Statement of
The Honorable David H. Stevens
President and Chief Executive Office
The Mortgage Bankers Association

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

"New Ideas for Refinancing and Restructuring Mortgage Loans"

September 14, 2011

I. Introduction

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

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

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

I am encouraged by the fact that the focus of today's hearing is toward the future and the role that private capital can play in recovering from this extraordinary collapse of the housing market. MBA is grateful for the variety of relief efforts undertaken by Congress and two administrations to bolster the markets such as the Home Affordable Refinance Program (HARP), first-time homebuyer tax credits, and the Hardest Hit Funds. Clearly, the challenge is greater than these programs could support on their own. The private sector also has risen to the challenge of

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

assisting borrowers in need by refinancing approximately four million mortgages – five times as many as all federal programs combined. This is why MBA believes a long-term sustainable remedy will only come from a return of private capital to the housing finance sector.

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

I also want to highlight the fact, as shown in recent MBA data on delinquencies and foreclosures, that the foreclosure overhang is heavily concentrated in just a handful of states. This has important policy implications because more aggressive measures may be required in some areas, while they may not be needed in others. For example, bulk sales of real estate owned (REO) properties may be necessary and helpful in severely impacted markets, but may be harmful in markets that are currently muddling through. Different prescriptions may be needed in different geographies.

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

II. Obstacles to Recovery

Obstacle 1: High Unemployment

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

- Economic growth was disappointingly slow in the first half of 2011, and job growth essentially halted during the summer.
- The unemployment rate remained stuck at 9.1 percent as of August, as no new jobs were created during the month. Private sector job growth remains weak, while state and local governments continue to cut back employees.
- MBA expects the unemployment rate to be little changed through the remainder of 2011, and only slight declines in the unemployment rate in 2012, decreasing to 8.8 percent by the end of 2012.

- MBA forecasts economic growth to run at 1.3 percent for 2011, and 2.2 percent for 2012 - barely enough to bring down the unemployment rate over time.
- On the housing front, we expect the purchase market will remain slow. In short, the key obstacle to a more robust market continues to be unemployment.

Obstacle 2: Conflicting Policy Objectives

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

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

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

Obstacle 3: Regulatory Uncertainty

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

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

Obstacle 4: Repurchase and Litigation Risk

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

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

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

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

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

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

Obstacle 5: Inconsistent Foreclosure Regimes

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

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

Obstacle 6: Excess Housing Inventory

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

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

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

III. MBA's Recommended Solutions

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

<u>Solution 1: Restructuring Existing Mortgages</u>

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

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

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

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

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

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

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

<u>Solution 2: REO Inventory Sales</u>

Of the excess inventory on the market a significant number of properties are bank owned, or real estate owned (REO), properties. In August, the FHFA, in consultation with the Department of Treasury (Treasury) and HUD, released a request for information (RFI) soliciting input on new

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

options for selling single-family REO properties held by Fannie Mae, Freddie Mac, and FHA. To respond to the RFI, MBA formed an interdisciplinary REO Asset Disposition Working Group of industry practitioners with expertise in this area.

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

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

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

For example, FHA should introduce an investor program, specifically one that includes a renovation option. One solution would be to temporarily lift the moratorium on investors participating in the Section 203(k) Rehabilitation Loan Program. The FHA Section 203(k) Rehabilitation Loan Program helps buyers of properties in need of repairs reduce financing costs, thereby encouraging rehabilitation of existing housing. With a Section 203(k) loan, the buyer obtains one FHA-insured, market-rate mortgage to finance both the purchase and rehabilitation of a home. Loan amounts are based on the lesser of the sum of the purchase price and the estimated cost of the improvements or 110 percent of the projected appraised value of the property, up to the standard FHA loan limit.

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

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

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

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

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

[3] Fannie Mae, Loan-Level Price Adjustment (LLPA) Matrix and Adverse Market Delivery Charge (AMDC) Information, 12.23.2010, 2011.

700, the investor must pay another one point. Thus, a typical investor's rate could be seven percent to 7.5 percent even in this historically low rate environment.

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

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

Bulk sales should incorporate mandatory hold or recapture provisions.

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

- <u>Mandatory Hold Period</u> – One of the objectives of the RFI is to remove the significant numbers of REO from the market that are placing enormous downward pressure on home prices. Ideally, converting these homes to rental properties removes at least some of the REO supply from the market and helps improve the stock of affordable rental housing. To increase the likelihood that REOs sold to investors actually become rental properties and do not simply get flipped, we suggest that Fannie Mae, Freddie Mac, and FHA consider a mandatory hold period of three years. Such a hold requirement could be managed through deed restrictions. We recognize, however, those deed restrictions may reduce the pool of bidders or negatively impact bid prices.

- <u>Profit or Equity Sharing</u> - Profit sharing would allow Fannie Mae, Freddie Mac, and FHA to share in gains on sales of REO properties later sold by the investor. MBA prefers equity sharing provisions over mandatory hold periods because it allows more asset liquidity. Such equity sharing could be structured as a waterfall so that Fannie Mae,

[4] Freddie Mac Seller Servicer Guide, 22.22.1.
[5] Fannie Mae Seller Servicer Guide, B2-2-03.

> Freddie Mac, and FHA would share in a greater percentage of the profit from sales in earlier years. The equity sharing should decrease incrementally over a period of time, such as three to ten years. The equity sharing concept might be preferable over a mandatory hold period because it allows the investor to sell homes at any time when the housing market improves more rapidly than anticipated or for other liquidity purposes, but protects the Fannie Mae, Freddie Mac, and FHA against fraud in valuation (e.g. flopping). Importantly, terms of the waterfall may be unique to each bulk deal, with clearly defined terms outlined in the prospectus of the deal and the bidding process, and an open and transparent bidding process. Profit or equity sharing should not apply if companies sold the homes to a related company, to achieve balance sheet management for example. MBA notes that equity sharing agreements currently exist in the market, so model agreements are readily available.

Evaluate Capital Gains Treatment

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

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

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

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

Create Incentives for Investors to Rehabilitate REO Properties

MBA estimates that 30-40 percent of the existing REO properties require significant renovation. A focus of the RFI is to address housing needs in strong rental markets by turning REO properties into safe rental properties for families who are no longer homeowners. MBA is concerned that REO properties will transfer from the government's balance sheet to the private sector's balance sheet without addressing the goals of the RFI. MBA is also mindful of over-interference by the government in an already highly regulated market and does not want to suggest program restrictions that constrain the investor or are cumbersome for the government to administer.

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

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

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

IV. Implementation Logistics

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

V. Conclusion

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