causes many families to simply walk away and accept a foreclosure on their home. This is contrary to every policy designed to keep people in their homes and prevent foreclosures. Today, more than 5 million families remain in a home that is "under water."

Although not under the purview of this Subcommittee, NAR urges all Members to support an extension of, "The Mortgage Forgiveness Tax Relief Act." This bipartisan legislation would extend an expired provision that has helped millions of distressed American families by allowing tax relief for homeowners when lenders forgive some portion of the mortgage debt they owe. If this provision is not extended hundreds of thousands of American families who did the right thing by short-selling their home will have to pay income tax on "phantom income." Moreover, more distressed homeowners will decide to take a pass on opportunities for workouts with the lender or short sales, opting instead for continued delinquency or possible default until foreclosure, or simply to walk away from the property. This will destabilize the communities where such homes are located.

**SHORT SALES STILL A PROBLEM**

NAR believes that the short sale process would significantly improve with the passage of S.361, "The Prompt Notification of Short Sale Act," introduced by Senators Brown (D-OH) and Murkowski (R-AK). This legislation requires servicers to decide whether to approve a short sale within 30 days of completion of the file. The bill attempts to prod servicers to make the short sales process more efficient by setting standards and penalizing them for inadequate performance.

Too often, short sales are still a story of delay and unrealistic views of current home values, resulting in the potential buyer cancelling the contract and the property going into foreclosure. Enormous amounts of time are spent on potential short sales that result in foreclosures. Even if successful, the process usually takes many months and countless hours and often requires re-marketing because buyers lose patience and terminate the contract. Streamlining short sales will reduce the amount of time it takes to sell the property, improve the likelihood the transaction will close, and reduce the number of foreclosures. This will benefit the lender, the seller, the buyer, the community.

NAR supported the Consumer Financial Protection Bureau's final rule on mortgage servicing that requires servicers to comply with new loss mitigation procedures for loans secured by a borrower's principal residence. If the servicer receives a complete loss mitigation application more than 37 days before a scheduled foreclosure sale, the servicer must evaluate the borrower within 30 days for all loss mitigation options available, including loan modifications and short sales. A borrower may appeal a denial of a loan modification only if the complete application was received 90 days or more before a scheduled foreclosure.

**GSE NOTE SALES REDUCE HOME BUYER OPPORTUNITIES**

NAR applauds FHFA's efforts to broaden opportunities for consumers to refinance as well as encouraging the GSEs to take every feasible action to keep families in their homes with a loan modification. These home retention initiatives both mitigate losses to the GSEs and taxpayers, and provide stability to local housing markets.

Conversely, NAR is concerned about alternative asset disposition programs that actually seem to contribute to reducing home purchase opportunities for owner occupants. REALTORS® strongly believe that every effort should be made to incentivize individual as opposed to bulk sales, in the form of REO assets or note sales, since marketing an individual property maximizes recovery on the asset and minimizes the impact on housing values and neighborhood disruption.

REALTORS® believe the best opportunity to reduce costs to taxpayers and assist in the stabilization of housing values and neighborhoods is to respond more effectively to, and provide more resources for, pre-foreclosure efforts on loans owned or guaranteed by the GSEs. These efforts not only are net-positive outcomes for homeowners, but taxpayers as well. Refinancing programs, such as the Home Affordable Refinance Program (HARP), allow responsible homeowners to lower their monthly mortgage payments and

reduce their risk of default. Due to the prolonged housing recovery, many private market participants have found that foreclosures are typically more costly than loan modifications and short sales. Renewing and increasing the focus on foreclosure alternatives such as loan modifications and short sales will minimize the need for more taxpayer dollars being lost to investors who benefit from the discount purchase on these notes.

Recent strategies, specifically, the bulk sale of mortgage notes by Freddie Mac to large investors, reduces opportunities for owner occupants to purchase homes and unsettles the recovery of neighborhoods. It is important that stakeholders understand how these transactions, without expectations or restrictions, blunts the opportunity for first-time homebuyers to aid a recovery in the broader housing market.

Though there is limited information available about this program, one concern is that these properties will end up as rentals, thus limiting the supply of affordable housing inventory available for purchase. NAR's concern is that this leads to less affordable inventory being available for purchase by the same first time homebuyers that the market requires to keep moving. The GSEs, with FHFA's guidance, have an opportunity to lead an effort to provide first-time homebuyers with greater purchase opportunities through sensible disposition strategies.

**FHFA MUST INCREASE DISCLOSURES ON THE NOTE SALES PROGRAM**

NAR understands that, as conservator, FHFA must protect taxpayers from losses and that the pilot bulk note sale is intended to save money. While NAR appreciates these efforts, it is also important to measure the program and its impact to communities. Information on the sale of the notes has not been made available and NAR believes it is important to be able to study the cost and impact of bulk note sales to institutional investors.

FHFA should collect and share more detailed performance data about the note sale. For example, the loans were sold seemingly without any restrictions or expectations for outcomes. FHFA should disclose the name of the investor who purchased the pool of notes and track outcomes. Of the loans sold, how many were offered foreclosure alternatives? How many ended as post-foreclosure rentals?

NAR looks forward to hearing more about the note sale program and is committed to working with FHFA to find ways to protect taxpayers while continuing to promote homeownership and preserve affordable housing options for potential homebuyers.

**FORECLOSURE RELIEF MUST BE EXHAUSTED BEFORE MOVING TO FHA LOAN SALES PROGRAM**

NAR believes that FHA must improve its pre-foreclosure sales process to ensure that mortgage servicers have fully complied with the agency's loss-mitigation requirements before referring loans to the Single Family Loan Sales program (SFLS). The SFLS program is used to sell delinquent loans and recover losses for the FHA. However, we believe that this program has been too aggressive, auctioning large pools of mortgages to the highest bidder, in some cases without considering the investor's ability to achieve neighborhood stabilization goals such as homeownership preservation and affordable housing.

Several changes would make this program stronger and ensure neighborhood stabilization. First, note sales should be in small, manageable numbers in limited geographical areas, and utilize the expertise of local businesses, including contractors, real estate brokerage firms, property managers, and non-profits that know the area. Second, FHA should closely monitor loans entering the SFLS program to ensure the servicers have exhausted all loss mitigation options. Third, FHA should increase home purchase opportunities by instituting a "first look" program for owner occupants once the homes have fallen into foreclosure. Currently many of these homes are being turned into single family rental properties that do not contribute to the stabilization of the neighborhoods around them. Lastly, the program needs to provide more transparency. FHA needs to collect and share more detailed performance data about the programs. Many loans are purchased and then resold to investors. What is the impact on these transactions on neighborhoods and homeowners? NAR supports FHA's goals to recover losses and keep the Fund solvent. But we want to make sure that such a program also continues to promote homeownership and preserve affordable housing options. .

## CONCLUSION

The U.S. housing sector is in the midst of recovering from the worst economic downturn since the Great Depression. Home prices and sales, as well as household wealth, are all up from a year ago. While this industry continues to face many headwinds such as stagnant job growth and a tight supply of homes, ensuring that Americans have access to affordable mortgage credit will be key to our nation's economic recovery. This will only be possible if Congress and the Administration have the willingness to address key policy issues such as high guarantee fees and loan level pricing adjustments charged by the GSEs, as well as excessive FHA premiums, which continue to exacerbate the tight credit market.

Policymakers can also have a positive impact on the housing market by fixing burdensome condominium restrictions that have kept consumers, especially first-time homebuyers, on the sideline. Additionally, by tackling the 3 percent cap on fees and points issue, lawmakers will address some of the regulatory burdens that are inhibiting financial institutions from lending.

While NAR is encouraged by FHFA's recent decision to provide more clarity on representations and warranties as well as restoring the GSE's longstanding practice of purchasing loans with 3 percent downpayments, it is imperative lenders improve the quality of their underwriting and halt preventable mistakes during this process. Furthermore, NAR believes Congress can help to further improve the current lending environment by passing legislation that would provide mortgage debt forgiveness as well as more certainty during the short sale process.

Only until policymakers deal with the confluence of issues listed above, will Americans have access to affordable mortgage credit, which will allow our nation to return to prosperity.

## PREPARED STATEMENT OF JULIA GORDON

DIRECTOR OF HOUSING FINANCE AND POLICY, CENTER FOR AMERICAN PROGRESS

DECEMBER 9, 2014

Good morning Chairman Menendez, Ranking Member Moran, and Members of the Subcommittee. My name is Julia Gordon, and I direct the housing finance team at the Center for American Progress, a nonpartisan think tank dedicated to improving the lives of Americans through progressive ideas and action. Thank you so much for convening this hearing on the critical topic of inequality and opportunity in the housing market. I greatly appreciate the opportunity to testify today about the state of our housing recovery and its relationship to the well-being of families and the broader economy.

Research and our lived experience confirm the link between housing and opportunity in this country, from the many benefits of home ownership for families and communities to the central role of the housing economy on economic vitality. A healthy housing market, when coupled with appropriate protections to ensure responsible and sustainable lending, offers opportunities for young people to begin building wealth through home ownership, for growing families to access good schools and high-opportunity neighborhoods, and for older people to choose whether to age in place or seek a smaller or more supportive environment.

Yet at present, our Nation's housing recovery is neither strong nor equitably distributed. Not only has the mortgage market shrunk nationally, but many communities, especially communities of color, lag far behind other parts of the country, with hard-hit neighborhoods continuing to suffer the ongoing effects of multiple foreclosures, negative equity, vacant homes, and blight. We have turned back the clock nearly 20 years on home ownership rates, and rental costs are soaring relative to incomes.[1]

Historically, the housing sector has led economic recoveries following downturns. Unfortunately, the market is not yet strong enough now to play that role, which is one of the reasons why the overall recovery still has a lot farther to go. While we have had 57 months of consecutive private sector job growth, too many people are still out of work or underemployed, small business formation remains depressed,[2] and consumer demand has not rebounded sufficiently. The combination of stagnant wages and rising costs for basic needs, including housing, has squeezed the budgets of all families in America, with the result that entering or even staying in the middle class has become increasingly difficult.[3]

Despite this bleak picture, we see many options for policy choices that can help strengthen the housing market, aid struggling families, and revitalize hard-hit neighborhoods. In this testimony, we provide a set of recommendations to help. While no single recommendation is a silver bullet, taken together, we believe we could move the dial significantly. Many of these recommendations do not require legislative action, but can be accomplished by regulatory agencies, while others would require Congress to act.

To increase access to safe and affordable credit, we recommend:

a. Congress should complete comprehensive reform of the housing finance system.

b. The Federal Housing Finance Agency should play a powerful role in increasing access to credit.

c. As a provider of credit to so many underserved populations, the Federal Housing Administration should continue to improve access to and affordability of credit.

d. Congress and regulators should support alternative mortgage channels, innovative products to reach underserved borrowers, and effective housing counseling.

e. Congress should extend the Mortgage Forgiveness Debt Relief Act, and it should convert the mortgage interest deduction to a tax credit.

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[1] Prashant Gopal, "U.S. Homeownership Rate Falls to the Lowest Since 1995", Bloomberg, April 29, 2014, available at *http://www.bloomberg.com/news/2014-04-29/u-s-homeownership-rate-falls-to-the-lowest-since-1995.html*; Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Evolving Markets and Needs", (2013) Table A–1, available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/ahr2013_appendix_tables.pdf.*

[2] U.S. Census Bureau, "Business Dynamics Statistics", available at *http://www.census.gov/ces/dataproducts/bds/.*

[3] Center for American Progress, "The Middle-Class Squeeze", (2014), available at *https://www.americanprogress.org/issues/economy/report/2014/09/24/96903/the-middle-class-squeeze/.*

f. Regulators should collect better mortgage data to help identify problems and potential solutions in the market.

In addition, to assist struggling families and neighborhoods, we recommend:

a. FHA should improve its Distressed Asset Sale Program to better promote home retention and neighborhood stability.
b. FHFA should take additional steps to aid struggling homeowners and communities.
c. The Consumer Financial Protection Bureau should continue to improve its servicing rules.
d. Policymakers should take steps to help renters, particularly very low-income renters.

**Background: The State of the Housing Market**

Overall, the national mortgage market today is significantly smaller than it was before the Great Recession, both in terms of overall volume and home sales. [4] The national home ownership rate has dropped from close to 70 percent to 64 percent. Cash investors made 29 percent of all purchases in 2013, way above their historic norm of 10–12 percent. [5] Housing starts remain depressed, and even optimistic projections for 2015 remain well below levels seen before the housing boom. [6]

Additionally, access to credit remains tight. For a conventional home purchase mortgage, the average FICO score is 754. While FHA credit is easier to obtain, with average credit scores for purchase money mortgages around 680, it is still tighter than historical norms. [7] The Urban Institute estimates that approximately 1.2 million fewer purchase mortgages were made in 2012 than would have been the case had credit availability remained at pre-bubble 2001 levels. [8] Testimony today from the National Association of Realtors provides considerable additional detail on the size and condition of the market. [9]

In terms of specific populations, home ownership rates for young people (ages 25–34) are among the lowest in decades. [10] While that could in part be explained by the timing of the Great Recession and by the later ages at which this demographic group is forming families, even 35 to 54 year olds (Generation X)—which should be in their prime home ownership years—have a home ownership rate lower than expected. [11]

The health of the mortgage market is also important for the Baby Boomer generation, many of whom will soon be seeking to sell their homes. The Bipartisan Policy Center estimates that Echo Boomers—those born between 1981 and 1995—will drive 75 to 80 percent of owner-occupied home acquisition before 2020 as Baby Boomers sell off their homes. [12] Homes are significant reservoirs of wealth, and a

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[4] Johnathan Miller, "Real-Estate Appraisals Are Bubbly Again", *Bloomberg View,* December 4, 2014, available at *http://www.bloombergview.com/articles/2014-12-04/back-to-inflated-realestate-appraisals.*

[5] Realtytrac, "Short Sales and Foreclosure Sales Combined Accounted for 16 Percent of U.S. Residential Sales in 2013", Press Release, January 22, 2014, available at *http://www.realtytrac.com/content/news-and-opinion/december-and-year-end-2013-us-residential-and-foreclosure-sales-report-7967.*

[6] Bill McBride, "Preliminary: 2015 Housing Forecasts", Calculated Risk, October 31, 2014, available at *http://www.calculatedriskblog.com/2014/10/preliminary-2015-housing-forecasts.html;* Census Bureau data shows we averaged more than 1.5 million annual housing starts between 1998 and 2002.

[7] Ellie Mae, "Origination Insight Report: October 2014", (2014) available at *http://www.elliemae.com/origination-insight-reports/Ellie_Mae_OIR_OCTOBER2014.pdf;* Historical FHA data available in HUD's FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Reports to Congress, available at *http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.*

[8] Laurie Goodman, Jun Zhu, and Taz George, "Where Have All the Loans Gone? The Impact of Credit Availability on Mortgage Volume", (Washington: Urban Institute, 2014, available at *http://www.urban.org/publications/413052.html.*

[9] Statement of the National Association of Realtors before the United States Senate Committee on Banking, Housing, and Urban Affairs Subcommittee on Housing, Transportation, and Community Development, "Inequality and the Housing Market", December 9, 2014.

[10] HUD, "U.S. Housing Market Conditions Historical Data".

[11] Jed Kolko, "The Recession's Lost Generation of Homeowners Isn't Millennials—It's the Middle-Aged", Trulia Trends, July 16, 2014, available at *http://www.trulia.com/trends/2014/07/recessions-lost-generation/.*

[12] Bipartisan Policy Center, "Demographic Challenges and Opportunities for U.S. Housing Markets", March 2012, available at *http://bipartisanpolicy.org/library/report/demographic-challenges-and-opportunities-us-housing-markets.*

lack of sufficient effective demand for homes could significantly affect the retirement security and the ability to remain independent for these families.

Perhaps most troubling, home ownership rates for people of color have dropped dramatically, with Latinos falling by 9 percent from their peak, and African Americans by 13.7 percent.[13] Because the majority of families formed in America going forward will be families of color, a steep reduction in the numbers of Latinos and African Americans buying homes spells trouble for the housing market for decades to come.[14]

The drop in home ownership rates plays a significant role in the ever-increasing wealth disparities between Whites and people of color. The median White household lost 29 percent of their home-equity-based wealth between 2005 and 2011, while the median African American household and the median Hispanic household lost 38 percent and 55 percent of their home-equity wealth, respectively.[15] Loss of home equity translates directly in overall asset reductions, especially for households of color, since their homes are their largest asset (for African American families, homes account for more than half of all wealth, compared to 39 percent for Whites).[16] Specifically, Whites lost about 26 percent of their net worth during this period, while African Americans lost 50 percent and Hispanics lost 61 percent.[17]

Today's lending patterns mirror our long history of unequal access to mortgage credit for low- and moderate-income and minority communities and borrowers. Census tracts with low levels of any type of home purchase lending are disproportionately minority (45 percent on average, compared to 33 percent in other areas) and lower-income (with an average income of 82 percent of area median income vs. 107 percent of AMI in other areas).[18] In 2013, African Americans received only 4.8 percent of home purchase mortgages, despite making up 13 percent of the population, and Hispanics received 7.3 percent of these loans, despite constituting 17 percent of the population.[19] Minority households disproportionately lack access to the more affordable mortgage credit offered in the conventional market, as 70 percent of home purchase loans made to African Americans and 63 percent of these loans made to Hispanics in 2013 were Government supported.[20]

Recently, the Urban Institute's Housing Finance Policy Center developed a groundbreaking methodology for measuring the tightness of credit in the housing market.[21] This technique better accounts for the changing credit profile of applicants over time, an important adjustment because far fewer applicants with weaker credit profiles are applying for mortgages than did during the housing bubble (2004–07) or the more normal period of lending activity that preceded it (1998–2003). Most notably, in the conventional sector,[22] only 8 percent of conventional borrowers in the post-crisis period were of lower credit quality compared to 29 percent in the pre-bubble years, before the rise of the irresponsible practices that led to the crisis. This tightness in the conventional sector has a disproportionate impact on borrowers of

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[13] Calculations based on U.S. Census Bureau Housing Vacancies and Homeownership data, available at *http://www.census.gov/housing/hvs/data/histtabs.html.*

[14] Daniel McCue, "Baseline Household Projections for the Next Decade and Beyond", (Cambridge: Harvard Joint Center for Housing Studies, 2014), available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w14-1_mccue_0.pdf.*

[15] Center for American Progress calculation based on 2005 and 2011 Survey of Income and Program Participation data, adjusted for CPI-U.

[16] Thomas Shapiro, Tatjana Meschede, and Sam Osoro, "The Roots of the Widening Racial Wealth Gap: Explaining the Black–White Economic Divide", (Waltham, MA: Institute on Assets and Social Policy, 2013) available at *http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf.*

[17] Center for American Progress calculation based on 2005 and 2011 Survey of Income and Program Participation data, adjusted for CPI-U.

[18] Low-lending census tracts defined as those with fewer originated home purchase loans per owner-occupied home than the median (2.15 percent) in 2012. Center for American Progress analysis based on 2012 HMDA data for applications for conforming loans for the purchase of 1–4 family owner-occupied units.

[19] Clea Benson and Alexis Leondis, "Lending to Minorities Declines to a 14-Year Low in U.S.", Bloomberg, September 24, 2014, available at *http://www.bloomberg.com/news/2014-09-24/lending-to-minorities-declines-to-a-14-year-low-in-u-s-.html.*

[20] Neil Bhutta and Daniel R. Ringo, "The 2013 Home Mortgage Disclosure Act Data", (Washington: Federal Reserve, 2014), available at *http://www.federalreserve.gov/pubs/bulletin/2014/pdf/2013_HMDA.pdf.*

[21] Wei Li and Laurie Goodman, "A Better Measure of Mortgage Application Denial Rates", (Washington: The Urban Institute, 2014), available at *http://www.urban.org/UploadedPDF/2000031-A-Better-Measure-of-Mortgage-Application-Denial-Rates.pdf.*

[22] The conventional channel includes GSE, bank portfolio, and private-label securities executions. The Government channel consists of FHA, VA, and USDA loans guaranteed by Government agencies.

color, who find themselves relegated to the more expensive Government-backed channels or locked out of the mortgage market altogether.

At the same time, while home prices nationally have rebounded from the lows reached during the Great Recession, price recovery has been remarkably uneven, with some geographies still deeply underwater. Not only are 8.7 million (17 percent) of homeowners underwater nationally,[23] but in the 395 hardest-hit zip codes, between 43 percent and 76 percent of homeowners are underwater.[24] More than 70 percent of these zip codes have incomes below the national median, and in two-thirds of them, African Americans and Latinos account for at least half the population.

The combination of tremendous home price declines, widespread negative equity, and the impact of the recession on unemployment resulted in the worst foreclosure crisis since the Great Depression. Since the start of the crisis, there have been 5 million completed foreclosures. Even today, with foreclosure rates much lower, about 630,000 homes are currently in some stage of the foreclosure process while more than 1.6 million borrowers are seriously delinquent.[25] Foreclosures have cost homeowners, neighborhoods, and investors dearly. A typical foreclosure costs borrowers up to $7,000 in administrative costs alone,[26] costs investors more than $75,000,[27] reduces the value of neighboring homes,[28] and burdens local governments through reduced property taxes and increased anti-blight expenditures.[29] A recent study even linked foreclosures to declines in neighbors' health.[30] Weakness in the housing market deprives our economy of the economic multiplier effects of a strong housing market, including additional construction jobs, consumer demand for household-related items, and local and State tax revenue. The stubborn persistence of negative equity also continues to depress aggregate consumer demand for all goods and services, with significant macroeconomic consequences; homeowners with high levels of debt relative to the value of their assets have experienced larger declines in consumption than less highly leveraged homeowners, even after taking into account declines in net worth.[31] Additionally, fewer small businesses are being founded in the aftermath of the Great Recession,[32] which is not surprising given that roughly one in four small-business owners uses home equity as a source of capital or collateral.[33]

Finally, the decline in home ownership has led to an increase in renters, placing significant upward pressure on rent prices. As of 2012, more than half of all renters spend more than 30 percent of their income on housing, which is the historical

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[23] Zillow, "Negative Equity Causing Housing Gridlock, Even as It Slowly Recedes", (2014) available at *http://www.zillow.com/research/2014-q2-negative-equity-report-7465/.*

[24] Peter Dreier and others, "Underwater America: How the So-Called Housing 'Recovery' Is Bypassing Many American Communities" (Berkeley, CA: Haas Institute for a Fair and Inclusive Society, 2014).

[25] Corelogic, "National Foreclosure Report: March 2014", (2014) available at *http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-march-2014.pdf;* Corelogic, "National Foreclosure Report: August 2014", (2014) available at *http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-august-2014.pdf.*

[26] HUD, "Economic Impact Analysis of the FHA Refinance Program for Borrowers in Negative Equity Positions", available at *http://www.hud.gov/offices/adm/hudclips/ia/ia-refinancenegativeequity.pdf.* Family Housing Fund, "Cost Effectiveness of Mortgage Foreclosure Prevention", (1995) available at *http://www.fhfund.org/__dnld/reports/MFP__1995.pdf.*

[27] HUD, "Economic Impact Analysis of the FHA Refinance Program for Borrowers in Negative Equity Positions".

[28] Massachusetts Institute of Technology, "How Foreclosures Hurt Everyone's Home Values", Press release, July 20, 2010, available at *http://newsoffice.mit.edu/2010/housing-prices-0720.*

[29] William C. Apgar, Mark Duda, and Rochelle Nawrocki Gorey, "The Municipal Cost of Foreclosures: A Chicago Case Study", (Minneapolis: Homeownership Preservation Foundation, 2005), available at *http://www.nw.org/network/neighborworksProgs/foreclosuresolutionsOLD/documents/2005Apgar-DudaStudy-FullVersion.pdf.*

[30] Dina ElBoghdady, "Foreclosures May Raise Neighbors' Blood Pressure, Study Finds", *Washington Post,* May 12, 2014, available at *http://www.washingtonpost.com/business/economy/study-foreclosures-may-raise-neighbors-blood-pressure/2014/05/12/5f519952-da03-11e3-bda1-9b46b2066796__story.html;* Mariana Arcaya, M. Maria Glymour, Prabal Chakrabarti, Nicholas A. Christakis, Ichiro Kawachi, and S.V. Subramanian, "Effects of Proximate Foreclosed Properties on Individuals' Systolic Blood Pressure in Massachusetts", 1987–2008. Circulation, May 2014.

[31] Karen Dynan, "Is a Household Debt Overhang Holding Back Consumption?" (Washington: Brookings Institution, 2012), available at *http://www.brookings.edu//media/projects/bpea/spring%202012/2012a__dynan.pdf;* Atif Mian and Amir Sufi, "House of Debt", University of Chicago Press, 2014.

[32] U.S. Census Bureau, "Business Dynamics Statistics".

[33] Mark E. Schweitzer and Scott A. Shane, "The Effect of Falling Home Prices on Small Business Borrowing", (Federal Reserve Bank of Cleveland, 2010), available at *http://www.clevelandfed.org/research/commentary/2010/2010-18.cfm.*

upper limit of rent affordability. More than a quarter of all renters spend more than half of their gross income on rent, significantly reducing their ability to pay for food, child care, health care, and other necessities.[34] While the number of households experiencing "worst case" housing needs—either because they live in severely inadequate housing or spend more than half of their income on rent—has increased, Congress has repeatedly cut rental assistance programs, and the share of households eligible for these benefits that actually receive them has continued to fall.[35]

**Policy Recommendations**

*Increase Access to Safe and Affordable Credit*

Ironically, even as home prices experienced historic declines over the past 6 years, the tightness in the credit market meant that far too many households—especially families of color and lower-wealth families—missed what could otherwise have been an ideal opportunity to access affordable and sustainable home ownership, build family wealth and security, and provide better opportunities for their children. Too many communities that lost significant wealth due to foreclosures are now failing to rebuild it through home ownership; as more people rent, and especially as more formerly owner-occupied homes transition to long-term rental, payments that could be contributing to rebuilding residents' wealth continue to flow to investors, many of whom live outside the community.

It is not too late to turn this situation around, but we must focus our efforts on enabling more families to join the ranks of home ownership. While there is no one silver bullet, there are many dials and levers that can help increase access without opening the door to predatory or unsafe lending.

At the same time, it is critical to ensure that any expansion of access not lead to the same predatory and abusive market practices that led to the crisis. While the Dodd-Frank Act created strong protections for mortgages, and while the Consumer Financial Protection Board (CFPB) has tried to set a sensible, moderate course in implementing those protections, some industry participants continue to fight for broader and more exemptions from Dodd-Frank's mandate for creditors to assess a borrower's ability to repay a mortgage loan. An exemption for an entire class of assets, such as portfolio loans, is overly broad and would undermine existing incentives that deter creditors from ignoring the damage caused by making unaffordable loans.

Moreover, we do not believe the Dodd-Frank rules will adequately protect consumers unless all market participants, including brokers, appraisers, lenders, securitizers, and investors, bear liability for noncompliance. Additionally, while we commend regulators involved in the so-called QRM rulemaking for choosing not to impose a downpayment requirement, which we believe would have unfairly excluded lower-wealth households from home ownership, we support the overall risk retention rule as an important tool to provide securitizers with skin in the game.

*A. Congress should complete comprehensive reform of the housing finance system.*

One thread that runs throughout most policy recommendations about easing tight credit is the need to provide as much certainty as possible to market participants and stakeholders. Perhaps the largest of such uncertainties is the fate of mortgage giants Fannie Mae and Freddie Mac, which have now been under conservatorship for more than 6 years.

Some advocate for simply returning to the system we had before the crisis, where Fannie and Freddie's private shareholders profited from an implicit Government guarantee with minimal capital requirements. While we agree the conservatorship should not last forever, it is critical that in the process of ending it, we fix the misaligned incentives that resulted in the GSE's financial crisis and that we create an explicit, priced, and paid-for Government guarantee to protect the taxpayer.

In our view, S. 1217 provided a very useful framework for this conversation. However, the legislation as passed by the Senate Banking Committee lacked a number of essential elements that we have recommended, particularly with respect to access to and affordability of credit.[36] Placing the goal of access to affordable, sustainable

[34] Center for American Progress analysis of Minnesota Population Center, "Integrated Public Use Microdata Series", available at *https://usa.ipums.org/usa/* (last accessed June 2014).

[35] Doug Rice, "Better Federal Policy Needed To Address Rental Affordability Crisis", Off the Charts Blog, July 2, 2014, available at *http://www.offthechartsblog.org/better-federal-policy-needed-to-address-rental-affordability-crisis/*.

[36] Testimony of Julia Gordon before the Senate Committee on Banking, Housing, and Urban Affairs, "Essential Elements of Housing Finance Reform", (2013) available at *https://*

Continued

credit at the center of the new system's purpose will provide the greatest benefit in the long run not only to families but also to lenders and investors, and will also protect taxpayers from future bailouts.

We look forward to working with the 114th Congress to craft a housing finance system that can take this country into the future smoothly and successfully.

*B. The Federal Housing Finance Agency can play a powerful role in increasing access to credit.*

While comprehensive housing finance reform proceeds through the legislative process, we urge the Federal Housing Finance Agency (FHFA) to use its extraordinary powers of conservatorship to promote a robust, inclusive mortgage market that provides liquidity for the broadest possible range of credit needs.

*1. FHFA should use its housing goals and duty to serve rulemakings to expand access to populations that are being left out of the housing recovery.*

Given the GSE's dominance in the secondary market, their appetite for mortgages essentially determines whether the mortgages will be made at all by the primary market. Understanding this dynamic, Congress has charged FHFA with advancing access to credit by setting specific goals for the GSEs to meet in supporting underserved borrowers and communities and by asking the GSEs to provide "leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market," supporting very low- to moderate-income families in the areas of manufactured housing, affordable housing preservation, and rural markets.[37]

*Housing Goals:* In recent years, FHFA has failed to set strong goals that push the Enterprises to responsibly innovate and serve broadly, instead setting single-family goals that allow the Enterprises to lag the primary market's performance. During this time, whole segments of the market have moved to FHA or have not been served at all. In 2012, for example, the Enterprises financed only 16 percent of home purchase loans originated in low-income and minority census tracts, a quarter of home purchase loans to African Americans, and under one-third of home purchase loans to Hispanics or Latinos.[38]

This year's goals rulemaking is an important opportunity to push the Enterprises to support low- and moderate-income communities. We recommend that FHFA set strong single- and multifamily benchmarks for GSE performance, including a 27 percent goal for low-income home purchase lending; take strong and predictable enforcement action that considers the performance of the overall market when the Enterprises fail to meet the housing goals; and establish subgoals for small multifamily properties and reporting requirements for single-family rental.[39]

*Duty To Serve:* Although more than 6 years have passed since Congress asked FHFA to create this requirement for the GSEs, the rule proposed in 2010 has not been finalized or implemented. Because the housing market and the financial status of the Enterprises has evolved significantly in the intervening years, we urge FHFA to re-propose the rule and once again take public comment. The proposal should encourage responsible innovation and give the Enterprises strong incentives to serve broadly and lead the market.[40]

FHFA can make a significant contribution to greater affordability in the manufactured housing area by using the duty to serve rule to push the market toward more responsible practices in the area of chattel lending (the majority of manufactured housing is titled as chattel rather than real property, meaning that buyers often lack basic consumer protections).[41] In the affordable housing preservation and rural markets, we similarly believe that the Enterprises can actively support these markets through new products, flexible underwriting, affirmative outreach, and other

*www.americanprogress.org/issues/housing/report/2013/09/12/74041/essential-elements-of-housing-finance-reform/.*

[37] Public Law 110-289, Sec 1129.

[38] Center for American Progress analysis of 2012 Home Mortgage Disclosure Act Data for applications for conforming loans for the purchase of 1–4 family owner-occupied units.

[39] For more detail, see Center for American Progress and Consumer Federation of America, "Comments on the Proposed Rule on the Enterprises' Housing Goals 2015–2017", (2014) available at *http://www.consumerfed.org/pdfs/CAP-CFA-Comments-on-the-Enterprises-Housing-Goals-2015-2017.pdf.*

[40] For a fuller set of recommendations, see Center for American Progress and others, "Re: Enterprise Duty to Serve", (2014), available at *http://www.consumerfed.org/pdfs/CAP-letter-FHFA-on-Fannie-and-Freddie.pdf.*

[41] Consumer Financial Protection Bureau, "Manufactured-Housing Consumer Finance in the U.S.", (2014), available at *http://www.consumerfinance.gov/reports/manufactured-housing-consumer-finance-in-the-u-s/.*

activities, including grants to and partnerships with high-performing nonprofits devoted to this work.

*2. FHFA should adjust its pricing to pool risk and to charge only for its actual risk, thereby making loans more affordable, and should align pricing policies with private mortgage insurer counterparty requirements.*

We consider it critical that FHFA return to a pricing structure that is transparent, countercyclical (or, at the very least, not procyclical), and takes full advantage of the Enterprises' unique ability to pool risk.

After the inception of the conservatorship, Fannie and Freddie instituted across-the-board risk based pricing through a system of loan level price adjustments, or LLPAs. The LLPAs charge different prices for different loans depending on the profile of both the loan and the borrower. This change from more of a risk pooling approach occurred at a time when housing prices were dropping, foreclosure rates were rising, and the Enterprises were in dire straits financially. FHFA also was concerned about the financial woes of private mortgage insurer counterparties, many of which struggled or even went under financially during the crisis and could not pay all their claims.

Today, the Enterprises are in a very different financial condition, having returned to profitability due to a very strong book of new loans, a decline in foreclosure rates, an increase in home prices, and numerous big-dollar settlements with financial institutions. These profits also have enabled them to use deferred tax assets, further improving their financial position. At the same time, the private mortgage insurers also have returned to financial health, and FHFA is now instituting a set of capital and management requirements for those companies that will significantly reduce the Enterprises' exposure to counterparty risk.

Yet the LLPAs remain in force, where they play a significant role in driving less wealthy borrowers out of the conventional market and making loans for those borrowers more expensive—which in and of itself increases the risk of the loans. We recommend that FHFA immediately discontinue use of the LLPAs and return to the historical norm.

Additionally, we do not believe additional increases to the base g-fee are required at this time. FHFA has justified these increases by claiming they are needed to encourage the return of private label securitization. Yet, analysts believe current fees more than cover outstanding risk,[42] and even the dramatic increase in g-fee over the past several years has not succeeded in "crowding in" private capital, although it has undoubtedly driven business to FHA, which carries a 100 percent explicit Government guarantee.

As we recommended in our comment letter to FHFA,[43] we think FHFA should price based on what is needed to cover expected losses and costs—including a justifiable level of capital and revenue to support its cost—and protect the taxpayer in the event of stress scenarios, rather than on pursuing particular market shares for non-GSE entities or sectors.

Similarly, while we support the overall effort to impose meaningful requirements on private mortgage insurer counterparties, we have serious concerns about the financial requirements as proposed.[44] Because the cost of private mortgage insurance by definition falls on lower-wealth borrowers, first time homebuyers, and borrowers of color, the PMIERs are as important, if not more important, than guarantee fees when it comes to affordable credit. In our view, the proposed requirements will unnecessarily raise the cost of credit for the very borrowers for whom the GSE mission is most important, and we suggest that significant adjustments be made before finalizing these requirements. It is also critical to coordinate g-fees and LLPAs with the private mortgage insurance requirements.

*3. Providing a 97 LTV product is a good start, and FHFA also should provide public, loan-level data on past efforts to promote access to credit.*

We support the recently announced policy change permitting Fannie and Freddie to buy mortgages with as little as 3 percent down under certain circumstances. Properly underwritten, low-downpayment mortgages with long-term, fixed-interest

[42] See, e.g., joint comment letter from 23 industry and consumer groups, available at *https://www.fhfa.gov//AboutUs/Contact/Pages/input-submission-detail.aspx?RFIId=164;* Laurie Goodman, Jim Parrott, Ellen Seidman, and Jun Zhu, "Guarantee Fees—An Art, Not a Science", (Washington: Urban Institute, 2014) available at *http://www.urban.org/publications/413202.html.*

[43] Center for American Progress, Consumer Federation of America, and the Mortgage Finance Working Group, "Re: Request for Input on Guarantee Fees", (2014), available at *http://www.consumerfed.org/pdfs/CAP-CFA-g-fee-comment-final-9-8-14.pdf.*

[44] For specific recommendations, see Center for American Progress and others, "Re: Private Mortgage Insurance Eligibility Requirements", (2014), available at *http://www.consumerfed.org/pdfs/CAP-PMIER-sign-on-letter-9-8-14.pdf.*

rates have performed well even throughout the Great Recession. The predatory mortgages that brought down Wall Street's house of cards sometimes included low downpayments, but also layered multiple risks—such as exploding interest rates, exorbitant fees, and steep prepayment penalties—with little or no underwriting. Most of these practices are now prohibited by the Dodd-Frank mortgage rules.

We also generally support FHFA's intention in its strategic plan to ask the Enterprises to "assess whether there are additional opportunities to reach underserved creditworthy borrowers."[45] Prior to conservatorship, the Enterprises undertook diverse efforts to promote access to affordable mortgage credit, with flexible underwriting standards for core affordability products such as MyCommunityMortgage as well as specialized products that met the particular needs of borrowers, such as SmartCommute and Construction-to-Permanent mortgages. They also worked to serve harder-to-serve markets, such as community land trusts, tribal lands, and small multifamily properties, and partnered with diverse entities in support of their affordable housing mission, including nonprofits, housing counseling agencies, Housing Finance Agencies and Community Development Financial Institutions.

However, in considering how Fannie and Freddie should proceed, FHFA should instruct the Enterprises to conduct detailed analyses of their past efforts to promote access to affordable mortgage credit to use in designing effective programs for the future. In addition to analyzing previous efforts, we encourage FHFA to make release to the public performance data on affordable lending efforts so that external stakeholders working in the housing finance field can understand better how to reach underserved borrowers and communities. We commend the Enterprises for releasing loan characteristic and performance data on a large number of their acquisitions in recent years,[46] but data released so far is limited to single-family, 30-year, fixed-rate, full documentation, fully amortizing mortgages.

*4. FHFA should require Fannie Mae and Freddie Mac to update the credit score model used by their automated underwriting systems.*

Currently, the Enterprises require the use of a "classic" FICO credit score—i.e., FICO 04—in their automated underwriting systems.[47] However, newer scoring models, including both FICO 09 and VantageScore, have made some critical changes that will improve the reliability of scores and/or allow the scoring of tens of millions of consumers.

These newer models no longer consider paid collection items, including medical debt collections, and give less weight to unpaid medical debts. Given that the CFPB has found that the presence of medical debt on a credit report results in a credit score that is typically lower by ten points than it should be, and for paid medical debt, up to 22 points lower than it should be,[48] and given that about 35 percent of Americans—or 77 million—have debt collection items on their credit reports,[49] about half of which are for medical debt,[50] this is a critical issue.

In addition, these newer models are better able to deal with consumers with limited credit history, or "thin file" consumers. For example, FICO 09 has enhancements to better assess thin file consumers, and VantageScore claims to be able to score an additional 30 to 35 million thin file consumers.[51]

While Fannie Mae and Freddie Mac have already agreed to study the issue, we do not believe more research is necessary to demonstrate the advantages of alternative models. Instead, FHFA should instruct them to modernize their systems forthwith.

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[45] Federal Housing Finance Agency, "FHFA Strategic Plan for FY2015–2019", (2014) available at *http://www.fhfa.gov/AboutUs/Reports/Pages/FHFA-Strategic-Plan-for-FY-2015-2019.aspx.*

[46] See Freddie Mac's Single Family Loan-Level Dataset at *http://www.freddiemac.com/news/finance/sf__loanlevel__dataset.html* and Fannie Mae's Single-Family Loan Performance data at *http://www.fanniemae.com/portal/funding-the-market/data/loan-performance-data.html.*

[47] See Fannie Mae Selling Guide, B3-5.1-01, General Requirements for Credit Scores, available at *https://www.fanniemae.com/content/guide/selling/b3/5.1/01.html* (last accessed December 2014).

[48] Consumer Financial Protection Bureau, "Data Point: Medica Debt and Credit Scores", (2014) available at *http://files.consumerfinance.gov/f/201405__cfpb__report__data-point__medical-debt-credit-scores.pdf.*

[49] Caroline Ratcliff and others, "Delinquent Debt in America", (Washington: Urban Institute, 2014) available at *http://www.urban.org/publications/413191.html.*

[50] Robert Avery, Paul Calem, Glenn Canner, and Raphael Bostic, "An Overview of Consumer Data and Credit Reporting", Fed. Reserve Bulletin 89(2)(2003); Ernst & Young, The Impact of Third-Party Debt Collection on the National and State Economies (2012), available at *www.acainternational.org/files.aspx?p=/images/21594/2011acaeconomicimpactreport.pdf.*

[51] VantageScore, "VantageScore 3.0: Better Predictive Ability Among Sought-After Borrowers", (2013), available at *http://www.vantagescore.com/images/resources/VantageScore3-0__WhitePaper.pdf.*

*C. As a provider of credit to so many underserved populations, FHA should continue to improve access to and affordability of credit.*

The Federal Housing Administration (FHA) has played a crucial role in supporting our economic recovery, preventing not only even more catastrophic home price declines but also a double-dip recession. While this support came at a cost to the agency's capital ratio, a combination of strong management and improvement in the economy has put the agency on track to fully replenish its reserves by 2016. FHA has particularly supported first-time homebuyers and buyers of color, who are all currently poorly served by the conventional market. The following are three suggestions for FHA to help expand affordable credit further.

*1. FHA should reassess its insurance premium structure to see if it is possible to reduce premiums.*

As noted above, FHA has of necessity focused very heavily in recent years on making programmatic changes to help replenish its insurance fund. While such a focus is important, we believe the fund is strong enough at this point for FHA to reconsider the pricing of mortgage insurance premiums. Forty percent of the agency's home purchase loans made in the second half of 2013 qualified as high cost, which—despite otherwise providing fixed rate, long-term credit—can in and of itself make a loan more risky.[52] If FHA's fees are not set correctly, its customers, who are more likely to be minority and first time homebuyers, will be saddled with additional unnecessary expenses, perpetuating an unequal mortgage market. Additionally, the dramatic increases in premiums appears to be driving borrowers away from FHA, reducing its volume significantly, and with FHA operating as the only program available for many lower-wealth borrowers and borrowers of color, we fear those borrowers will not find other alternative credit sources.

While we do not believe we have sufficient information at this time to recommend a specific change to the premium structure, we strongly encourage FHA to examine the impact its premiums are having on access to credit and to consider whether some reductions could provide sufficient additional volume to offset any harm to the fund.

*2. FHA should complete its work to provide clarity to lenders and reduce overlays.*

To address lender concerns about indemnification, FHA has proposed a new system for detecting defects in loan quality and holding lenders accountable for such defects. In this proposal, FHA more clearly identifies and classifies defects in loan applications, establishes severity levels of such defects and provides a more objective approach to analyzing appropriate cures for defects. We support this effort and believe it is extremely important, although we believe more work is required to clarify and align definitions and to further reduce subjectivity in defect and cure classifications. Additionally, we believe it would be sensible for FHA to work closely with FHFA to align its policies protecting lenders, such as providing a 3-year window of clean payment history for indemnification with exceptions for fraud, data inaccuracies, and compliance with responsible lending practices.

*D. Congress and regulators should support alternative mortgage channels, innovative products to reach underserved borrowers, and effective housing counseling.*

Many communities hardest hit by the housing crisis and the economic downturn have long been either underserved or not served by traditional financial institutions that could provide safe and affordable credit. Similarly, for many borrowers, the most popular mainstream products will always be difficult to access. For this reason, we recommend taking steps to strengthen alternative mortgage channels and experiment with safe but innovative products to reach more borrowers.

The strong need for alternative lenders in underserved communities can be attributed to years of discrimination, redlining, and market failures in which mainstream financial institutions lacked incentives to lend to projects where the aggregate social return was positive. Community Development Financial Institutions (CDFIs) and Housing Finance Agencies (HFAs), which combine deep knowledge of local communities' needs with safe, targeted products, can identify and assist potential homeowners, and CDFIs can also provide business and consumer loans, investments, and retail banking services to neighborhoods that need critical economic catalysts to overcome years of disinvestment.

Congress and regulators should consider whether there are changes to regulations such as the Community Reinvestment Act (CRA) that can be used to strengthen these institutions. For example, changing the way that financial institutions subject to CRA receive credit for investing in CDFIs could provide a win-win solution for

[52] Bhutta and Ringo, "The 2013 Home Mortgage Disclosure Act Data".

banks unwilling to take risks on certain populations, especially since CDFIs and nonprofits receive special treatment in the Dodd-Frank mortgage rules to enable them to better serve lower-income families. Similarly, sources of funding such as recent settlements between Government agencies and large banks could be directed to helping alternative mortgage channels scale their operations.

Similarly, a typical mortgage product is not always accessible to some households due to the downpayment requirements or fear of placing assets in a first loss position. Shared equity/shared appreciation approaches can provide a middle ground between renting and traditional home ownership. In general, these products share certain common features: owner occupancy of residential properties, initial affordability, and sharing of risk and equity/appreciation. These strategies can potentially support modest individual asset accumulation while protecting consumers against home price declines while also providing more stability to the macroeconomy in times of market disruption.[53] Congress and regulators should consider how to encourage safe experimentation with alternative products.

Finally, it is critical to support housing and credit counseling to help more people achieve sustainable home ownership. Whether counseling a first-time homebuyer to avoid predatory loans, negotiating a modification that will allow a distressed homeowner to stay in their home, helping a low-income family find affordable rental housing, or helping a homeless person find emergency shelter, nonprofit housing counselors are advocates for housing consumers, especially those from traditionally underserved communities such as communities of color, low- and moderate-income communities, and the elderly. A growing body of research demonstrates that those who receive housing counseling realize better outcomes than similarly situated people who do not.[54]

Recently, FHA proposed a program entitled "Homeowners Armed With Knowledge" (HAWK) that would offer reductions on the upfront and annual mortgage insurance premiums (MIPs) to FHA borrowers who participate in a specified housing counseling curriculum. Other Government agencies such as VA and USDA could create the same type of program, and FHFA could work with Fannie and Freddie to create a similar incentive structure in the secondary market through preferential pricing for counseled mortgages. Borrowers could yield additional incentives if they committed to post-purchase counseling, as well. Bonus points could be awarded under the goals that would incent this kind of proven, safe and sustainable lending. Additionally, Congress should grant HUD's Office of Housing Counseling the authority to accept funds from private entities to be distributed and used for housing counseling activities.

*E. Congress should extend the Mortgage Forgiveness Debt Relief Act, and it should convert the mortgage interest deduction to a tax credit.*

*Mortgage Forgiveness Debt Relief Act:* When a lender forgives mortgage debt through a short sale, a principal reduction modification, or even after a foreclosure, the amount that the borrower no longer owes counts as taxable income to the borrower unless it fits into an exemption in the tax code. Given the deep inappropriateness of this result for those losing their homes, Congress created a tax code exemption in 2007 entitled the Mortgage Forgiveness Debt Relief Act. For the past several years, the MDRA has been extended on a year-to-year basis.

The MDRA has been crucial to virtually every effort to assist troubled homeowners and restore the housing market to health. However, this past year, the MDRA was not extended. Consequently, the number of short sales dropped, adding to the continued woes of the housing market. What's more, principal reduction is less valuable to homeowners if they must pay tax on the forgiven debt, which hampers loss mitigation efforts. Congress must extend the MDRA not just until the end of 2014, but at least until the end of 2015. Ideally, this exemption would become permanent.[55]

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[53] Atif Mian and Amir Sufi, "House of Debt".

[54] Neil S. Mayer and Kenneth Temkin, "Pre-Purchase Counseling Impacts on Mortgage Performance: Empirical Analysis of NeighborWorks America's Experience" (Washington: Neighborworks America, 2013); Marvin M. Smith et al., "The Effectiveness of Pre-Purchase Homeownership Counseling and Financial Management Skills", (Philadelphia: Federal Reserve Bank of Philadelphia, 2014); Kenneth M. Temkin et al., "National Foreclosure Mitigation Counseling Program Evaluation: Final Report, Rounds 3 Through 5", (Washington: Neighborworks and the Urban Institute, 2014).

[55] See Mark Goldhaber and Julia Gordon, "Extend and Broaden the Mortgage Debt Relief Act Now", *American Banker,* September 5th, 2012, available at *http://www.americanbanker.com/bankthink/extend-and-broaden-mortgage-debt-relief-act-now-1052364-1.html;* see also Laurie Goodman and Ellen Seidman, "The Mortgage Forgiveness Debt Relief Act Has Expired—Re-

Mortgage Interest Deduction: The Federal Government spends $70 billion a year on the mortgage interest deduction—more than a trillion dollars over a 10-year period and more than the entire HUD budget. [56] Yet, the benefit of the mortgage interest deduction is heavily skewed to households in upper-income tax brackets. As a taxpayer's income increases, their tax rate increases and so does the value of the deduction. In addition, the mortgage interest deduction is only available to those who are able to itemize deductions, rather than taking the standard deduction. According to the Tax Policy Center's analysis of 2010 data, less than a third of taxpayers itemize their deductions, and the majority of those who itemize fall in the top income tax brackets. [57]

As part of comprehensive tax reform, we recommend replacing the current mortgage interest deduction with a tax credit. Our proposal would gradually phase out the current deduction and replace it with an 18 percent nonrefundable tax credit. [58] The effect of this change would be to provide the same benefit to all taxpayers, rather than a much larger benefit to those with higher incomes. Increasing the value of the credit to low- and moderate-income taxpayers not only increases fairness and access to home ownership, but also contributes to economic growth, since it puts more money in the hands of a large number of families who typically need to spend every dollar they earn just to get by.

*F. Regulators should collect better mortgage data to help identify problems and potential solutions in the market.*

As a free and public database, the Home Mortgage Disclosure Act (HMDA) provides critical data to housing market participants and stakeholders, especially to nonprofits and other entities without access to expensive proprietary databases. However, the HMDA database has long suffered from some key omissions, both in terms of who is reporting data and what data are reported.

Recently, the CFPB issued a set of proposed changes to HMDA, including changes to definitions of covered institutions and transactions as well as the addition of the proposed new fields would improve the usefulness and quality of the HMDA data. We strongly support the CFPB's efforts. In addition to their proposals, we recommend additional data enhancements that would be of great benefit to researchers and community groups in the efforts to promote fair access to credit, while also helping equip regulatory and enforcement agencies with fair lending compliance.

For example, we think the CFPB should take further steps to simplify the reporting requirement to one eligibility standard, should add further fields on various topics such as denials and language/race, and collect information on loan modifications and housing counseling. [59]

*Assist Struggling Families and Neighborhoods*

*A. FHA should improve its Distressed Asset Sale Program to better promote home retention and neighborhood stability.*

Since 2012, the FHA has been selling distressed loans in bulk prior to foreclosure in order to save money and potentially provide these borrowers with a last chance to save their homes. The Distressed Asset Stabilization Program has auctioned about 100,000 loans over the past 2 years, and the FHA still insures about a half million seriously delinquent loans that could be eligible for the program. The FHA's program sells some loan pools with almost no strings attached, while others are sold through a special "neighborhood stabilization" channel that requires the buyers to help families and neighborhoods. The loans sold through neighborhood stabilization auctions tend to be geographically concentrated, while the loans sold through the national auctions are dispersed among many States.

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newal Could Benefit Millions", (Washington: The Urban Institute, 2014), available at *http://www.urban.org/UploadedPDF/413025-Mortgage-Forgiveness-Debt-Relief-Act-Has-Expired.pdf.*

[56] See *http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist04z1.xls; http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/teb2015.xls.*

[57] Benjamin H. Harris and Daniel Baneman, "Who Itemizes Deductions?" (Washington: Tax Policy Center, 2011), available at *http://www.taxpolicycenter.org/UploadedPDF/1001486-Who-Itemizes-Deductions.pdf.*

[58] Roger Altman and others, "Reforming Our Tax System, Reducing Our Deficit", (Washington: Center for American Progress, 2012) available at *https://www.americanprogress.org/issues/tax-reform/report/2012/12/04/46689/reforming-our-tax-system-reducing-our-deficit/*.

[59] For more information, see Center for American Progress, Center for Responsible Lending, and others, "Re: Consumer Financial Protection Bureau's Amendments to Regulation C", (2014) available at *http://www.responsiblelending.org/mortgage-lending/research-analysis/HMDA-Comment-Final-10-29-14.pdf.*

This summer, the FHA released outcome data about these pools for the first time since the program's inception.[60] Nearly one quarter of loans sold through the neighborhood stabilization outcome auctions and resolved have resulted in the homeowners staying in their homes, at least for the time being. Another 35 percent of families have avoided foreclosure through a short sale or similar outcome. Loans that were sold in pools without requirements and later resolved, on the other hand, had a markedly different outcome. Less than 9 percent of those families remained in their homes, and 21 percent avoided foreclosure. In short, the data demonstrate that imposing even relatively modest and flexible requirements on auctioned loan pools can lead to much better outcomes for households and neighborhoods. The geographic concentration of the loans sold through the neighborhood stabilization auctions may also make it easier for note buyers to service the portfolio.

Distressed mortgage sale programs, if designed responsibly, can limit the damage of the foreclosure crisis by helping homeowners to access foreclosure alternatives, supporting neighborhood home prices, and limiting losses to taxpayers. However, if loans are simply passed off to the highest bidder without any built-in protections for homeowners and neighborhoods, we will have missed an extraordinary opportunity to support the housing recovery.

Thus, as the FHA moves forward with more auctions, we suggest the following four overarching recommendations to promote home retention and neighborhood stability while still helping the agencies save taxpayer dollars.

- FHA should impose a set of basic requirements on all buyers in all pools. First, the agency should require all buyers to work with existing homeowners to keep them in their homes if possible through a sustainable, permanent loan modification (perhaps using the HAMP program). When a loan modification is not possible, buyers should be required to pursue short sales or deeds in lieu of foreclosure before foreclosing on a property. For properties that go to REO, FHA should require that the investor provide an opportunity for owner-occupant purchase before either selling to another investor or transforming into long-term rental. Reasonable requirements of this nature may have less of an impact on price than FHA may fear, both because the loans with requirements have sold for similar prices to those with no requirements and because demand for all of these pools is only growing with time.[61]
- FHA should help nonprofits participate effectively in the bidding process because neighborhood-based nonprofits often produce the best outcomes for families and neighborhoods. To the extent that nonprofits lack either capital or capacity, we believe the best option is for FHA to provide a preference to private investors that partner with nonprofits and have a track record of serving homeowners effectively.
- Before placing loans in a sale pool, FHA should ensure that mortgage servicers have fully complied with the agency's requirements for attempting to assist borrowers and that the home is still occupied before placing a loan into distressed mortgage sale programs. Reports from buyers and from consumer representatives indicate that some loans are moving into the program before servicers have completed their work with homeowners, and that many homes are vacant when the buyer takes possession of them. The Government should be careful that servicers are prevented from using the program to evade their contractual responsibilities.
- FHA should collect and share more detailed performance data about the programs so the public can fully understand their effectiveness. The agency took roughly 2 years to publish its first set of outcomes, and that information is very limited. These agencies have an obligation to track in detail what happens to the loans after they are sold and to share this information with the taxpayers, neighborhoods, and local governments.

*B. FHFA should take additional steps to aid struggling homeowners and communities.*

As with respect to access to credit, FHFA's singular role in the housing market provides them with many opportunities to support struggling families and communities. Over the past several years, the agency has made improvements to the HARP refinancing program and to their own Servicing Alignment Initiative that

[60] Federal Housing Administration, "Quarterly Report on FHA Single Family Loan Sales: Data as of May 30, 2014", (2014) available at *http://portal.hud.gov/hudportal/documents/huddoc?id=report082814.pdf.*

[61] Heather Perlberg and John Gittelsohn, "Hedge Funds Boost Bad-Loan Prices as U.S. Sales Increase", *Bloomberg News,* August 11, 2014.

have provided assistance to many borrowers, but there are many additional steps they can take to ensure that both homeowners and neighborhoods are better protected.

*1. To assist performing borrowers, improve the HARP program to reach more people.*

The Obama administration's HARP program has already helped over 2.7 million households refinance their mortgages and could reach many more with a few targeted improvements. The Responsible Homeowner Refinancing Act of 2013 would require that Fannie Mae and Freddie Mac eliminate all upfront participation fees to borrowers; that the same benefits be available to all eligible lenders, including waivers of certain representations and warrantees; and that all borrowers with Fannie- and Freddie-backed mortgages will be notified about the program, its eligibility requirements, and participating lenders.[62] These changes could help more homeowners take advantage of low interest rates, lower their monthly mortgage payment, and reduce the risk that they will default on their mortgage.

*2. FHFA should join Treasury and FHA in extending the GSE Home Affordable Modification Program (HAMP) at least to 2016.*

Some months ago, Treasury announced it would extend its HAMP modification program at least through 2016. We urge FHFA to ensure that HAMP will continue to be available to Fannie and Freddie borrowers as long as HAMP is available to private label borrowers. Moreover, when HAMP expires (and especially if FHFA does not require the GSEs to extend HAMP to 2016), FHFA should require Fannie and Freddie to implement a new proprietary modification that includes measures to ensure affordability, which the current Standard Modification does not do.

*3. To assist troubled borrowers, participate in the HAMP principal reduction alternative and enable borrowers who lose their homes through a short sale or foreclosure to buy back their homes at fair market value.*

We are encouraged that FHFA's strategic plan expresses a commitment to "develop and actively promote home retention and loss mitigation programs." Unfortunately, FHFA still prohibits the Enterprises from engaging in one of the most effective forms of loss mitigation: principal reduction. Numerous studies have demonstrated that principal reductions help keep troubled borrowers in their homes more effectively than loan modifications alone.[63] Additionally, the Congressional Budget Office has estimated that allowing principal reductions through HAMP on loans guaranteed by the Enterprises would result in savings for the taxpayer.[64]

Lifting this prohibition should be an FHFA priority. FHFA could either design its own principal reduction modification or use the HAMP Principal Reduction Alternative (HAMP–PRA). If FHFA is worried about strategic default, HAMP–PRA requires a borrower to be delinquent or in imminent default, to demonstrate a hardship, and to meet various other criteria related to the size of the loan, owner-occupancy, etc. The modification must be both net-present-value positive and affordable by the borrower. Working through HAMP also would provide access to Treasury incentive payments and related Treasury programs such as the second-lien modification program (2MP). HAMP–PRA also allows an investor to create a shared appreciation modification, where any gains upon sale would be shared by the investor and homeowner, as some Senators have recommended.[65]

FHFA has previously raised concerns about the operational burdens associated with implementing principal reduction. While these concerns are valid and real, Treasury has offered to pay the additional administrative costs required to implement HAMP–PRA and to free up human and technical resources that would accelerate implementation of this program.

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[62] The Responsible Homeowner Refinancing Act of 2013 (S. 249), available at *https://www.congress.gov/bill/113th-congress/senate-bill/249/text.*

[63] See, e.g., Standard and Poor's, "The Best Way To Limit U.S. Mortgage Redefaults May Be Principal Forgiveness", (2012) available at *http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245335672295;* Andrew Haughwout, Ebiere Okah, and Joseph Tracy, "Second Chances: Subprime Mortgage Modification and Re-Default", Federal Reserve Bank of New York Staff Reports (2010) available at *http://www.newyorkfed.org/research/staff__reports/sr417.pdf*; Roberto G. Quercia and Lei Ding, "Loan Modifications and Redefault Risk: An Examination of Short-Term Impacts", CityScape (2009) available at *http://ccc.unc.edu/contentitems/loan-modifications-and-redefault-risk-an-examination-of-short-term-impacts/.*

[64] Congressional Budget Office, "Modifying Mortgages Involving Fannie Mae and Freddie Mac: Options for Principal Forgiveness", (2013) available at *http://www.cbo.gov/publication/44115.*

[65] *https://www.congress.gov/bill/113th-congress/senate-bill/2854?q=%7B%22search%22%3A%5B%22Preserving+American+Homeownership+Act%22%5D%7D*

If FHFA will not provide principal reduction, or for homeowners for whom a new principal reduction program would not come in time, we encourage FHFA to continue to explore additional ways to enable former homeowners to buy back their homes at fair market value. Recently, FHFA announced that it will permit former homeowners who have gone through a foreclosure or deed-in-lieu to buy back their house at fair market value if they are able to obtain financing through a channel other than the GSEs. However, most homeowners whose homes are already in the REO portfolio are not likely to be in a position to return to their home or to obtain financing to do so, given the damage to their credit score and the need to have already moved out.

Instead, FHFA should focus on enabling mission-based organizations to assist troubled underwater borrowers in a short sale transaction whereby homeowner can repurchase their own home if they can afford the mortgage at the fair market value. Sometimes called a "structured short sale," this transaction provides a way for borrowers to right-size their mortgage without forcing them through a foreclosure or risking an eviction. Borrowers should still be required to meet the GSE's existing hardship requirements for obtaining a short sale.

*4. If and when Fannie Mae or Freddie Mac sell nonperforming loans in bulk, FHFA should require that these sales actively promote home retention and neighborhood stability.*

Between them, Fannie Mae and Freddie Mac hold close to 700,000 seriously delinquent loans.[66] Many of these loans have languished for years, with foreclosures in process or imminent. Observers had long speculated that Fannie and Freddie would sell these loans to investors at a discounted rate to minimize Enterprise losses, as the Federal Housing Administration, or FHA, has been doing. Confirming this speculation, this past August, Freddie Mac auctioned its first pool of nonperforming loans.[67]

We encourage FHFA to follow the recommendations we outlined above for FHA in making home retention and neighborhood stability an explicit goal for any further Enterprise note sales. In particular, we recommend that FHFA impose on purchasers meaningful post-sale requirements aimed at home retention and neighborhood stabilization, including an explicit loss-mitigation waterfall; encourage sales to nonprofit or other entities who will prioritize these goals; and collect and regularly share data on outcomes.[68] Especially given strong investor demand for nonperforming loans, we do not think such requirements would unduly impact investor bids for the loans.

*5. FHFA should instruct Fannie and Freddie to reform their approach to lender-placed (force-placed) insurance.*

FHFA has recognized that abuses within the lender-placed insurance market—the insurance a lender must obtain on behalf of a homeowner if a homeowner's property insurance lapses—are burdensome not only for consumers but also for Fannie Mae and Freddie Mac. The GSEs spent $360 million on lender-placed insurance premiums in 2012 alone, according to the FHFA Office of Inspector General.[69] The costs of forced-placed insurance are exorbitant because mortgage servicers often receive kickbacks—in the form of free or below-cost services, commissions or bonuses—from insurance companies. Homeowners, and the GSEs when a homeowner loses their home to foreclosure, are responsible for paying the FPI bill.

FHFA took an important step last year to lower FPI costs by prohibiting mortgage servicers from collecting commission from insurance companies for buying FPI. FHFA also included lowering FPI costs as an objective in the GSEs 2014 performance scorecard. However, these steps alone will not bring down the costs of FPI since insurance companies, and mortgage servicers are likely to find new ways to exchange kickbacks. FHFA must consider a more comprehensive approach to prevent the kickbacks between insurance companies and mortgage servicers, and we recommend they consider allowing the GSEs to purchase insurance directly, instead

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[66] Federal Housing Finance Agency, "Foreclosure Prevention Report: May 2014", (2014) available at *http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/ForeclosurePreventionReportMay2014FINAL.pdf.*

[67] Nick Timiraos, "Freddie Mac To Sell $659 Million in Defaulted Home Loans Sale Is a First for the Mortgage Finance Giant Under Government Control", *The Wall Street Journal,* August 1, 2014.

[68] To view CAP's full recommendations on how FHA should improve the DASP program, see Sarah Edelman, Julia Gordon, and Aashna Desai, "Is the FHA Distressed Asset Stabilization Program Meeting Its Goals?" (Center for American Progress: 2014), available at *http://www.americanprogress.org/issues/housing/report/2014/09/05/96531/is-the-fha-distressed-asset-stabilization-program-meeting-its-goals/.*

[69] FHFA Office of Inspector General, "FHFA's Oversight of Enterprises Lender-Placed Insurance Costs", (2014) available at *http://fhfaoig.gov/Content/Files/EVL-2014-009.pdf.*

of reimbursing mortgage servicers. Cutting out the middle man could help protect consumers and taxpayers from inflated costs.

*C. The Consumer Financial Protection Bureau should continue to improve CFPB servicing rules.*

The CFPB's servicing rules provide essential procedural protections that promote better servicing outcomes for homeowners, investors, and communities. The recent proposed amendments to that rule make substantial improvements in crucial areas including transfers of servicing, bankruptcy, and access to the loss mitigation system for subsequent hardships. They also make important strides in protecting homeowners who seek assistance following death or divorce of a cohomeowner.

However, there are still some basic building blocks to servicing reform that are not yet in place. First, servicer compensation reform has been sidetracked and must be revived. As long as servicers profit at the expense of homeowners and investors, the system will not reliably produce healthy outcomes for the housing market and communities regardless of the rules or enforcement thereof. Regulators must come together to develop a framework to modernize and rationalize servicer compensation.

Second, with the eventual sunset of the Home Affordable Modification Program (HAMP), policymakers need to find a way to require loss mitigation and to require sustainable modifications to homeowners that also benefit investors. Loss mitigation before HAMP did not always happen, and when it did, it did not always promote long-term home retention. Without rules in place, it is possible—perhaps even likely—that the system will soon forget the lessons of the crisis. To the extent that CFPB does not or cannot mandate loss mitigation and a substantive requirement for loan modifications, Congress and other regulators should step in to ensure that such a requirement is developed.

Third, we encourage CFPB to continue to address issues that remain outstanding in other follow-up actions to their servicing rules. For example, current rules do not yet clarify what homeowners need to submit to have their request for assistance reviewed. In addition, borrowers who do not speak English as their native language continue to face significant problems communicating orally and in writing with mortgage servicing companies.

*D. Policymakers should take steps to help renters, particularly very low-income renters.*

*1. FHFA should capitalize the Housing Trust Fund and Capital Magnet Fund.*

In the Housing and Economic Recovery Act of 2008 that created FHFA, Congress created a mechanism by which Fannie and Freddie would capitalize the Housing Trust Fund and Capital Magnet Fund, both sources of subsidy to produce affordable housing for very low-income families. After FHFA put Fannie and Freddie into conservatorship, however, it prohibited the companies from contributing these funds at all.

While this prohibition may have been justified when the Enterprises were drawing on taxpayer funds to stay afloat, now that they have returned to profitability, there is no justification for continuing the prohibition. We believe that FHFA has both the right and the responsibility to direct the Enterprises to begin contributing to these funds right away.

*2. Congress should extend the Low-Income Housing Tax Credit.*

Since its creation in 1986, the Low-Income Housing Tax Credit, or LIHTC, has leveraged more than $100 billion in private investment capital through a dollar-for-dollar reduction in a developer's tax liability, providing critical financing for the development of more than 2.5 million affordable rental homes.[70] The program annually supports 95,000 jobs and finances approximately 90 percent of all affordable rental housing. Moreover, it is a critical resource to transform communities suffering from blight.[71]

Ever since the minimum Housing Credit rate expired at the end of 2013, Housing Credit developments have been underwritten using a floating rate, which has hovered near 7.5 percent. The tax extenders package from the House would provide a minimum 9 percent credit rate through January 1, meaning there are essentially no housing deals that will benefit from this provision. Congress should extend the Housing Credit's 9 percent minimum credit rate floor for 2 years until the end of 2015 so at least 1 year would have the full benefit.

[70] LISC, "The Low Income Housing Tax Credit", (2013), available at *http://www.lisc.org/docs/resources/policy/Policy__Brief__LIHTC.pdf.*

[71] Ibid.

*3. Congress should protect important programs for affordable housing from budget cuts.*

In 2012, 75 percent of extremely poor households paid more than half of their meager incomes for housing. This results in little left over for groceries, medication, transportation, and other of life's necessities. It also is a strong determinant of homelessness, which is much more expensive than rental assistance to mitigate.

HUD's rental assistance programs (public housing, project-based Section 8, and housing choice vouchers), which serve about 5 million extremely low income households, are facing a big threat next year: sequestration. HUD programs, although they serve the poorest households, are not exempt from sequestration's impacts. Sequestration has already led to 100,000 fewer low-income families receiving housing vouchers.[72] As a result of sequestration and other austerity measures enacted since 2011, nondefense discretionary funding in FY14 was about 15 percent below 2010 levels, adjusted for inflation. Without action to stop sequestration, in FY16 nondefense discretionary programs will decline to 3.1 percent of GDP—equal to the lowest level in at least 50 years. These programs already serve only one quarter of those eligible, and it is critical not to cut these budgets further.[73] Congress must protect these most vulnerable residents from losing one of the few forms of housing assistance currently available.

Additionally, we recommend a renewed commitment of funding to the HOME Investment Partnerships program. This program creates affordable housing for people in need nationwide—since 1992 over one million homes. It does so by giving States and localities the flexibility to deploy scarce resources to the affordable housing challenges particular to their communities. HOME leverages other resources almost four to one, and frequently is critical gap financing for Low Income Housing Tax Credit properties.

*4. Congress and agencies should act to encourage renters to increase their savings.*

Another opportunity for addressing inequality in our housing market lies in developing programs that effectively encourage renters to build assets. Renter households in the United States have a median net worth of about $5,100, while households that own homes have a median net worth of more than $170,000.[74] This inequality remains true when comparing renters with incomes comparable to their homeowner counterparts.[75] A significant cause of this phenomenon is the fact that mortgage payments typically represent a form of "forced savings," while renting lacks a similar mechanism to encourage households to save. The proportion of the population who rents is expected to grow in the coming years, portending an increase in our Nation's already large wealth inequality.

Addressing this issue will not be easy, but research and experience suggest there are ways we can encourage more renters to save. HUD's Family Self-Sufficient Program, which escrows into a separate account the increased portion of rent a public housing tenant would be expected to pay if their income increases, has proven to be a powerful savings vehicle for many participating households.[76] We support legislative efforts to enhance and extend this program to more groups of renters receiving some kind of Government assistance.[77]

Programs implemented by nonprofits and for-profit landlords alike likewise show promise in promoting savings among renting households. And behavioral economics research suggests that an effective renter savings program would make savings automatic, make participation easy, give short-term rewards for saving and, if possible, provide a match for savings.[78] As more families rent rather than own homes,

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[72] Douglas Rice, "Sequestration's Rising Toll: 100,000 Fewer Low-Income Families Have Housing Vouchers", (Washington: Center on Budget and Policy Priorities, 2014), available at *http://www.cbpp.org/cms/index.cfm?fa=view&id=4229.*

[73] Rice, "Better Federal Policy Needed To Address Rental Affordability Crisis".

[74] Joint Center for Housing Studies, "The State of the Nation's Housing 2013: Appendixes", (2013) Table A-6, available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013_chap7_appendix_tables.pdf.*

[75] Joint Center for Housing Studies, "America's Rental Housing: Evolving Markets and Needs", (2013), available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs_americas_rental_housing_2013_1_0.pdf.*

[76] Hannah Emple, "Asset-Oriented Rental Assistance: Next Generation Reforms for HUD's Family Self-Sufficiency Program" (Washington: New America Foundation, 2013); Planmatics, Inc. and Abt Associates Inc., "Evaluation of the Family Self-Sufficiency Program: Prospective Study" (U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 2011).

[77] See the Family Self-Sufficiency Act (S. 454), introduced by Sens. Reed and Blunt.

[78] This research is summarized in David Abromowitz and Sarah Edelman, "As More Households Rent, How Can We Encourage Them to Save?" (Washington: Center for American Progress, 2014), available at *https://www.americanprogress.org/issues/housing/report/2014/09/10/96706/as-more-households-rent-how-can-we-encourage-them-to-save/.*

it is critical to ramp up the policy discussion about how to make it easier for renters to build wealth.

**Conclusion**

In the aftermath of the Great Recession, policymakers face some important choices. We can tolerate a weaker housing market in which fewer families build wealth through home ownership, more lower-income renters must choose between decent housing and other necessities, and too many communities lack access to safe and affordable mortgage credit. Alternatively, we can work to create a healthier and more equitable housing market by promoting sustainable home ownership, affordable rental housing, and stronger neighborhoods. Choosing the latter will require action by a wide array of policymakers and market participants, which is challenging. Ultimately, however, by working together, we can create a more robust, fairer housing market that drives economic growth and promotes opportunity for America's families.

Thank you again for inviting me to testify today. I look forward to continuing to engage with you on these and other issues.

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## PREPARED STATEMENT OF DEBORAH GOLDBERG

SPECIAL PROJECT DIRECTOR, NATIONAL FAIR HOUSING ALLIANCE

DECEMBER 9, 2014

Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for the opportunity to testify here today on "Inequality, Opportunity, and the Housing Market". My name is Debby Goldberg, and I am a Special Project Director at the National Fair Housing Alliance (NFHA). Founded in 1988, and headquartered in the District of Columbia, the National Fair Housing Alliance is a consortium of more than 220 private, nonprofit fair housing organizations, State and local civil rights groups, and individuals from 37 States and the District of Columbia. Through comprehensive education, advocacy, and enforcement programs, NFHA seeks to provide equal access to housing for millions of people.

The title for this hearing is one that resonates with NFHA and its members. We work at the intersection of housing and opportunity, and we are very mindful of the impact that where people live has on so many aspects of their lives. It determines whether they have access to good schools, good jobs, quality health care, good transportation, a healthy environment, and so much more—the kinds of resources and opportunities that we all need to flourish. As Americans, we believe strongly that everyone should have access to opportunity, regardless of the color of their skin, their gender, their ancestry, the language they speak, where they worship, or whether they have children. Unfortunately, the reality often differs from this ideal, as we can see clearly in the housing market.

My testimony today will focus on widespread problems in the maintenance and marketing of foreclosed properties, particularly in communities of color, and the long-term impact of those problems. It is based on a 5 year investigation conducted by the National Fair Housing Alliance. I will also describe some of the patterns and practices that, over many decades, created the conditions in which these problems could take root. Finally, I will draw some lessons for future policies and programs that are suggested by the conclusions of our investigation.

**Why Homeownership Matters**

Home ownership has long been the key to opportunity in this country—a path into the middle class. Home ownership has provided millions of families the means to create economic stability and build wealth. Families have used the equity in their homes to send their kids to college, start or expand small businesses, weather economic hardships, fund retirement, and pass along wealth to the next generation.

But home ownership rates in the U.S. vary tremendously by race and national origin, and have done so for many decades. According to the Census Bureau,[1] in 1994, some 70 percent of White households were homeowners, while for both Black and Hispanic households the rate was closer to 42 percent. In 2004, the White home ownership rate hit a high of 76 percent, while the rates for Black and Hispanic households rose to 49 percent. At the end of the third quarter of this year, the White home ownership rate had fallen to 72.6 percent, and the rates for Blacks and Hispanics were 42.9 percent and 45.6 percent, respectively. As these figures illustrate, while home ownership rates have risen and fallen for all homeowners, the gap be-

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[1] See "Quarterly Homeownership Rates by Race and Ethnicity of Householder: 1994 to Present", available at *http://www.census.gov/housing/hvs/data/histtabs.html*.

tween home ownership rates for White households and others has remained remarkably constant. Households of color have not experienced the benefits of home ownership to the same degree as their White counterparts.

There are many factors that explain these differences. They include policies of the Federal Government, enacted many decades ago, that provided access to affordable home ownership for White families while denying it to their Black counterparts. Foremost among these were the early policies of the Federal Housing Administration (FHA). FHA fueled the expansion of the suburbs in the post-World War II era, insuring construction loans for companies building new subdivisions, as long as they agreed not to sell any of the houses to Black families. Similarly, FHA's insurance for individual mortgages made long term, fixed rate, low downpayment loans available to White families of modest means, but excluded Black families from obtaining similar mortgages.[2] This practice came to be known as "redlining." FHA has long since changed its policies, and has become an important source of mortgage financing for many families, including families of color. But the policies it adopted in its early years laid the foundation for the differences in home ownership rates that we see today. And the policy changes alone have not eliminated the gap.

These Federal Government policies were adopted by those in the private sector, and for decades, inner city communities, communities of color, and low- and moderate-income communities were redlined—denied access to affordable, sustainable mortgages from mainstream financial institutions.

During this past decade, communities of color that had previously been starved for credit were flooded with subprime and other unsustainable mortgages, a phenomenon that some have called "reverse redlining." According to the Federal Reserve Board, in 2005–2006—the peak subprime lending years—more than 53 percent of the home purchase loans made to African Americans nationwide were subprime loans, as were more than 49 percent of the refinance loans made to these borrowers. African American borrowers were 3 times more likely to get a subprime home purchase loan and 2 times more likely to get a subprime refinance loan than White borrowers. During those same years, more than 46 percent of the home purchase loans made to Latino borrowers were subprime, as were more than 34 percent of the refinance loans made to Latinos. They were 2.5 times more likely to get a subprime home purchase loan and more than 1.5 times more likely to get a subprime refinance loan than White borrowers.[3]

These differences cannot be explained by the creditworthiness of the borrowers. A *Wall Street Journal* analysis of subprime loans made in 2005–2006 found that more than half of the borrowers (55 percent in 2005, 61 percent in 2006) would have qualified for a prime mortgage.[4] Evidence from several fair lending cases brought by the Department of Justice found that some lenders steered thousands of African American and Latino borrowers into subprime loans even though they were qualified for prime mortgages.[5]

These subprime loans, and other exotic mortgage products offered during the early and mid-2000s proved to be expensive and unsustainable. They contained many risky features, such as high upfront costs, negative amortization and adjustable payments that caused monthly payments to rise rapidly. They were targeted and heavily marketed to borrowers for whom they were not a suitable product, particularly borrowers of color. And they defaulted at historic rates. Research from the Federal Reserve Bank of San Francisco found that more than 35 percent of the subprime first lien mortgages originated in 2006 defaulted within the first 24 months, compared to just over 10 percent of prime first lien mortgages originated in the same year.[6]

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[2] For a more detailed description of the racially exclusionary policies of the FHA and other Government agencies, see Richard Rothstein, "The Making of Ferguson: Public Policies at the Root of Its Troubles", Economic Policy Institute, October 15, 2014, available at *http://www.epi.org/publication/making-fguson/*.

[3] Avery, Robert B., Kenneth P. Brevoort, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data", Federal Reserve Bulletin, available at *http://www.federalreserve.gov/pubs/Bulletin/2006/hmda/default.htm;* and "The 2006 HMDA Data", Federal Reserve Bulletin vol. 93, December 21, 2007, available at *http://www.federalreserve.gov/pubs/bulletin/2007/07index.htm.*

[4] Brooks, Rick and Ruth Simon, "Subprime Debacle Traps Even Very Creditworthy", *Wall St. Journal,* December 3, 2007.

[5] See, for example, the cases brought by DOJ against Bank of America's Countrywide unit and Wells Fargo. Details available at *http://www.justice.gov/crt/about/hce/whatnew.php.*

[6] Amromin, Gene, and Anna L. Paulson, "Default Rates on Prime and Subprime Mortgages: Differences and Similarities", *Profitwise News and Views,* Federal Reserve Bank of San Francisco, September, 2010.

The result has been a deluge of foreclosures—an estimated 5 million since 2008.[7] Just as subprime lending was concentrated in communities of color, so have foreclosures been concentrated in these communities. Neighborhoods that were targeted for subprime lending have become neighborhoods with high rates of foreclosure. In 2011, the Center for Responsible Lending (CRL) found that, "Nearly 25 percent of loans in low-income neighborhoods and 20 percent of loans in high-minority neighborhoods have been foreclosed upon or are at high risk of default."[8] CRL's research also found that, "Approximately one quarter of all Latino and African American borrowers have lost their home to foreclosure or are seriously delinquent, compared to just under 12 percent for White borrowers." As these statistics suggest, in many communities of color, there are now large numbers of vacant, foreclosed properties, also known as REOs (Real Estate Owned properties).

**NFHA's REO Investigations**

Several years into the foreclosure crisis, NFHA began to hear complaints about the neglect of REO properties and the negative impact of those properties on the surrounding neighborhoods. This prompted us to begin investigating the REO maintenance and marketing practices of major lenders and the Government Sponsored Enterprises (GSEs). Since April, 2009, in partnership with 17 of our members, NFHA has inspected 3,726 foreclosed properties in 29 metropolitan areas and 22 States. Some of these properties are located in predominantly White neighborhoods. Others are located in predominantly Black and/or Hispanic neighborhoods. Many of these neighborhoods are stable communities where the rate of home ownership is high. At each house, our investigators evaluate more than 30 aspects of maintenance and marketing, including curb appeal, structural integrity, signage, indications of water damage and the condition of the paint, siding, gutters, and downspouts.

**Our Findings**

The findings of our investigation are detailed in the report, "Zip Code Inequality: Discrimination by Banks in the Maintenance of Homes in Neighborhoods of Color", a copy of which is attached to my testimony. This is the third report NFHA has issued since our investigations began in 2009, and unfortunately, the findings described in this report are as troubling as our earlier ones. What we found in many cases was that the system for managing REO properties in communities of color was broken. The companies that were hired to do the on-the-ground work of maintaining and marketing foreclosed properties failed to do their jobs properly. The banks, owners and investors who hired those on-the-ground companies failed to manage and oversee their work. And, for the most part, the Federal agencies with supervisory responsibility in this area failed to provide the guidance and oversight needed. The problem was particularly acute in communities of color, with a negative impact on the families who lost their homes to foreclosure, the families in the surrounding homes, and the cities in which those homes were located. In all of these ways, these neglected properties are a drag on our broader economic recovery. Because the problems are most acute in communities of color, they constitute a violation of the Federal Fair Housing Act, which prohibits discrimination in all aspects of housing, including marketing and maintenance, on the basis of race, color, religion, sex, national origin, family status, or disability. The Fair Housing Act also requires Federal agencies with housing and community development programs and activities to administer those programs and activities in a manner "affirmatively to further" the purposes of the Act. That is, in a manner to combat the problems associated with segregation and take steps to overcome them. The Fair Housing Act provides both a mandate and a tool for dealing with the kinds of problems we found with foreclosed homes in communities of color across the country.

Some of the highlights of our findings are described below.

We found that REO properties in White neighborhoods were well-cared for and well-marketed. They were more likely to have neatly manicured lawns, securely locked doors, and attractive, professional "For Sale" signs out front. These properties tended to be maintained to the standards of other homes in the neighborhood and

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[7] CoreLogic estimates that 4.4 million foreclosures were completed between 2008 and May, 2013. It estimates another 594,000 foreclosures were completed between June, 2013, and May, 2014. See CoreLogic National Foreclosure Report, May, 2013, available at *http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-may-2013.pdf,* and CoreLogic National Foreclosure Report, May, 2014, available at *http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-may-2014.pdf.*

[8] Bocian, Debbie Gruenstein, Wei Li, Carolina Reed, and Roberto G. Quercia, "Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures", Center for Responsible Lending, November 2011.

attractive to real estate agents and potential homebuyers. Someone driving down the street would likely never know that the property was for sale because of a foreclosure.

In contrast, REO properties in communities of color were more likely to have overgrown yards, trash on the premises, unsecured doors, and broken or boarded windows. These properties were not maintained to the standards of nearby homes. They appeared abandoned, blighted, and unappealing to potential homebuyers, even though they were located in stable neighborhoods where the surrounding homes were well maintained.

Overall, our investigation found that, compared to REO properties in White communities, REOs in communities of color were:

- 2.2 times more likely to have significant amounts of trash and debris on the premises;
- 2.3 times more likely to have unsecure, broken, or damaged doors;
- 2.0 times more likely to have damaged, broken, or boarded windows;
- 2.1 times more likely to have holes in the structure; and
- 1.3 times more likely to lack a professional "for sale" sign.

In some cities, the disparities were much starker. For example:

- In Memphis, TN, REOs in communities of color were 8.8 times more likely to have significant amounts of trash and debris littered throughout the property than REOs in White communities.
- In Hampton Roads, VA, REOs in communities of color were 6 times more likely to have unsecured, damaged, or boarded doors than REOs in White communities.
- In Miami, FL, REOs in communities of color were 3.7 times more likely to have overgrown grass or dead leaves on the property than REOs in White communities.
- In Kansas City, MO/KS, REOs in communities of color were 3.6 times more likely to have damaged, broken or boarded windows than REOs in White communities.

Further, these maintenance deficiencies were cumulative. That is, REOs in communities of communities of color were more likely to have a greater number of deficiencies than those in White communities. In our investigation, 43.2 percent of REOs in White communities had fewer than 5 deficiencies, compared to only 21.7 percent of those in communities of color. Conversely, 32 percent of the REOs we inspected in communities of color had 10 or more deficiencies, compared to only 12.4 percent of those in White communities.

In other words, REOs in communities of color were much more likely to have a great many deficiencies—such as large quantities of trash, broken or unsecured doors and/or windows, holes in the roof, missing or damaged gutters and downspouts, overgrown lawns and invasive plants, graffiti, damaged siding, and exposed or damaged utilities—than those in White communities.

**Poor Maintenance Causes Many Problems**

These cumulative deficiencies lead to a host of problems. For example, they can cause health problems, both physical and mental. REOs with unsecured doors and windows invite trespassers and vandals, as well as rodents, insects, cats, dogs, and wildlife. These, in turn, can increase the risk of disease, and may also be triggers for asthma for nearby residents. There are other health consequences, as well. Recent research published by the American Heart Association found that living near a foreclosed home that remains vacant for some period of time increases a person's chance of developing high blood pressure. People who live near vacant properties may feel an increased sense of social isolation, affecting their psychological well-being. They are also less likely to walk, run, and play outside, with further health consequences.

Poorly maintained REOs may also cause safety problems. They attract vagrants and criminal activity, and may be fire and safety hazards. Some of the REOs visited in NFHA's investigation have become the houses where people party on the weekends or engage in illicit activities, or where squatters take over. They also contribute to violent crime in a community. Research shows that for every 1 percent increase in the foreclosure rate in a census tract, violent crimes increase by 2.33 percent.[9]

All of these problems place an increased burden on municipal fire, police, health care, and other resources. At the same time, their poor condition depresses the value not only of these properties, but also the surrounding homes, even those that are occupied and well-maintained. This results in lower tax revenues for municipalities, even as they must expend more resources to cope with the problems created by the REOs. It is not surprising that a number of cities have taken legal action in an effort to recoup the increased costs they experience in dealing with vacant, poorly maintained REOs. One example is the City of Los Angeles, which has sued both Deutsche Bank and U.S. Bancorp over their failure to comply with municipal building codes in their maintenance of foreclosed homes in that city.

**Investor Purchases of REOs**

The poor maintenance and ineffective marketing of REO properties in communities of color also have an impact on who ultimately purchases these properties. In order to understand this relationship better, NFHA tracked the sales of REOs that were part of its earlier investigations in two Maryland Counties, Montgomery and Prince George's, and in Memphis, TN. In Maryland, we found that investors purchased 59 percent of REO properties that were poorly maintained (had 10 or more deficiencies), compared to 36 percent of those that were well maintained. Owner-occupants purchased 46 percent of the well maintained REOs, compared to only 12 percent of those that were poorly maintained. Because of the higher incidence of poor maintenance in communities of color, 52 percent of the REO properties whose sales we tracked in those communities were purchased by investors, compared to 33 percent of those in White communities.

We found similar outcomes in Memphis. There, 70 percent of the REOs with 10 or more deficiencies were sold to investors, compared to 46 percent of those that were well-maintained. Fifty-one percent of the well maintained properties were sold to owner-occupants, compared to only 20 percent of the poorly maintained REOs. In communities of color, 70 percent of the REOs were sold to investors, compared to 18 percent in White communities. Twenty-four percent of REOs in communities of color were sold to owner-occupants, compared to 78 percent in White communities.

**The Role of the Fair Housing Act**

The Federal Fair Housing Act requires banks, trustees, investors, servicers, and any other responsible party to maintain and market properties that are for sale or rent without regard to the race or national origin of the residents of a neighborhood. It is illegal to treat a neighborhood differently because of the race or national origin of the residents. Moreover, the law obligates banks, trustees, investors, and servicers to monitor the actions of vendors engaged in performing housing-related transactions to ensure that those third party entities comply with fair housing laws and obligations. Banks, trustees, investors and servicers who fail to ensure that the REOs they own and for which they are responsible are maintained and marketed without regard to the race or national origin of the residents of the neighborhood may be violating the Act.

The Fair Housing Act also requires Federal agencies (including those with regulatory or supervisory responsibility over financial institutions) with programs or activities related to housing and community development to conduct those programs and activities in a manner that affirmatively furthers the purposes of the Act. Those purposes are two-fold: to eliminate discrimination from the housing market, and to overcome the negative effects of entrenched segregation. The subprime lending that was targeted to communities of color and the subsequent surge in foreclosures in those communities has exacerbated the problems related to segregation. Failure to maintain and market these properties properly makes the problems even worse.

The Federal agencies responsible for overseeing the activities of banks, other investors and the GSEs have both the authority and obligation to ensure that they do not violate the Fair Housing Act in their maintenance and marketing of REO properties. Effective oversight can help stem this problem. To date, only the Federal Reserve Board has taken action in this area. It has provided guidance to the institutions it supervises about the liability to which they may be exposed for failure to

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[9] Immergluck, Dan, "The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime", Vol. 21, No. 6 in Housing Studies, 851–866, *http://www.prism.gatech.edu/di17/HousingStudies,pdf.*

ensure effective management of their REOs in communities of color.[10] Further, the Board is incorporating this issue into the risk assessments it conducts for institutions in advance of an on-site examination. To NFHA's knowledge, none of the other Federal agencies with fair housing responsibilities have taken similar action.

**Recommendations**

Based on the results of our investigations into the management, maintenance, and marketing of REO properties, NFHA recommends that a number of steps be taken to prevent the kinds of problems we identified. These are detailed in our report, and I provide some highlights below.

- *Better Oversight From Federal Regulators and Congress*—Many of the entities that have engaged in discriminatory practices in the REO market are federally regulated. Federal regulators, including the Federal Housing Finance Agency, Federal Reserve and others must be vigilant in their supervision to ensure that banks and the GSEs do not implement practices that harm neighborhoods of color or homeowners from protected classes under the Fair Housing Act. The CFPB also has a role to play as the key regulator of mortgage servicing. It does not have authority under the Fair Housing Act, but does have authority under the Equal Credit Opportunity Act. Congress must hold hearings to investigate discrimination in the REO arena so that neighborhoods of color and the businesses that support these neighborhoods are not left behind in the economic recovery.
- *Sales Practices Should Help Stabilize Communities*—banks and other owners of REOs should not allow the homes to sell at auction for prices significantly below the market value of other homes in the neighborhood.
- *Selection and Management of REO Vendors*—all of the vendors selected to work on the disposition of REOs should receive high-quality fair housing training, should not be the subject of pending discrimination complaints, and should have resolved any past complaints of discrimination successfully.
- *Marketing and Disposition Practices*—brokers selected to list REO properties for sale should have an office in close proximity to the property, have the capacity to closely manage and oversee the treatment of the REO, and should not have any discrimination actions pending or any past complaints that were not resolved satisfactorily. Further, banks and other REO owners should implement better incentives for their brokers to sell to owner-occupants rather than investors and should severely restrict bulk sales. They should also make sure that some of these homes are made available to nonprofit community development organizations, community land trusts, and other community-based and community-minded institutions that have a vision for rebuilding healthy and vibrant neighborhoods.
- *Quality Control Measures*—Banks and other owners must implement better quality control measures across the board, with swift and severe penalties for vendors who fail to do their work in a professional manor. Special attention must be directed to neighborhoods that have been found to be vulnerable to poor work by vendors, including neighborhoods that are predominantly African American, Latino, or Asian American, as well as low- and moderate-income neighborhoods.
- *Transparent, Accurate, and Accessible Information About REO Ownership*—Every bank or REO owner should maintain a public database containing all of its REO listings, including the name and contact information of those responsible for the maintenance or sale of the property. Neighbors and local advocates must have access to clear ownership records that are updated in an accurate and timely manner. Local governments should continue to implement Vacant Property Registries, monitor these registries, and routinely address any violations.
- *Create a Path Back to Home Ownership*—Five million families have lost their homes to foreclosure since September, 2008. Evidence from Federal enforcement actions tells us that many of these families were steered into loans that were more risky and more costly than their financial qualifications should have dictated. Others have been caught between record high levels of sustained unemployment and falling home prices that have made it impossible for them to sell

[10] See Federal Reserve Board Supervision and Regulation Letter SR 12-10 / CA 12-9, Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned (OREO) June 28, 2012, available at *http://www.federalreserve.gov/bankinforeg/srletters/sr1210a1.pdf.*

or refinance their homes. Offering these families a path back to home ownership is an important component of rebuilding stable, vibrant communities. Because so many of these families have been families of color, it is also a fair housing issue.

**Loss of Wealth Due to Foreclosures and Implications for the Future**

The foreclosure crisis has drained enormous wealth from communities across the country—an estimated $2.2 trillion, according to CRL. Half of that amount, $1.1 trillion, has been lost by communities of color.[11] To be clear, this is not the direct cost to families who have lost their homes to foreclosure, but rather the loss to families in nearby homes due to the decline in the value of their homes. The Pew Research Center reached similar findings. Between 2005 and 2009, according to Pew, Blacks and Hispanics lost 53 percent and 66 percent of their household wealth, respectively, due to declining property values. In contrast, White households experienced a 16 percent loss in median household wealth. Thus, while the typical White household had $113,149 in wealth in 2009, the typical Black household had only $5,677. For the typical Hispanic household, that figure was $6,325.[12]

This loss of wealth has tremendous implications for the future. It limits the ability of families of color to tap the equity in their homes in the way that so many others have done: to send their kids to college, to start or expand a small business, to weather financial difficulties, to fund retirement, and to pass along wealth to the next generation. In other words, it limits their options and opportunities.

This, in turn, has tremendous implications for the housing market and the economy as a whole. Seven out of ten new households formed over the next decade will be households of color.[13] By 2025, people of color will make up nearly half of the typical first-time homebuyer population.[14] If this group cannot afford to buy homes, the housing market may stall. Current homeowners may have difficulty selling their existing homes, whether to downsize as they age or to meet other needs. In order to maintain a robust housing market and a thriving economy, we must ensure that we address the lingering problems in communities hard hit by foreclosures and provide access to affordable, sustainable credit for borrowers of color.

**Lessons for Other Policies and Programs**

NFHA's investigations into the management of REOs provide a window into the devastation caused by the foreclosure crisis, to the housing market, the overall economy, and especially to communities of color. It is a reminder of the importance of taking effective action to prevent abusive lending practices from causing this kind of devastation in the future. Full recovery will also require us to take affirmative steps to help people affected by foreclosure get back on their feet and to revitalize the hardest hit communities. Congress has an important role to play in this effort, as it shines a light on housing problems in hearings like this and as it oversees the work of relevant Federal agencies.

**Reforming the Mortgage Market**

One way to prevent a recurrence of the foreclosure crisis is to ensure that the risky mortgage products and lending practices that characterized the subprime boom do not creep back into the mortgage market, either in the forms we saw during the 2000s or in new and different forms. By enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, with its prohibitions against the riskiest features of the types of mortgages and lending practices that caused the crash, Congress took an important step toward eliminating abusive mortgage lending practices. The regulations that the Consumer Financial Protection Bureau has issued to implement those statutory provisions will help ensure that Congressional intent is carried out. However, abusive practices can only be fully eliminated when strong regulations are accompanied by strong oversight and effective enforcement. In this, all of the Federal agencies with responsibilities for oversight of the mortgage

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[11] "2013 Update: The Spillover Effects of Foreclosures", Center for Responsible Lending, August 19, 2013, available at *http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosure-spillover-effects-final-aug-19-docx.pdf.*

[12] Kochhar, Rakesh, Richard Fry, and Paul Taylor, "Twenty to One: Wealth Gaps Rise to Record Highs Between Whites, Blacks, and Hispanics", Pew Research Center, July 26, 2011, available at *http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.*

[13] See The Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing: 2013", available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013.pdf.*

[14] See The Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing: 2014", available at *http://www.jchs.harvard.edu/research/state_nations_housing.*

market have important roles to play in policing the marketplace, as does Congress in its role as overseer.

While it is important to shore up the regulatory system to prevent risky and abusive products and practices, it is critical to balance this risk reduction effort with the need to preserve access to affordable, sustainable credit for creditworthy borrowers. This means we should eliminate the features that, when layered together, made loans unsustainable—such as high points and fees, negative amortization, rapidly rising monthly payments, and the like. At the same time, we must be careful not to impose requirements, such as large downpayments, that bear little relationship to risk but have the effect of eliminating a great many creditworthy potential borrowers, particularly borrowers of color, from eligibility for a mortgage. Similarly, we must ensure that the pricing policies adopted by the GSEs and FHA do not unfairly and unnecessarily shut these borrowers out of the market.

Another way to ensure that borrowers and communities are not further harmed by widespread foreclosures is to prevent those foreclosures that can be avoided, both now and in the future. This requires reforms to mortgage servicing. The CFPB has issued regulations to begin this process, and has further regulations in this area out for public comment now. The testimony of Julia Gordon, from the Center for American Progress, addresses these regulations and NFHA endorses her comments on this subject.

**Sale of Nonperforming Loans**

There are a great many borrowers currently at risk of foreclosure, whose loans are in default. Many of these loans are owned or backed by entities under Federal control. The Federal Housing Administration has more than 311,000 mortgages that are 90 days delinquent, [15] and the two GSEs have another $100 billion of seriously delinquent loans. [16] Both are taking steps to minimize their losses by selling pools of these nonperforming loans to investors rather than putting them through the foreclosure process. FHA has created the Distressed Asset Stabilization Program (DASP), and this past summer, FHFA authorized a bulk sale of nonperforming loans by Freddie Mac, which is expected to be the first in a number of such sales by both GSEs. In theory, selling these loans for an amount below the unpaid principal balance creates the opportunity for a win-win-win situation. The agencies that own or back these loans get an immediate return on the sales and eliminate their exposure to future risk. The investors who purchase these loans get a bargain and the opportunity to restructure the loan and create a stream of income for the future. The homeowner gets a shot at a restructured loan, which may include a reduced loan balance, which is affordable and sustainable and allows them to stay in the home. This avoids a foreclosure, which is costly to all parties. It avoids the potential problems that NFHA's investigation into REO maintenance and marketing identified, and it helps to stabilize the community, preserving the value of other loans in the same area that are owned or backed by the agency.

In order to achieve this triple bottom line, however, the sales of loan pools must be structured to accomplish all of these goals. To the extent possible, pools should be sold to mission-driven nonprofits or mission-minded for-profits that are committed to preserving home ownership for the largest possible number of borrowers. The desired outcomes and program parameters should be explicit, and purchasers should be required to report on the outcomes they achieve. The programs should be transparent, with information about outcomes made available to the public. And steps must be taken to ensure that borrowers of color are treated fairly and have the same opportunity to save their homes as other borrowers.

In addition, before any loan is sold, it is critical to ensure that all of the required loss mitigation steps have been taken. Servicers should document the steps they have taken, and the responsible agency should verify the accuracy of that documentation. Borrowers should be notified in advance that their loan may be sold, and should be informed of the loss mitigation steps their servicer says it has taken. In this way, the borrower can help with the verification process.

HUD is moving in the right direction with its DASP program, but that program can and should be strengthened. Provisions like these were not built into the nonperforming loan sales that Freddie Mac conducted last summer, and to date, it is not clear whether or how FHFA will structure future sales by the GSEs to accom-

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[15] Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2014, U.S. Department of Housing and Urban Development, Federal Housing Administration, November 17, 2014.

[16] Chrisman, Rob, "Non-Performing Loan Market on Fire; Rates Back to June 2013 Levels but Production May Drag", *Mortgage News Daily,* August 18, 2014.

plish these goals. This is another area where Congressional oversight would be useful.

**Conclusion**

We have made substantial progress in dealing with the foreclosure crisis, but there is more work to do to restore a robust housing market and ensure that all communities have an opportunity to share in the recovery. NFHA's investigation into the management of REO properties shines a spotlight on some of the persistent problems that remain to be solved. It also underscores the importance of using all of the Government's tools to their best effect to eliminate inequality and restore opportunity in our Nation's housing market.

Thank you for the opportunity to testify here today. I will be happy to answer your questions, and look forward to working with you in the months ahead.

## RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN MENENDEZ FROM WAYNE T. MEYER

**Q.1.** For communities that are still struggling to recover from the downturn—for example, with high concentrations of distressed mortgage borrowers or homeowners with underwater mortgages—in your experience in the market, are there strategies to break the cycle of home price decline? What more can be done?

**A.1.** At New Jersey Community Capital (NJCC), we believe early intervention and meaningful mortgage modification through principal reduction are the keys to stabilizing neighborhoods and halting the downward spiral of home prices. Gaining control of the properties is the first step. NJCC acquires nonperforming mortgages in bulk and works with homeowners to modify their mortgages to affordable levels through meaningful principal reduction. Other loans in the pools provide an opportunity to create affordable for-sale and rental housing units. NJCC also takes positions in properties through the acquisition of tax liens and looks to aggressively assume first position in an effort to gain the property through tax foreclosure and return it to productive reuse. NJCC also acquires real estate owned (REO) properties in an effort to rehabilitate abandoned and vacant properties and create accurate comparable real estate listings and pricing. Together these efforts create a healthy, stable local real estate market with rational home prices.

Additionally, we have been advocating with the FHFA to allow principal reduction as a modification strategy for FHA loans. We have also advocated with HUD to allow for changes to the Distressed Asset Stabilization Program (DASP), which we believe would bring about more positive neighborhood stabilization effects.

**Q.2.** As many of you noted in your testimony, the share of homeowners with negative or low equity on their homes has been improving, but it's still elevated and the rebound has not been uniform. In cities like Newark, Paterson, and Elizabeth in my State of New Jersey, for example, the underwater rates are much higher than the national average—and many in my State who were already struggling from the financial crisis then had to deal with an additional major hit from Superstorm Sandy.

Can you please explain the impact on the housing market of homeowners who are still struggling with high debt burdens, particularly at the entry-level segment of the market?

**A.2.** Homeowners struggling with high debt burdens will typically forgo paying mortgage payments after reducing other nonessential household expenses. However, certain expenses are simply necessary to daily life. After falling behind and becoming delinquent, it is near-impossible for most homeowners in at-risk communities to cure default. Instead, these homeowners are served a notice of foreclosure. First-time homebuyers, who do not receive counseling, often struggle with budgeting when household finances decrease or cease and in many cases do not know where to turn for help.

**Q.3.** Are there particular populations or communities that were especially hard hit and continue to face challenges?

**A.3.** Firstly, this problem impacts minority populations and communities both disproportionately and more severely. A home often represents a large portion of the generational wealth for these families, making the threat of foreclosure that much more devastating. In New Jersey, the major urban corridors of Newark, Jersey City, Paterson, Passaic, Trenton, Camden, Plainfield, Asbury Park, and Atlantic City continue to experience the compounding negative effects of increased foreclosures and neighborhood disinvestment and decline. However, more and more communities along the shore and elsewhere face mounting challenges and realize the hard-hitting effects of foreclosure, including Toms River, Bridgeton, Vineland, Brick, and Egg Harbor.

**Q.4.** What is the impact for the broader economy of the continuing number of homeowners with distressed mortgages? To what extent are consumers still holding back spending because of outsized debt burdens?

**A.4.** NJCC works in at-risk communities throughout the State, which share a disproportionate burden of homeowners in default. Several of these households are faced with the impossible choice to forgo proper nutrition and wellness in an effort to save their homes. These budgeting tactics risk more than just their financial ruin. In Newark, for example, Dr. Hanaa Hamdi, Director of Health and Human Services for the City, while completing research for her dissertation, found that price gouging by corner stores and bodegas in certain communities takes place at the beginning of each month when at-risk families receive public assistance, SNAP and WIC benefits. Even if these struggling families had the means to stimulate the broader economy with retail purchases, some still fall victim to the malice of others. These homeowners simply lack the necessary disposable income to boost the broader economy.

**Q.5.** As our witnesses know, the Federal Housing Finance Agency currently prohibits Fannie Mae and Freddie Mac from engaging in mortgage modifications that involve principal reductions for homeowners—even when it would result in a positive net present value compared to the alternative of a foreclosure. Mr. Meyer, you testified that principal reductions can be one of the most effective forms of modification—a win for the mortgage investor, the homeowner, and the community. Can you please elaborate?

**A.5.** When NJCC purchases delinquent loans, we are now the mortgage holder. We have the ability to modify our investment as we see fit. Everyone's home in the mortgage pool is eligible for a mortgage modification and principal reduction. We do not face moral hazard issues. However, after a thorough analysis of the household's finances by a ReStart Specialist—our specially trained, local housing counseling agency partners—many homeowners will not qualify for a modification. Those families are provided transitional assistance and the counseling agencies assist them with finding a new, sustainable living situation. For those homeowners, who do qualify, their mortgage is right-sized, meaning it is resized to the current market value or as close as possible to the current market value of the home. The homeowner then enters into a trial modification period for a period of 3–18 months. Once the trial is concluded, the modification becomes permanent. By offloading distressed assets, the mortgage issuer or current investor receives fair value for the mortgages, removes liabilities from their ledger, and can use the sale proceeds to make further investments. NJCC, as the new mortgage holder, helps anchor residents remain in their homes, decreasing neighborhood delinquency, and stabilizing the local markets through continued home ownership or the rehabilitation and sale or rental of the underlying homes at rational prices and affordable levels. Struggling neighborhoods profit the most, followed by our organization, and then the seller of the mortgages. However, stabilizing a neighborhood then protects the other investments NJCC or the seller of the mortgages has in that neighborhood. The seller can then realize gains on these stable investments and perhaps profit more on future home sales.

**Q.6.** Mr. Meyer, you testified about New Jersey Community Capital's ReStart initiative, under which you raise funding to purchase distressed mortgages and, where possible, modify them to find a sustainable mortgage for the homeowner or convert the property to affordable rental housing.

What impact do Hardest Hit Funds have on your ability to bid for, manage, and modify mortgages in these pools?

**A.6.** Senator Menendez, in Florida our ReStart program has benefited greatly from a set aside of Hardest Hit Funds. Not only do the Hardest Hit Funds allow us to write down mortgages to the current market value of the underlying property, but they are integral to amassing and leverage the large amounts of private capital needed to purchase these pools of delinquent notes. In New Jersey, for example, our economic model for purchasing the pools relies heavily on a blend of debt and equity, while in Florida our model can leverage a transaction comprised of almost all equity investment. The Hardest Hit Funds are this powerful in attracting private investment and giving private capital investors comfort. So much so, that as a nonprofit organization, which is able to access the Hardest Hit Funds for mortgage modifications, purchasers of delinquent pools eligible for Hardest Hit Funds, have come to us to be their loss mitigation manager for these pools. We use our ReStart model and the Hardest Hit Funding to write down the loans. We keep qualified homeowners in their homes and provide the mortgage holders with a right-sized, reperforming investment. Without a commitment of Hardest Hit Funds, our model is more difficult to administer, and our ability to manage pools for other investors is very limited.

**Q.7.** Your testimony discusses your work with loans sold by the Federal Housing Administration. Are you looking at ways to expand or pursue similar efforts, whether with FHA or other Government or private sector entities?

**A.7.** Yes, Senator. In fact, we are advocating and talking to Government-sponsored entities (GSEs), in an effort for them to allow the sale of delinquent loans via a program similar to the HUD DASP. We also continue to advocate for changes to DASP as well. While our ReStart model has shown the power of principal reduction and large-scale creation of affordable housing, we have had difficulty making headway with financial institutions in regards to direct purchases of pools of delinquent loans in their inventory. However, we hope to enter into due diligence for a mortgage pool transaction with one of the five major financial institutions in the country shortly.

**Q.8.** What lessons or recommendations would you make based on your experience with ReStart, whether for the FHA or other organizations like yours that might be interested in pursuing similar initiatives? For example, FHA and Freddie Mac have offered distressed asset sales. How could the terms and timelines for these offerings be improved to encourage more nonprofit and community lending organizations to participate?

**A.8.** This is perhaps the most important question and issue to address, Senator. It is very difficult for nonprofit organizations to participate in the loan sale programs. First, the size of the loan pools require a considerable amount of capital, which is difficult for nonprofits to raise in the time afforded. The size of the pools makes careful due diligence difficult to complete for nonprofits, and the period of time is also too short. Setting aside specific, smaller pools designated for nonprofits would help solve these two challenges. The other major challenge for nonprofits is the bid process itself. Bidding is highly competitive, and nonprofits are easily outbid by bigger capital players. Direct sales to nonprofits of these smaller, targeted pools are a simple and viable remedy. If the impetus for these loan sales is to stabilize neighborhoods, then nonprofit or proven, for-profit, mission-driven community builders are more likely to achieve the desired neighborhood stabilization outcomes. Private investors will continue to have a difficult time satisfying those neighborhood stabilization requirements. Other strategies could include giving nonprofit organizations and community lenders priority in winning bids. For example, if a qualified nonprofit does not win the bid, it could be given another, final opportunity to outbid the winning bidder, even if by one dollar, in an effort to effect more stabilization outcomes. More nonprofits and community lenders would be willing to participate in these transactions if the scale was not as large, the risk not as great, and the financial investment not as substantial. Although many nonprofits with substantial balance sheets exist, most community lenders do not belong to that category.

**Q.9.** Freddie Mac recently engaged in a bulk sale of nonperforming loans. How would you compare it with the FHA's program, in terms of neighborhood stabilization and avoiding unnecessary foreclosures?

**A.9.** We are aware of this pilot program in Detroit and Chicago, and we are very encouraged by it. In fact, we are advocating for the pilot program to be expanded to New Jersey. However, it would be premature to evaluate the outcomes and compare the pilot program to DASP.

**Q.10.** For the FHA's Distressed Asset Stabilization Program and similar initiatives, do you think neighborhood stabilization goals are in tension with the desire to maximize returns for taxpayers?

**A.10.** No, Senator, not at all. Preventing further delinquency and foreclosures is critical to halting falling home prices and greater disinvestment. Under DASP, FHA receives fair value for the delinquent assets. With additional changes to DASP, FHA could realize more neighborhood stabilization outcomes, which in turn stem further financial losses and prevent more delinquent assets from accumulating for the Government, financial institutions, and real estate investors.

**Q.11.** How can Federal programs like the Neighborhood Stabilization Program, borrower assistance programs like HAMP, HARP, and the Hardest Hit Fund be improved to spur the recovery in communities that are still struggling?

**A.11.** Senator, this is a great question. However, it requires a lengthy, detailed response.

NSP did not achieve its intended outcomes due to many factors. One of the major challenges is the significant home repair requirements for NSP, which in turn necessitate the need for a large amount of NSP subsidy dollars to realize a rehabilitation project. These requirements drive up the total development costs of the project, usually well beyond the fair market sales price for the newly renovated home. Therefore, a project only becomes viable, if the total development budget gap is filled with even more NSP subsidy dollars. This makes the program extremely inefficient and unable to achieve the scale necessary to adequately spur the economic recovery. The only reason why our organization, NJCC, has been able to efficiently use lower amounts of NSP monies is that we are able to purchase properties in bulk at a severe discount, lowering the total development costs for each project. The scale we are able to generate is not typical for other nonprofit community builders.

HAMP was structured to protect Fannie Mae and Freddie Mac loan assets. The program does not allow mortgages to be written down to the current appraised value of the home. Instead a balloon payment will become due at the end of 40 years, when homeowners will be looking to retire. So while HAMP loans can significantly reduce current monthly payments for the homeowner, in reality, the amount of the mortgage which remains underwater is exacerbated, since the "amount due on sale or refinance" will be substantially greater than the future worth of the home. Homeowners will simply be stuck, unable to sell or move to a new living situation, and can, in fact, be pursued by the GSEs for "nonpayment of amounts due." Future generations will be the ones to actually realize the losses on these past investments.

**Q.12.** Several of you discussed the importance of extending tax relief for mortgage debt forgiveness. This is an issue about which I've heard a great deal from people in my State, where many homeowners are struggling not only from the financial crisis, but also from damage inflicted by Superstorm Sandy. And when they finally receive a lifeline to address mortgage debt they are unable to pay, they risk being hit with a tax bill on phantom income that may be many times in excess of the salary they make as, say, a teacher or other profession.

Can you please describe why this tax relief is so important for families, communities, and the economy?

**A.12.** It is vitally important, Senator. As you say, the debt relief is not relief if taxes are assessed. If these struggling homeowners are taxed, the slight gain in disposable monthly income derived from the mortgage debt forgiveness cannot pay for the tax bill on this phantom income. In fact, we have had homeowners in our Re-Start program refuse a modification, because of the uncertainty around the tax extender bill. And since our trial modification plans can last longer than 12 months, we can inadvertently saddle these homeowners with a tax bill, should the relief not be reauthorized for another year. It is important that the extender bill be authorized for multiple years to provide reassurance to those homeowners lucky enough to receive mortgage debt forgiveness. Lastly, the gain or boon from the mortgage debt forgiveness should not be viewed as income for the individual, instead, I would argue, it is a boon to the local and regional economies. These homeowners can become consumers again, can address health concerns, and can provide quality food options to their children and family members. Their neighborhoods will be spared further disinvestment and decline, and the removal of the specter and fear of being forced out of your home by the sheriff eliminates a huge stress from these homeowners' lives, allowing them to regain a healthier quality of life. These are all things that should not be discounted, as they are interconnected and influence the economic recovery.

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## RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN MENENDEZ FROM MABÉL GUZMÁN

**Q.1.** For communities that are still struggling to recover from the downturn—for example, with high concentrations of distressed mortgage borrowers or homeowners with underwater mortgages—in your experience in the market, are there strategies to break the cycle of home price decline? What more can be done?

**A.1.** Only a few markets across the country are currently experiencing declining prices, but tepid price growth has been an issue in more places. Price growth has been the defining difference between markets that were underwater, but have since restored equity and those that have not. Price growth is driven by demand relative to supply. This demand is driven by economic growth and job creation. In recent years, single family investors have also played an important role in supplementing demand, but have also removed affordable inventory for first time buyers in many areas of the country.

**Q.2.** As many of you noted in your testimony, the share of homeowners with negative or low equity on their homes has been improving, but it's still elevated and the rebound has not been uniform. In cities like Newark, Paterson, and Elizabeth in my State of New Jersey, for example, the underwater rates are much higher than the national average—and many in my State who were already struggling from the financial crisis then had to deal with an additional major hit from Superstorm Sandy.

Can you please explain the impact on the housing market of homeowners who are still struggling with high debt burdens, particularly at the entry-level segment of the market?

**A.2.** Negative equity puts homeowners in a precarious situation, as it makes refinancing difficult, weakens owners' incentives, and makes owners more susceptible to events like an illness or loss of income/job that could push them into foreclosure.

In addition, owners in negative equity are less likely to trade-up, which in turn constrains the supply of available homes for the next generation of first-time or trade-up buyers. This trend has exacerbated inventory shortages in some local markets.

**Q.3.** What is the impact for the broader economy of the continuing number of homeowners with distressed mortgages? To what extent are consumers still holding back spending because of outsized debt burdens?

**A.3.** Rising home values can boost consumer spending through a "housing wealth effect." It stands to reason that falling values or negative equity can weigh on homeowners' spending decisions. Thus, negative equity can impact regional economic performance through constrained consumer spending.

Furthermore, the general negative equity environment creates uncertainty that weighs on consumers' demand for housing, builders' plans for construction, and lenders' willingness to originate. In turn, this can retard spending and hiring decisions.

**Q.4.** How can Federal programs like the Neighborhood Stabilization Program, borrower assistance programs like HAMP, HARP, and the Hardest Hit Fund be improved to spur the recovery in communities that are still struggling?

**A.4.** While the Neighborhood Stabilization Program and Hardest Hit Funds have largely played out in the States and localities, the principles of neighborhood stabilization are valid as we pursue other initiatives such as the Neighborhood Stabilization Initiative (NSI) now underway in Detroit and Chicago through the Federal Housing Finance Agency. The Chicago Association of Realtors, for example, has demonstrated a strong record of achievement in helping Chicago meet its NSP goals through helping to design strategies that make maximum use of limited resources to bring neighborhoods back.

**Q.5.** Several of you discussed the importance of extending tax relief for mortgage debt forgiveness. This is an issue about which I've heard a great deal from people in my State, where many homeowners are struggling not only from the financial crisis, but also from damage inflicted by Superstorm Sandy. And when they finally receive a lifeline to address mortgage debt they are unable to pay, they risk being hit with a tax bill on phantom income that may be many times in excess of the salary they make as, say, a teacher or other profession.

Can you please describe why this tax relief is so important for families, communities, and the economy?

**A.5.** Today, more than 5 million families remain in a home with a mortgage that is "underwater." If they hit a hardship and cannot pay their mortgage, or have to move due to a new job and sell their home, it is quite a trial to go through some kind of workout or short sale process. And even if they are successful with this process, they learn they can be subject to paying income tax on "phantom income" from their forgiven mortgage debt. This can come along at the very worst time possible, as families in this situation are very often struggling financially.

Unfortunately, the expiration of the tax provision that exempts this income from taxation encourages families to simply walk away and accept a foreclosure on their home. This harms families, neighborhoods and entire communities, and is contrary to every policy designed to keep people in their homes and prevent foreclosures.

Extending the income tax exemption on mortgage debt forgiven in a short sale or a workout for principal residences provides homeowners with certainty, allows them to make reasoned decisions about their mortgage, and provides stability to our housing markets and communities.

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## RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN MENENDEZ FROM DEBORAH GOLDBERG

**Q.1.** During the housing boom, some originators steered prime borrowers into subprime, exotic products. Can you please explain how the concentration of certain types of mortgage products or securitizations has affected a community's recovery rate?

**A.1.** The extent and nature of the steering that occurred during the boom is illustrated by several fair lending lawsuits brought by the U.S. Department of Justice against major mortgage lenders. Evidence presented in the lawsuits against Wells Fargo and Bank of America's Countrywide unit, in particular, shows that these institutions placed thousands of African American and Latino borrowers who were qualified for prime loans into more expensive, riskier subprime mortgages. [1] These subprime products had multiple risky features that made the loans unsustainable. Among these were high interest rates, high fees, frequent adjustments to the interest rate after an initial 2 or 3 year period which created rapidly escalating monthly payments, and negative amortization. As interest rates increased, many of the borrowers with such loans were faced with mortgage payments that had grown to a level they could no longer afford. Negative amortization resulted in an increase in the unpaid principal balance, despite making timely payments, and left many borrowers owing more than their homes were worth. This was exacerbated by declining home values. Selling the home, a traditional exit strategy for troubled borrowers, was not possible for those who were underwater because the sale would not bring enough money to enable them to pay off the outstanding mortgage. Some borrowers sought loan modifications, but for a variety of reasons many were unable to obtain affordable modifications and wound up in foreclosure. Five million families have lost their homes to foreclosure since 2008.

Residential segregation by race and ethnicity is widespread in this country. Thus, when African American and Latino borrowers were targeted for subprime and other exotic loans, the result was a concentration of such loans in communities of color, including high income communities of color such as Prince George's County,

[1] Details of the Department of Justice lawsuit against Countrywide are available at *http://www.justice.gov/usao/cac/countrywide.html;* details of the lawsuit against Wells Fargo are available at *http://www.justice.gov/opa/pr/justice-department-reaches-settlement-wells-fargo-resulting-more-175-million-relief.*

MD. According to the Federal Reserve Board, in 2005–2006, African American borrowers were three times more likely and Latino borrowers were 2.5 times more likely to receive a subprime home purchase loan than similarly qualified white borrowers. Borrowers of color were also much more likely to receive subprime refinance loans.[2]

Thus, while many neighborhoods have been affected by foreclosures, communities of color have been particularly hard hit due to the concentration in those communities of mortgage loans that were unsustainable from the outset. These foreclosures clearly have an enormous impact on the families who have lost their homes. They suffer significant financial losses, disruption to their lives and social networks, their children's performance in school may be affected, and a host of other problems may ensue.

However, the foreclosures also have a tremendous negative impact on the families who remain in the neighborhood. Perhaps most significant in terms of the implications for recovery is the financial impact they suffer as the result of a decline in the value of their homes. Research shows that foreclosures depress the value of nearby homes, and the effect is amplified when there are multiple nearby foreclosures. In Newburgh, NY, which has an estimated 600 vacant and abandoned properties, officials have estimated that each vacant and abandoned building reduces the value of surrounding properties by $7,000. According to their estimate, a group of 13 such properties has reduced surrounding property values by $500,000.[3] Collectively, across the many communities hit hard by the crisis, this loss of wealth is enormous. At the height of the crisis, the Federal Reserve Board estimated that declining property values had cost Americans $7 trillion in lost wealth.[4] African American and Latino households, whose wealth is disproportionately tied up in home equity, suffered the greatest loss of wealth: 53 percent and 66 percent respectively, according to research from the Pew Research Center. This compared to a 16 percent loss for white households.[5] The Center for Responsible Lending has estimated that the nearby foreclosures have drained $2.2 trillion in wealth from American homeowners, with half of that loss—$1.1 trillion—lost by homeowners in communities of color.[6]

This loss of wealth places both individual households and communities in a precarious position. As illustrated in the recent series in the *Washington Post,* "Dashed Dreams",[7] families whose mort-

[2] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data", Federal Reserve Bulletin, 2006, available at *http://www.federalreserve.gov/pubs/Bulletin/2006/hmda/bull06hmda.pdf,* and "The 2006 HMDA data", Federal Reserve Bulletin, 2007, available at *http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf.*

[3] Shantal Parris Riley, "The Housing Market Fallout Continues", *Mid-Hudson Times,* January 13, 2015. Available at *http://timesadmin.startlogic.com/wp/2015/01/the-housing-market-fallout-continues/.*

[4] Federal Reserve Board, "The U.S. Housing Market: Current Conditions and Policy Considerations", January 4, 2012.

[5] Kochhar, Rakesh, Richard Fry, and Paul Taylor, "Twenty-to-One: Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics", Pew Research Center, July 26, 2011. Available at *http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics//.*

[6] Center for Responsible Lending, "2013 Update: The Spillover Effects of Foreclosures", August 19, 2013. Available at *http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosure-spillover-effects-final-aug-19-docx.pdf.*

[7] "Dashed Dreams" a three-part series by *Washington Post* reporters Michael A. Fletcher, Kimbriell Kelly, John Sullivan, and Steven Rich, appeared on January 24–26, 2015. It is avail-

gages are underwater as the result of foreclosure-related drops in property values are stuck. Unless the loans are owned by Fannie Mae or Freddie Mac and therefore eligible for a refinance under the Federal Home Affordable Refinance Program (HARP), the homeowners are unable to refinance their mortgages to take advantage of lower interest rates because their homes are worth less than the amount of the mortgage. They are unable to move to take advantage of job opportunities elsewhere because they cannot sell their homes. They no longer have home equity that they can tap to pay for unexpected medical expenses, their children's educations, or their own retirement. They are extremely vulnerable to any disruption of income or unanticipated expense, and if such events occur, these homeowners may find themselves facing foreclosure. The tremendous loss of wealth also means they are less likely to be able to pass wealth along to the next generation, leaving their children a step behind rather than being able to offer them a leg up. This loss of intergenerational wealth means that the foreclosure crisis will have very long-lasting effects in communities of color.

At the community level, the effects of concentrated foreclosures are also felt in many ways. One is the increased burden on municipal resources to deal with the problems associated with vacant, abandoned homes. The Mid-Hudson Times story on Newburgh, NY, cited above, provides ample illustration of this problem. In Newburgh and many other places, city officials have been called on to perform a variety of duties on a more frequent basis than usual. These include cleaning out trash that is dumped on the premises of vacant homes, responding to criminal activity that takes place at those homes, putting out fires, boarding up or demolishing damaged and deteriorated properties that have become safety hazards, monitoring vacant properties on an ongoing basis, tracking down the parties responsible for upkeep, assessing fines for violations of city ordinances, and trying to collect those fines. All of these activities are expensive. At the same time, the concentrated foreclosures have brought down property values and reduced the in-flow of tax revenues that pay for these and other municipal services. This creates a drag on the community's recovery.

**Q.2.** As many of you noted in your testimony, the share of homeowners with negative or low equity on their homes has been improving, but it's still elevated and the rebound has not been uniform. In cities like Newark, Paterson, and Elizabeth in my State of New Jersey, for example, the underwater rates are much higher than the national average—and many in my state who were already struggling from the financial crisis then had to deal with an additional major hit from Superstorm Sandy.

Can you please explain the impact on the housing market of homeowners who are still struggling with high debt burdens, particularly at the entry-level segment of the market?

**A.2.** As the *Washington Post* series cited above describes so clearly, homeowners who are burdened with high debt—whether they are underwater on their mortgages and struggling to make those payments; have high levels of student, medical or other debt; or both—

able at *http://www.washingtonpost.com/sf/investigative/2015/01/24/the-american-dream-shatters-in-prince-georges-county/.*

are vulnerable to foreclosure, unable to sell their homes, and unable to purchase other homes. Rather than contributing to a well-functioning housing market, they are kept on the sidelines and their exposure to foreclosure risk can contribute to the destabilization of the housing market. In many cases, they have had their home equity stripped away by abusive mortgage practices and declines in home values. This makes it difficult for them to sell their homes because they cannot sell for a high enough price to enable them to pay off the existing mortgage. The inability to sell their home means they cannot purchase another home, either to gain more space, relocate to pursue job opportunities, or for any other reason. Their high level of debt and lack of home equity also means that they may not be able to make major repairs to their homes, potentially undermining the home's long term value. Nor can they make improvements to their homes, dampening the home improvement segment of the housing market with the jobs that it creates and its positive impact on housing values.

**Q.3.** You testified that minority communities were especially hard hit and continue to face challenges in this regard. Can you please elaborate?

**A.3.** As I stated in my testimony, communities of color were targeted for subprime and other unsustainable mortgage loans. These loans contributed to inflated housing prices in many of these neighborhoods, followed by a particularly large drop in housing prices when the bubble burst. According to Black Knight's November Mortgage Monitor, in States that have been the slowest to recover from the housing crisis, price recovery for homes in the bottom 20 percent in terms of value is lagging well behind that of homes in the top 20 percent. The report notes that, in California, properties in the top 20 percent price bracket are currently a little more than 3 percent below their precrisis peak, compared to a 32 percent lag for homes in the bottom 20 percent price bracket. Similar patterns exist in other States, as well. [8]

In NFHA's work, we have observed that homes in communities of color tend to be priced lower than comparable homes in white communities. Based on the numbers above, it appears that the recovery is slowest is communities of color, and many homeowners of color may still be underwater on their mortgages, keeping them on precarious financial footing. This is likely exacerbated by the continuing high unemployment rates for people of color. According to the Bureau of Labor Statistics, at the end of 2014 the unemployment rate for whites 16 years of age and older was 4.6 percent. For Hispanics in the same age bracket, the rate was 6.5 percent and for African Americans it was 10.5 percent. [9] The combination of loss of income due to sustained unemployment and the fall-out from abusive mortgage practices creates particularly difficult challenges for these families.

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[8] Garrison, Trey, "Black Knight: Affordable Homes Lagging Behind in Price Recovery", *HousingWire,* January 12, 2015.

[9] See "Labor Force Statistics From the Current Population Survey, Table E-16, 'Unemployment Rates by Age, Sex, Race, and Hispanic or Latino Ethnicity'", available at *http://www.bls.gov/web/empsit/cpsee_e16.htm.*

**Q.4.** What is the impact for the broader economy of the continuing number of homeowners with distressed mortgages? To what extent are consumers still holding back spending because of outsized debt burdens?

**A.4.** This excerpt from the *Washington Post* series cited above, "Dashed Dreams", captures clearly the dilemma of homeowners who are underwater and struggling to keep up with their mortgage payments. It describes a family in Prince George's County, MD, the Bryants. They bought a house in 2001 and later refinanced into a loan with terms that would no longer be permissible under the new Qualified Mortgage (QM) regulations. While the initial loan payments were affordable, the payments have more than doubled and the Bryants are struggling to keep up. Here is how the article described the impact of these unaffordable payments:

> The problem is not their income but their home. Once a source of wealth, it is now their biggest financial burden.
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> The Bryants owe just over $560,000 on their house, which they estimate is worth about $80,000 less than that. Since they moved in 2001, their monthly payment has more than doubled to nearly $3,900 a month—a predicament that arose because of an ill-advised refinancing into a loan whose terms the Federal Government now deems predatory.
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> The couple have never missed a mortgage payment. But now they are struggling to hold on. They have pulled their two preteen daughters out of private school. They bought inexpensive used cars. Instead of going on vacation last summer, they took the girls to Six Flags America, a nearby amusement park. They have little saved for college or retirement.

Multiply this by thousands of homeowners who are in the same situation and it is clear that this ongoing fall-out from unsustainable mortgage lending continues to undermine the broader economic recovery. It underscores the need for continuing assistance to borrowers who are at risk of default and foreclosure, and the importance of making principal reduction available to those whose mortgages are both unsustainable and underwater. Freeing these families from the burden of outsized, unaffordable debt would not only restore their economic security, it would speed the country's overall economic recovery and help ensure that it reaches those communities that were hardest hit by the crisis, including communities of color.

**Q.5.** As you know, the Federal Housing Administration and GSEs, like many private sector entities, are responsible for managing inventories and have engaged in sales of nonperforming loans and foreclosed properties. What policies or practices should be applied to these assets to ensure that their disposition best helps families, neighborhoods, and the overall recovery?

**A.5.** My testimony described the problems indentified through NFHA's investigation into the management and marketing of foreclosed properties in communities of color as compared to other communities. That investigation focused on bank-controlled foreclosures. Some of these are managed by various banks for Fannie Mae, Freddie Mac, or FHA, and some for other investors. In some cases the bank is the trustee, and is not directly involved in the day to day management of the properties, but is ultimately responsible to ensure that they are properly maintained and marketed on behalf of the investors. NFHA's investigation found that foreclosed properties in communities of color were much more likely to have multiple deficiencies, including unsecured doors and windows, holes in the structure, damaged or missing gutters and downspouts, accumulated trash and overgrown yards, and the like. These conditions depress the value of the individual home and the surrounding homes. They lower the municipalities' revenues from property taxes at the same time as they increase the demand for municipal services such as police, fire, health care, and others. They create a host of health and safety problems for the community.

NFHA's report, which was attached to my testimony, outlines a series of policy recommendations to improve the maintenance and marketing of these properties and minimize their negative impact on the communities in which they are located. Freddie Mac has adopted many of these recommendations, and the benefits can be seen in the good condition of the foreclosed properties it owns. Some banks also have effective systems for managing their foreclosed properties, but many do not. FHA's protocols require their asset managers to maintain the yards of FHA's foreclosed properties, but prohibit them from making repairs to the structures themselves, which can result in deterioration of those properties. The lack of industrywide standards and strong oversight by the Federal regulators means that, in too many cases, foreclosed properties in communities of color are blighted, linger on the market too long, and end up in the hands of investors rather than owner-occupants. The Federal Housing Finance Agency, Fannie Mae, FHA, and many banks have not yet taken the necessary steps to institute the kind of REO management policies that will help ensure that communities of color are not left behind in the recovery from the foreclosure crisis.

Similarly, Fannie Mae, Freddie Mac, and FHA all control sizeable portfolios of nonperforming loans. These are loans that are seriously delinquent but have not yet gone through foreclosure. The GSEs have some $100 billion of such loans between them,[10] and as of year-end 2014, FHA had more than 500,000 such loans.[11] From one perspective, these nonperforming loans are a drag on the balance sheets of FHA and the GSEs, and they have an interest in disposing of these loans in order to shore up their financial condition and protect American taxpayers. Experience to date suggests that there is considerable investor interest in the bulk purchase of these loans, which are being offered below par.

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[10] Chrisman, Rob, "Non-Performing Loan Market on Fire; Rates Back to June 2013 Levels but Production May Drag", Aug. 18, 2014, available at *http://www.mortgagenewsdaily.com/channels/pipelinepress/08182014-interest-rates-mortgages.aspx.*

[11] See U.S. Department of Housing and Urban Development, Office of Risk Management and Regulatory Affairs, Office of Evaluation, Reporting and Analysis Division, "FHA Single Family Loan Performance Trends: Credit Risk Report", December, 2014. Available at *http://portal.hud.gov/hudportal/documents/huddoc?id=FHALPT_Dec2014.pdf.*

The disposition of these nonperforming loans has a broader impact, however. In addition to affecting the bottom line for FHA and the GSEs, the way they are handled also affects the homeowners who have been struggling to make their mortgage payments, the value of the surrounding homes, and the likelihood of default of other loans in those communities, some of which are also guaranteed or insured by FHA and the GSEs. Given these larger impacts, it makes sense to approach the disposition of these nonperforming loans with two goals: reducing potential losses and stabilizing communities. Both of these are of equal importance, and in order to accomplish both goals, both must be built into the design of the asset disposition programs.

To date, FHA has taken modest steps toward this second goal in a small subset of the sales conducted through its Distressed Asset Stabilization Program, or DASP, launched in 2010. As FHA notes in the May 30, 2014, quarterly report on the program, its single family loan sales program, "maximizes recoveries to the MMI funds, reduces claims costs, minimizes the time that the assets are held by FHA, and helps keep borrowers—otherwise headed to foreclosure—in the home. The program also serves as part of FHA's effort to target relief to areas experiencing high foreclosure activities. For purchasers, the program is an opportunity to acquire assets at competitive prices with the flexibility to service the assets while providing borrowers an opportunity to avoid costly foreclosures." [12] In other words, FHA expects that the purchasers of the distressed loans, who have purchased the loans at a significant discount, have the financial incentive and opportunity to offer affordable loan modifications under terms not otherwise permitted by FHA regulations, such as principal reduction. The reports from the field mentioned below indicate that this objective is not being met.

As of May 30, 2014, FHA had sold 71,231 loans through the DASP program, with an approximate aggregate unpaid principal balance of $12,263,325,938. Many of these loans are still unresolved. Of those where an outcome has been reached, 31 percent have gone through foreclosure, 35 percent have been sold to other investors and no information about their current status is available, and the remaining 34 percent have been resolved in a manner that avoided foreclosure. Eleven percent of the loans in this last category are reperforming, the rest have had short sales, deeds-in-lieu or similar outcomes. In other words, this part of the program has had minimal success in helping homeowners save their homes.

Beginning in 2012, FHA instituted the sale of so-called Neighborhood Stabilization Outcome (NSO) pools of loans. In these pools, the terms of the sale specify that, for at least 50 percent of the loans in each NSO pool, the investor must resolve the delinquency through one of a series of allowable nonforeclosure outcomes. Among these are reperformance, rental to a borrower, gift to a land bank, or payoff of the loan. As of May 30, 2014, FHA had sold 17,828 loans with an approximate aggregate unpaid principal balance of $3,164,052,483 in NSO pools. The experience with these loans is more limited than with the national pools, both because of

[12] U.S. Department of Housing and Urban Development, Federal Housing Administration, "Quarterly Report on FHA Single Family Loan Sales", available at *http://portal.hud.gov/hudportal/documents/huddoc?id=report082814.pdf.*

their fewer numbers and the shorter time since the launch of the program. So far, however, the outcomes appear significantly more promising than those of the other sales. FHA has reported results on three of the NSO pools, and for those three, of the loans that have been resolved, 27.7 percent, 20.6 percent, and 17 percent respectively are reperforming, meaning that the borrower is once again making mortgage payments. These are substantially better outcomes than those achieved by the national pools.

FHA should build on the early successes of the NSO pools to ensure that more of the borrowers in its defaulted loans are able to save their homes or otherwise avoid foreclosure. To accomplish this, it should adopt the following measures:

- *Ensure that loans are not sold through the DASP program before all required loss mitigation steps have been completed.* There have been reports from housing counselors and borrowers' attorneys in the field about clients who were in the middle of loss mitigation only to be told that their loans had been sold, were no longer FHA insured, and that their pending loan modification could not move forward. FHA should expand its oversight on this issue to confirm, prior to including a loan in the DASP pool, the accuracy of the servicers' certification that they have complied with all loss mitigation requirements. In addition, FHA should conduct more extensive quality assurance on loans that will be included in DASP pools to ensure that servicers have completed the waterfall analysis required under FHA's loss mitigation rules. Further, to aid FHA in its quality assurance protocol, before any loans are sold through the DASP program, the homeowners should receive a notice of the impending sale. The notice should inform them of the servicer's determination that all FHA loss mitigation options have been exhausted and give them an opportunity to rebut the servicer's certification, provide information about the process and the obligations of the servicer, and include an explanation of their rights.
- *Apply neighborhood stabilization requirements to all pools.* The early experience with the NSO pools suggests that many more homeowners are able to save their homes when this program goal is made explicit. This outcome benefits benefit of the homeowner, the community and the investor. It is important to note that incorporating neighborhood stabilization outcome requirements into the program has not resulted in any negative impact on the price for which the loans were sold. In other words, there is no conflict between stabilizing neighborhoods and shoring up the FHA insurance fund. It makes sense, therefore, to adopt neighborhood stabilization requirements for all of the DASP pools.
- *Strengthen the requirements for neighborhood stabilization outcomes for loans sold through DASP.* This should include setting out standards for what constitutes an affordable loan modification—including the use of principal reduction, and increasing the percentage of loans in any pool that should receive sustainable modifications. In cases where no modification is possible, the priorities should be selling the home to another owner-oc-

cupant or making it available as affordable rental housing for low- and moderate-income households.

- *Take steps to make it possible for mission-driven community-based organizations to purchase more loans through DASP.* This may mean creating smaller pools that are more affordable for organizations with limited access to capital, including in the bidder qualifications a requirement that the bidder demonstrate capacity and commitment to meeting neighborhood stabilization objectives, and helping to develop additional sources of capital available to qualified community-based organizations for the purchase of nonperforming loans.
- *Increase program transparency.* To facilitate oversight and accountability, FHA should collect and publish information on program outcomes on a regular basis. This should include loan-level data on borrower demographics, the geographic location of the loans, and more detail on post-sale resolutions. In particular, it is important to capture information on the current status of the loans and any changes to the loan terms, including interest rate reductions, principal forgiveness or forbearance and term extensions, along with post-modification debt-to-income ratios. There have been reports from the field of DASP borrowers being required to become current before being eligible for a loan modification, being required to make an upfront payment of thousands of dollars, and being offered modifications that do not result in affordable monthly payments. Such modifications are not affordable or sustainable, and having more detailed information about the terms that borrowers are being offered will help to weed out such practices. In addition, it is important to track any differences in the modifications offered or outcomes achieved based on borrower characteristics or geographic location in order to ensure that the program is operating in a fair and nondiscriminatory fashion.

As noted in my testimony, Freddie Mac conducted one sale of nonperforming loans this past summer. To date, Fannie Mae has not followed suit, but between them, the GSEs have some $100 billion of nonperforming loans on their books and indications are that they are likely to conduct more sales in the future. Little information is available publicly about the details of the Freddie Mac sale, but it does not appear that the terms of the sale incorporated any of the principals described above. If there are further sales of nonperforming loans by either GSE, they should adopt the kinds of neighborhood stabilization goals outlined here.

**Q.6.** Several of you discussed the importance of extending tax relief for mortgage debt forgiveness. This is an issue about which I've heard a great deal from people in my State, where many homeowners are struggling not only from the financial crisis, but also from damage inflicted by Superstorm Sandy. And when they finally receive a lifeline to address mortgage debt they are unable to pay, they risk being hit with a tax bill on phantom income that may be many times in excess of the salary they make as, say, a teacher or other profession.

Can you please describe why this tax relief is so important for families, communities, and the economy?

**A.6.** Mortgage debt forgiveness is particularly important for creating sustainable mortgages for families who are not only delinquent on their mortgages or at imminent risk of default, but who are also underwater (that is, they owe more on their mortgages than their homes are worth). These families are highly vulnerable financially. A loan modification that reduces their interest rate and/or mortgage payment may not be enough to restore their financial stability. As long as they remain underwater, they remain at risk of default and foreclosure if they face future financial difficulties, such as the loss of a job, reduction in hours or income, or medical or other unexpected expenses. A family in this situation cannot sell its home to move for a job opportunity, to get a bigger house as the family grows or for any other reason. Nor can it sell its home to get out from under the debt burden, because the home cannot be sold at a price high enough to pay off the existing mortgage. Such families face extremely limited geographic and economic mobility. For them, a loan modification that includes principal forgiveness is a lifeline that can secure their financial stability and economic mobility. However, if they incur significant tax liability on that principal forgiveness, it may be impossible for them to afford to accept the loan modification. They remain vulnerable and financially stressed.

Communities with significant numbers of families in this situation may have a harder time recovering from the recession. The economy also suffers when such families and communities are economically constrained.

Congress has an important role to play in solving this problem. To date, it has only provided limited and temporary relief from tax liability associated with principal forgiveness obtained through 2014. More families would be able to take advantage of loan modification offers that include principal forgiveness, and thereby regain their financial footing, if the relief were made permanent, and if it applied to all mortgage debt rather than only debt that was incurred to "buy, build, or substantially improve" the borrower's principal residence. This limited definition of debt in the Mortgage Forgiveness Debt Relief Act does not include loan modifications on investment properties, such as those offered in the Home Affordable Modification Program (HAMP Tier 2). Nor does it cover all refinance debt for a primary residence—debt that was often incurred in predatory loan transactions. In addition, most homeowners are not aware that debt forgiven in a short sale, deed in lieu of foreclosure, or an uncollected deficiency after foreclosure can also give rise to potential taxable income. Thus, the foreclosure prevention options that can help stabilize communities, such as modifications, short sales and deeds in lieu of foreclosure that involve principal forgiveness, can ultimately harm borrowers who believe they have made a fresh start but later learn that they face a significant income tax liability despite having resolved the mortgage matter. Congress should move quickly to pass the Act on a permanent basis, expanding the range of loans to which it applies, as described above.