September 20, 2011 Laurie S. Goodman / lgoodman@amherst.com / 212.593.6026

9/20/2011 Testimony of Laurie S. Goodman, Amherst Securities Group to the Subcommittee on Housing, Transportation and Community Development of the Senate Committee on Banking, Housing and Urban Affairs Topic— New Ideas to Address the Glut of Foreclosed Properties

Mr. Chairman and Members of the Subcommittee, thank you for your invitation to testify today. My name is Laurie Goodman, and I am a Senior Managing Director at Amherst Securities Group LP, a leading broker/dealer specializing in the trading of residential mortgage-backed securities. I am in charge of the strategy and business development efforts for the firm. We perform extensive, data-intensive research as part of our efforts to keep ourselves and our customers informed of critical trends in the residential mortgage backed securities market.

One of the trends that we have documented is a very significant supply/demand imbalance in the housing market. Distressed loans are moving very slowly through the delinquency/foreclosure pipeline. These loans weigh heavily on the residential real estate market, and are often referred to as shadow inventory. In addition, many of the borrowers that are not delinquent on their loans have a tainted credit history and/or are seriously underwater, suggesting more defaults to come. Thus, there are many distressed homes that will need to change hands over the next 5–6 years. At the same time, mortgages are becoming increasingly difficult to obtain. Overall credit availability is tightening and the pool of qualified mortgage applicants is shrinking dramatically. A large number of borrowers who are delinquent on their current mortgage, and do not have the financial means to purchase another home, are likely to convert to renters. Despite this cloud surrounding the mortgage market, we see housing as very affordable by most traditional measures.

Given this backdrop, we believe that long-term investors in 1–4 family residential real estate are the key to a housing recovery: they are the only potential buyers of many distressed homes that are likely to hit the market over the next 5–6 years. Investors need to be part of the solution.

At the same time, this is a good business opportunity for interested investors to rent the distressed homes as the rental market strengthens. Given the large decline in home prices, rental yields are high enough now to attract a limited amount of private capital. With modest governmental action (not assistance), more private investment capital can be attracted to this market, helping to stabilize home prices, neighborhoods and communities, and very importantly, ensure that the housing needs of the distressed homeowners and their families are met. In fact, my firm, Amherst Securities Group LP, along with several of our partners, has successfully launched such a program. In the final section of this testimony, we present our views as to the best way for the government to structure increased investor participation in the market; these views are firmly grounded in our analysis of the problem.

Sizing the Problem

Many analysts looking at the housing problem mistakenly assume it is limited to loans that are currently non-performing (we use 60+ days past due as our definition of non-performing). Such borrowers have a high probability of eventually losing their homes. However, the problem also includes loans with a compromised pay history; these are re-defaulting at a rapid rate. We define these re-performers as loans that were at one point 60+ days delinquent, but no longer are.

Moreover, borrowers with good pay histories who are substantially underwater have shown that they, too, have a reasonable probability of transitioning to default (going 60+ days delinquent).

Let's review the scope of the housing problem. An understanding of this will allow market participants and policy makers to put our supply/demand imbalance numbers in perspective.

In Exhibit 1 (below) we have outlined our methodology for estimating the total supply of homes which may be subject to distressed sales over time. We show both a number we view as reasonable as well as a "lower bound" estimate. To derive these results, we classify the outstanding loans into five groups. In total, we estimate that there are approximately 80 million homes in the US, 55 million of which have a mortgage. Of these 55 million mortgages, there are 4.5 million non-performing loans (NPLs), 3.9 million re-performing loans, 2.6 million always performing loans with a mark-to-market LTV (loan-to-value) ratio >120, 5.4 million always performing loans with a mark-to-market LTV of 100-120, and 38.6 million always performing loans with a mark-to-market LTV of ≤100. To size the problem, we focused on the eventual default rate of each group of loans. Our methodology is detailed in the Appendix.

Our results indicate if no changes in policy are made, 10.4 million additional borrowers are likely to default under our base "reasonable" case, and 8.3 million borrowers will default under our lower bound numbers. Since there are 55 million homes carrying mortgages, 10.4 million borrowers roughly equates to 1 borrower out of every 5. This includes 4.1 million of the 4.5 million borrowers who are already non-performing; the remainder of defaults will come from borrowers current on their loans, but who are likely to eventually default. Many in this group (2.5 million) represent re-performing loans that history suggests are very prone to another default.

Exhibit 1: Sizing The Crisis

	DQ Status	Number of Loans	% of Loans	Total Balance	% by Balance	WA MTM LTV	3Mo cTr	3Mo vPr	3Mo D/TV
Total	NPL	4,517,820	8.2%	934,226,036,870	9.9%	117.8	-	-	-
Total	RPL	3,863,756	7.0%	661,639,607,498	7.0%	105.2	47.2%	2.6%	94.7%
Total	APL >120 MTM LTV	2,646,578	4.8%	518,227,067,100	5.5%	140.9	13.8%	5.0%	73.6%
Total	APL 100-120 MTM LTV	5,351,340	9.7%	1,047,433,214,477	11.1%	110.7	7.0%	7.0%	49.9%
Total	APL <=100 MTM LTV	38,574,077	70.2%	6,309,815,808,405	66.6%	68.6	2.4%	13.3%	15.4%
Grand Total		**54,953,570**		**9,471,341,734,350**					

			Estimated Default Rate		Number of Homes in Jeopardy	
	DQ Status	Total Number of Loans	Lower Bound Estimate	Reasonable Estimate	Lower Bound Estimate	Reasonable Estimate
Total	NPL	4,517,820	80%	90%	**3,614,256**	**4,066,038**
Total	RPL	3,863,756	50%	65%	**1,931,878**	**2,511,441**
Total	APL >120 MTM LTV	2,646,578	25%	40%	**661,644**	**1,058,631**
Total	APL 100-120 MTM LTV	5,351,340	10%	15%	**535,134**	**802,701**
Total	APL <=100 MTM LTV	38,574,077	4%	5%	**1,542,963**	**1,928,704**
Grand Total				**Total**	**8,285,875**	**10,367,515**

- The estimated default rates used in the "reasonable" calculation are more conservative than what is currently being experienced
- Assumes no change in overall housing prices, interest rates, or new home construction

Legend:
NPL = Non-Performing Loans
RPL = Re-Performing Loans
APL = Always Performing Loans
Non-PLS = Agency/Portfolio Loans
PLS = Private Label Securitized Loans

cTr = Annualized Monthly New Default Transition Rate
vPr = Annualized Voluntary Prepay Rate
D/TV = cTr / (cTr + vPr)

* - CoreLogic reports on approximately 60% of the non-PLS universe, which is extrapolated to the entire mortgage market

Source: CoreLogic, Amherst Securities as of August 2011

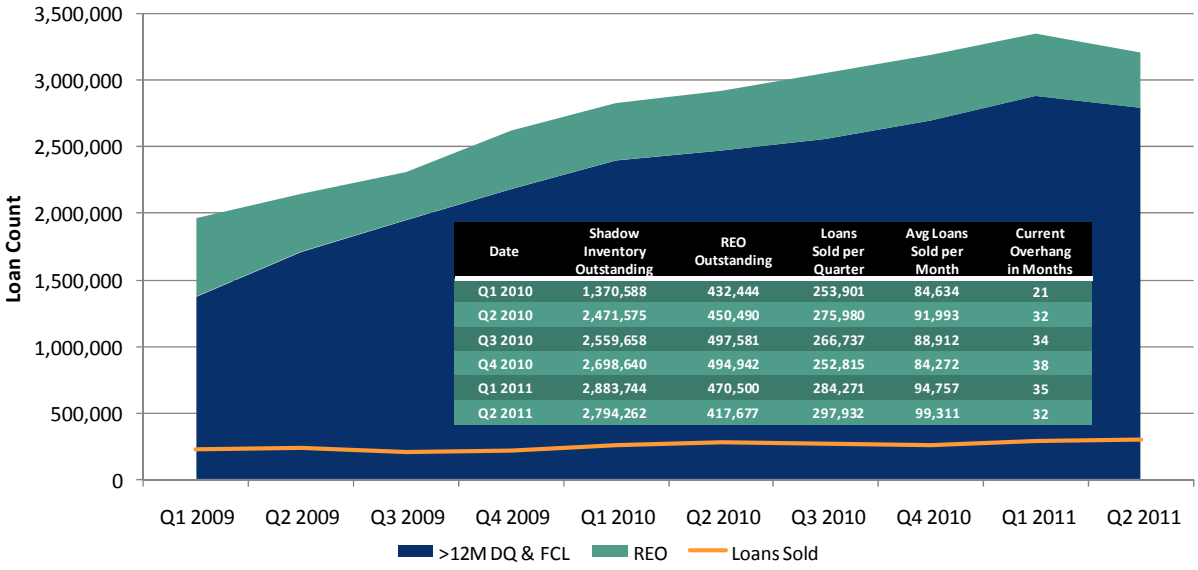
Supply/Demand Imbalance

In today's market, precisely when we have a large number of loans that will need to liquidate, liquidations are quite slow. Exhibit 2 (below) shows that we are liquidating roughly 95,000–100,000 loans every month. Even if we define the shadow inventory very narrowly (as homes that are >12 months delinquent or in foreclosure), we find that there are 2.8 million units, with another 400,000 plus units in REO, which raises total shadow inventory to 3.2 million units. So, if we are liquidating 100,000 loans/month, it will take 32 months (or 2.7 years) just to liquidate what is already ≥12 months delinquent. However that overlooks loans that are <12 months delinquent, as well as re-performers, that have a high chance of eventual default, or "always current" loans that are deeply underwater.

As we have demonstrated, the supply/demand imbalance is caused not just by the loans in REO, but the seriously delinquent loans behind them, and the borrowers that are paying on underwater mortgages behind that. ***We believe that any comprehensive solution should include a plan to deal with non-performing loans as well as loans in REO.***

To put these numbers in context and calculate the supply/demand imbalance, we have taken a very simple view of the market, as shown in Exhibit 3 (next page). For the supply side, let's use our estimate of the 8.3–10.4 million defaulters as a starting point. Assuming that these defaults occur over 6 years (an admittedly arbitrary assumption), this suggests a range of 1.38 (8.3/6) to 1.73 (10.4/6) million units defaulting yearly. Adding 500,000 units of new 1–4 family construction gives us 1.88–2.23 million units of total supply. [Over the last 2 years, 1–4 family housing completions has totaled approximately 500,000 units per year, we use this number as our going forward estimate. This is much higher than new home sales, as new home sales include only homes that are built for sale. New home sales does not include custom

Exhibit 2: Growth—Shadow Inventory



Date	Shadow Inventory Outstanding	REO Outstanding	Loans Sold per Quarter	Avg Loans Sold per Month	Current Overhang in Months
Q1 2010	1,370,588	432,444	253,901	84,634	21
Q2 2010	2,471,575	450,490	275,980	91,993	32
Q3 2010	2,559,658	497,581	266,737	88,912	34
Q4 2010	2,698,640	494,942	252,815	84,272	38
Q1 2011	2,883,744	470,500	284,271	94,757	35
Q2 2011	2,794,262	417,677	297,932	99,311	32

- Despite Liquidations averaging 90k loans per month, since January 2009 the balance of the Shadow Inventory (loans greater than 12 months DQ, loans in foreclosure and REO properties) has increased by an average of 60k loans each month
- These figures DO NOT include any contribution from borrowers less than 12 months DQ, who have a very substantial chance of entering the Shadow Inventory over the next year, or re-performing borrowers, who have a reasonable chance of becoming delinquent again over the near term
- Current Overhang = (Shadow Inventory Outstanding + REO Outstanding) divided by Average Loans Sold Per Month

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, FDIC, Fannie Mae, Freddie Mac, FHA, Amherst Securities as of August 2011

Exhibit 3: Mortgage Market Math: Supply/Demand Gap

- 10.40 million homes are at risk of default over the next 6 years. Even if we try to be extremely conservative we can't get the number below 8.3 million units.

Estimate of Supply (per Year)	
	1.38 – 1.73 million distressed units per year
+	0.50 million units new construction
	1.88 – 2.23 million units total annual supply
Estimate of Housing Demand (per Year)	
	0.60 million demand due to demographics (1.20 million housing formation x 0.50 home ownership)
	0.40 million obsolescence
+	0.20 million second home purchase
	1.20 million units total annual demand
	1.88 – 2.23 million total supply per year
-	1.20 million total demand per year
	0.68 – 1.03 million units net annual supply
Over the next 6 years:	
	4.1 – 6.2 million units

- To solve the housing crisis you must create **4.1 to 6.2 million units** of housing demand over the next 6 years.

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, US Census Bureau, Amherst Securities as of August 2011

homes in which the homeowner buys the land, and works with a general contractor, or acts as his own general contractor to build a home. It also does not include homes built to rent out.]

The demand side of the equation is more difficult. Household formation has been very low in recent years. Census data (The Current Population Survey/Annual Social and Economic Supplement) indicates that the rate of household formation from 2007–2010 is about 500,000 units. This is very low by historical measures. The average rate of household formation for the period 2000–2010 was 1.3 million units per year. It was 1.0 million units per year during the 1990s. We assume a more normal household formation rate of 1.2 million units annually. The Joint Center for Housing Studies of Harvard University in their State of the Nation's Housing, 2011, has estimated that out of the nearly 12 million units of expected household formation over the 2010–2020 period, 7 out of 10 will be minorities, whose home ownership rate has been historically lower. Note that we used a very generous number (50%) for demand from new households. We add to this the 400,000 units that will become obsolete each year and 200,000 second home purchases. This gives us 1.20 million (600K + 400K + 200K) units of total annual demand. So, excess supply is 0.68 to 1.03 million units/year (1.88 to 2.23 million units of total supply—1.2 million units of total annual demand). Thus, over the next 6 years, excess supply will total 4.1–6.2 million units.

It is important to realize that the problem is not over-building, it is quite simply that there are fewer families that can and want to own a home than there are homes for sale. While overbuilding played a role in the initial downturn in the market in 2006–2007, 3.5 years of very limited new home construction has brought the supply and demand for newly constructed housing into balance. Over the 10-year period from 2001–2010, new home construction + placements of mobile homes was about 16 million units, averaging 1.6 million units per year; assuming that 300,000 units per year were lost to obsolescence over this period, that will roughly balance the 1.3 million new households per year that were formed over the period.

The supply/demand imbalance is not uniform nationwide. There are some areas in which the housing market is relatively healthy, and other areas in which the problem is much worse than the national average.

Tightening of Credit Standards

The supply/demand imbalance is exacerbated by the tightening credit standards for new GSE origination, as demonstrated by ever-higher FICOs and ever-lower LTVs. To a large extent credit availability has been choked off. A few exhibits will make this very clear. Exhibit 4 (below) shows that of the 55 million borrowers with a mortgage in June 2007, 19% of those homeowners would not qualify for a mortgage today due to pay history. That is, 5% of the borrowers have defaulted on their mortgage, and the home has been liquidated. Another 14% have reached 90+ days delinquent. Taking out 19% of all borrowers at a time when increased demand is needed is likely to have adverse consequences. In addition, many Americans that want to buy a home despite the fact that home prices could decline further will either not have the necessary down payment or will lack the high credit score now required for home ownership. Exhibit 5 (below) shows that average LTV ratio is 67% and the average FICO (Fair Isaac Corporation) score for new GSE origination (excluding HARP loans) was 762 for 2009 and 2010.

Exhibit 4: Supply & Demand Function of Housing = Broken

Status since June 2007	Loan Count	% of Loans
Prepaid	19,892,400	36%
Never 90 days DQ	24,549,503	45%
Reached 90+ DQ	7,400,774	14%
Defaulted	2,954,733	5%
Total Outstanding Residential Mortgages as of June 2007	54,797,410	100%

Based upon payment history of mortgages originated before June 2007,

***19%** of all homeowners **NO LONGER QUALIFY** for a mortgage loan based solely upon Payment History.*

Source: CoreLogic, Amherst Securities as of August 2011

Exhibit 5: GSE & Bank Portfolio Loans Exhibit Similar Origination Characteristics (2009/2010 originations)

	Orig. LTV	Orig. FICO	Balance ($MM)	% Purchase	% Conforming Fixed	% Jumbo Fixed	% Conforming ARM	% Jumbo ARM
GSE	67	762	1,373,034	19.8	95.5	0.0	4.5	0.0
Bank Portfolio	66	756	77,784	27.7	47.2	19.8	8.4	24.6

	Orig FICO				
	< 700	700 to 750	>=750	Missing	Total
GSE	8.2	21.7	67.5	2.6	100.0
Bank Portfolio	11.1	22.0	66.2	0.7	100.0

	Orig LTV				
	<=70	70 to 80	80 to 90	> 90	Total
GSE	48.5	37.0	8.5	6.0	100.0
Bank Portfolio	53.6	34.3	4.3	7.8	100.0

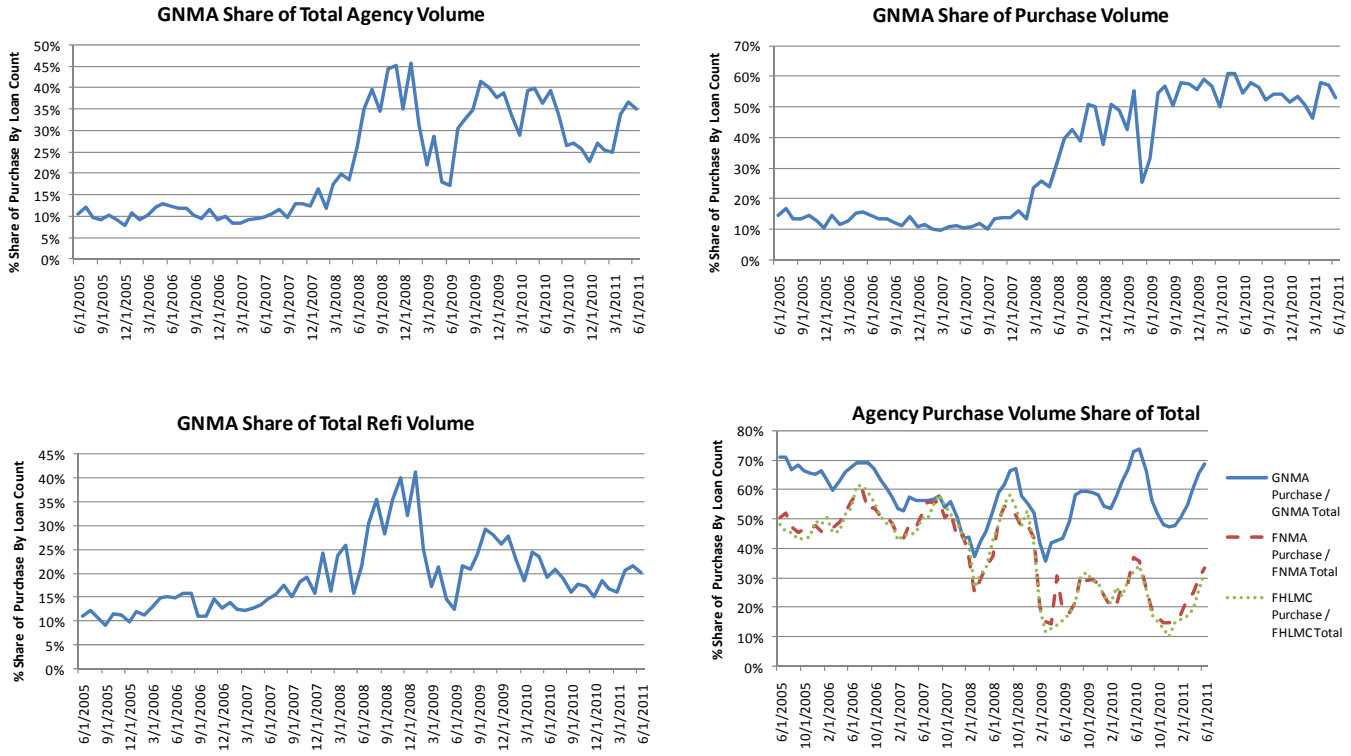
Source: Source: CoreLogic Prime Servicing Database, Amherst Securities as of August 2011

Do bank portfolios have more relaxed standards? Are they absorbing loans that would not be GSE-qualifying? Exhibit 5 illustrates the banks are not filling the gap. Bank portfolio origination standards do not differ significantly from those for GSE loans. That is, versus GSE loans, bank portfolio loans on average tend to have a marginally lower average FICO score (756 for bank portfolio loans, 762 for GSE loans), and a marginally lower average LTV (66 for bank portfolio loans, 67 for GSE loans).

How are purchase borrowers meeting GSE guidelines? The short answer is that they are not meeting the guidelines. The top left section of Exhibit 6 (below) shows that the GNMA share of total Agency volume [GNMA/ (GNMA + Fannie Mae + Freddie Mac)] has been running around 30–35%. GNMA mortgage-backed securities are comprised primarily of FHA and VA loans. The top right section of the exhibit shows that the GNMA share of purchase volume has consistently ranged 50–60%. The bottom left section shows that GNMA share of refinance (refi) volume has been 15–20%. Thus, GNMA is a far larger part of the purchase market than of the refi market. The best way to look at the relative amount of purchase activity is shown in the bottom right section. GNMA purchases comprise 60–70% of total GNMA activity. Freddie and Fannie purchase comprises 20–30% of total Freddie and Fannie activity. Thus, FHA/VA loans, which comprise GNMA pools, are the main mortgage vehicle used for home purchases. Fannie Mae and Freddie Mac process mostly refi loans.

Almost every single proposed governmental action has been aimed at further tightening credit availability. HUD is considering tightening the DTI (Debt to Income ratio) requirements on FHA loans. FHFA has observed that lower credit mortgages are subsidized by their higher credit counterparts (FHFA Report "Fannie Mae and Freddie Mac Single-Family Guarantee Fees" dated July 2010). It seems inevitable that loan level pricing adjustments will rise further. And the proposed Dodd Frank rules implementing the Qualified Residential Mortgage (QRM) and Qualified Mortgage (QM)

Exhibit 6: GNMA Has Become The Major Outlet For Purchasing A Home (%s are in loan count terms)



Source: Freddie Mac, Fannie Mae, Ginnie Mae, Inside MBS & ABS, Amherst Securities

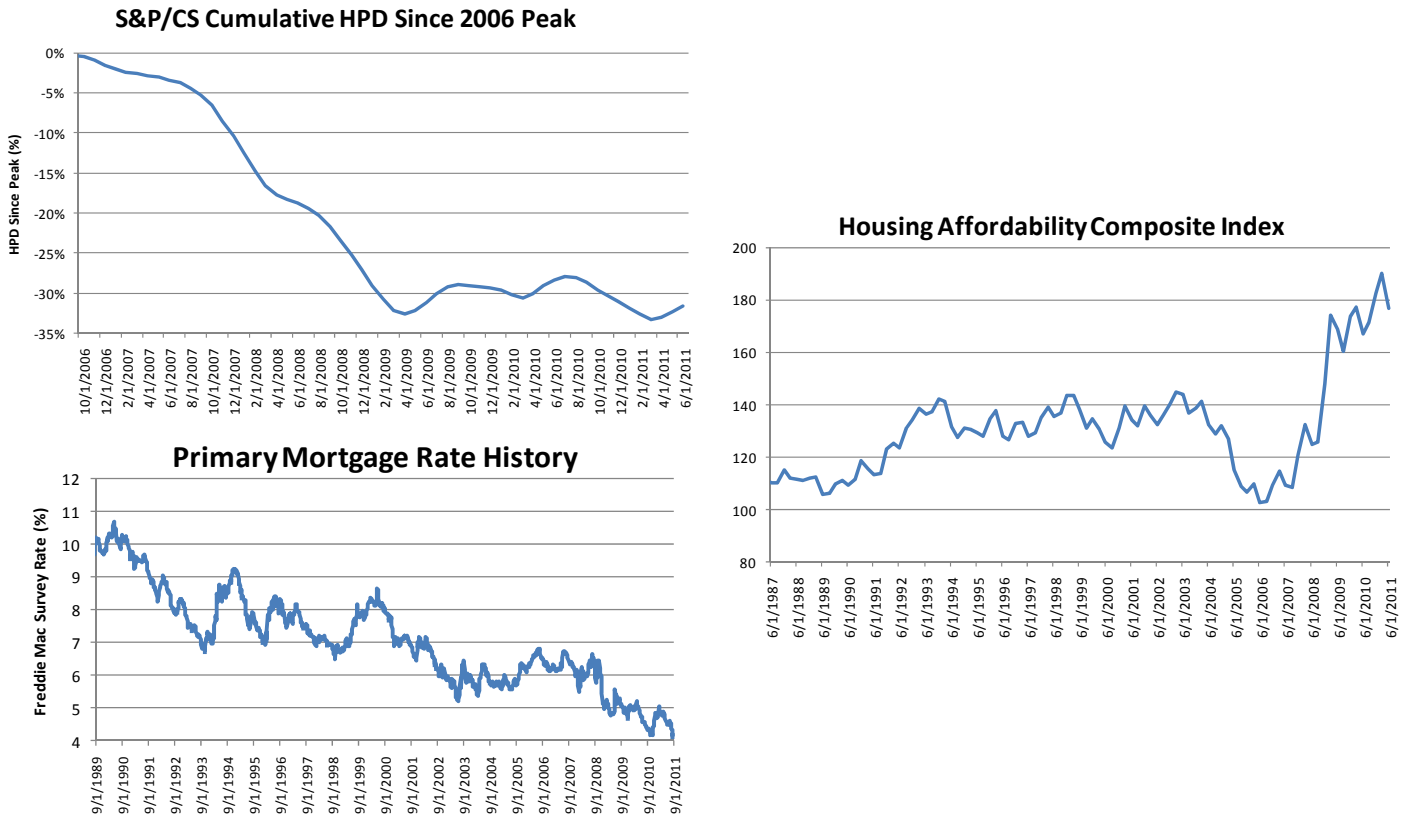
provisions are likely to tighten credit availability further, particularly when the interplay between these two proposed rules and the lower HOEPA thresholds, which are also included in the legislation, are considered. The combined impact of the QRM and QM rules may be delayed because Fannie and Freddie mortgages are exempt from QRM until they are no longer in conservatorship. The impact of the lower HOEPA thresholds may be felt sooner.

Let's put it all together. Almost 1 out of every 5 borrowers is in danger of losing their home if no further policy actions are taken. That will create a huge supply/demand imbalance over the next six years or so, as these homes must change hands. Thus far, the supply/demand imbalance has been contained through modification plans that have had low success rates, and through a huge increase in the amount of time necessary to liquidate a home. These actions have not solved the problem, they have merely postponed it. Meanwhile, there are not enough potential homeowners to absorb the number of homes that need to be purchased. Nearly 1 borrower out of 5 that had a mortgage in 2007 does not qualify for a new mortgage by virtue of payment history alone. And mortgage origination standards have tightened considerably, thus it's even harder for existing borrowers to trade up, or for first time purchasers to enter the market. Finally, a majority of governmental action that has been taken makes already tight credit availability even tighter.

Implications—Home Prices

This housing supply overhang occurs against a backdrop in which homes are very affordable using traditional measures. Exhibit 7 (below) shows that the S&P/Case Shiller 20-City Composite Index is off 32% since its peak in mid-2006. Primary mortgage rates are at a generational low, and look extremely attractive in any reasonable historical context. Affordability is well illustrated in the bottom left section of Exhibit 7, showing the Freddie Mac Survey rate from 1989–present. The result is that housing is very affordable using traditional metrics. The ability of the average family to afford the average price home is at a generational high, as shown on the right side of Exhibit 7.

Exhibit 7: Prices Down, Rates Low → Affordability At 20-year High



Source: Freddie Mac, National Association of Realtors, S&P/Case-Shiller, Amherst Securities

However, the overhang means that home prices, despite being very affordable, are likely to decline further. This may re-create the housing death spiral—as lower housing prices mean more borrowers become underwater. We have determined LTV is the single most important predictor of default. So more underwater borrowers means more defaults; more defaults means more inventory, more overhang, and even further declines in home prices. While home prices can go down another 5% without re-igniting this housing death spiral, a 10% decline would certainly re-ignite the spiral in our opinion.

What is the best solution? There is no simple solution, but we believe the situation requires both supply side and demand side measures. On the supply side, the modification success rate needs to rise in order to keep homes off the market. We actually know exactly what it takes to create a successful modification—reduce principal, give the borrower substantial payment relief, and modify the borrower in the early stages of delinquency. Since negative equity drives defaults, principal reduction is the key to a successful modification. ***On the demand side, we need to increase the level of investor participation, and a government program is the best way to start.***

Encouraging Investor Participation in the Market

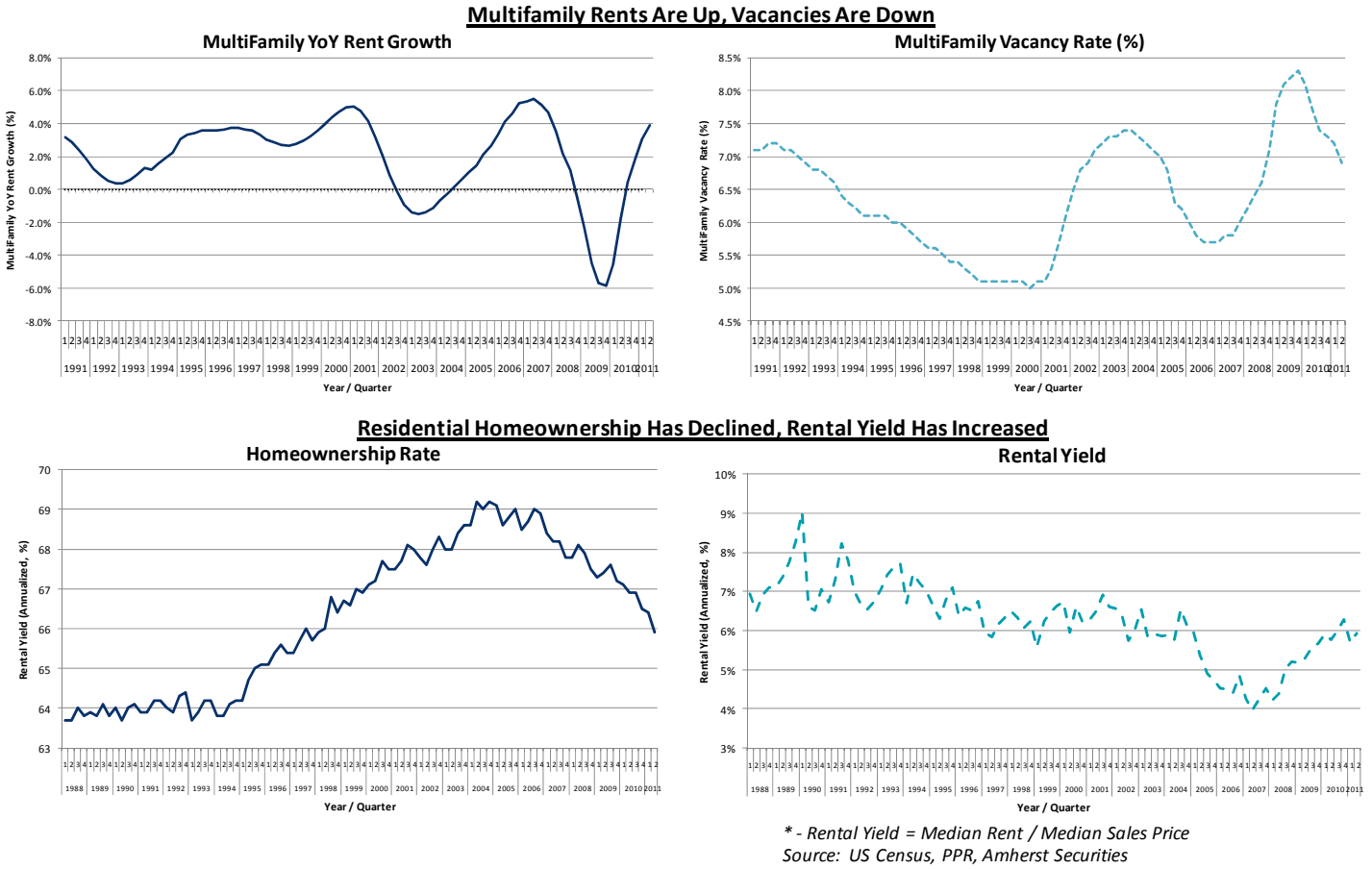
The only way to absorb the excess supply of housing in an environment of constrained demand is to increase the demand for housing. This can come from two sources: either allow borrowers who recently defaulted on their mortgages to qualify for new mortgages, or encourage investor purchases. The problem with the former is that borrowers who have just defaulted do not have the means to make a down payment on a new home. Investors represent the most promising avenue to increase demand. It is very clear that policymakers need to aid the creation of a new asset class—investor-owned homes for rent. Thus far, the overwhelming majority of the rental units are in multi-family properties. That has to change.

What makes this asset class attractive for investors? First, as shown in the top left section of Exhibit 8 (next page), rents are up 3.9% on a year-over-year basis. The multi-family vacancy rate is down from the peak of 8.4% to 6.9%, as shown in the top right section of Exhibit 8. That is, as the homeownership rate has declined from 69.2% to 65.9% (bottom left section of the exhibit); many of these families have become renters, which pushes up the rental rate. And given the overhang we have discussed above, as well as the demographic make-up of new households, the homeownership rate is apt to decline more, putting further upward pressure on rents. In fact, we would argue that the borrower who has not made his mortgage payment in 18 months should not be considered a homeowner for the purposes of these calculations, but he is!

The bottom right section of Exhibit 8 shows that rental yield has risen dramatically—from 4% to 5.9%. This number was computed from comparing annual income on a 2 bedroom apartment to the average selling price of a single family home using US Census Bureau numbers. The average rental income was calculated from the Census Bureau's Housing Vacancy Survey. For Q2 2011, the average asking rent was $684/month or $8,208/year. The average selling price of a home was $138,400. Thus, the average rental yield is 5.9%. This yield calculation is likely to be substantially understated, because we are using the average selling price (not the average distressed price) to determine the rental yield (distressed sales occur at a discount to non-distressed sales). We have also assumed rental income remained constant. We would expect it to rise, as the demand for rental housing increases; this is courtesy of increased housing formation as well as borrowers who can no longer afford, choose not to be, or cannot qualify to be homeowners. However, we have not included any of the costs in this calculation; this includes rental fees, insurance and maintenance expenses and property taxes. It is substantially more expensive to maintain scattered site properties than single site properties. Moreover, the net rental yield based on the distressed selling price and adequately reflecting costs and expenses will differ substantially from market to market.

What has to happen to increase investor participation in this market? It is very clear that investors are already participating in this market to some degree. The most recent release of National Association of Realtors data (July 2011) shows that 29% of existing home sales were for cash, 18% was to investors. While the National Association of Realtors has stated (and we agree) that "investors account for the bulk of cash purchases"; we would go one step further and

Exhibit 8: Rental Demand Is Outpacing Rental Supply



Source: Freddie Mac, National Association of Realtors, S&P/Case-Shiller, Amherst Securities

assert that most of these cash purchases are on distressed properties. We do not have the data to know what percent of the distressed market is trading to investors for cash; unfortunately, it is not tracked.

A Successful Government Program would Spur Investor Participation

Investor participation needs to happen on a much larger scale. A government program is necessary to spur investor participation without further declines in home prices. We would argue that a successful government program must have four objectives. First, it must be scalable enough to have an impact. Second, it must hold homes off the market for several years to give the market a chance to stabilize. Third, it must place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers. Finally, it should maximize the economics for the GSEs and the taxpayers.

We believe all these objectives could best be accomplished by allowing for a program in which: *(1)* opportunities were provided for bulk purchases of REO properties as well as non-performing loans; and *(2)* financing was more available to investors. We discuss each of these items in turn.

Selling Blocks of Distressed Properties

The difficulty of buying up sizable blocks of distressed properties inhibits large scale investors from participating in the market. In order to build out a rental organization, which includes rental agents and property managers, it is critical to

obtain a critical mass of properties in a given area. Thus, we would strongly urge the FHFA, working with Fannie and Freddie, to bundle together properties in a given MSA (Metropolitan Statistical Area) and conduct an auction on an all-or-none basis**. *One very important point: a program that includes NPLs as well as REO properties would be more effective than an REO program alone.*** If the REOs are auctioned, but a large stock of NPLs remain, the government will not get the best price. Bidding a portfolio of NPLs/REOs would allow for the bundling of a larger group of properties in a given geographic area. In addition, since the borrower is often a very suitable tenant for a property, it saves the transaction costs of a move, the emotional costs of a move, and it keeps the family entrenched in the community. Finally, the bidder is often willing to pay more if the home is sold with a "ready-made" renter (the distressed borrower), as it saves the time, effort, and cost of finding a renter.

This is not just a theoretical idea of my firm, Amherst Securities. We believe in it and have put our own capital to work. We recently purchased, for September settlement, the first block of homes auctioned by Fannie Mae with a tenant in the home. (This was known as the TIP Portfolio, for "Tenant in Place").

We would suggest the following auction parameters:

- **One MSA per auction. (This will provide for stronger bids, as some investors will want to specialize in a few geographies).**
- **No less than 200 properties in an MSA. (This will allow large scale buy-to-rent organizations to obtain critical mass.)**
- **Bidders would be given the information with a 2–4 week lead time. This will give investors time to evaluate the properties.**
- **Investors must bid on the entire pool of assets; the winning bidder should be able to kick out assets only because they do not meet the stated parameters**. Thus, investors would submit a bid on each individual asset, as well as a bid on the whole pool. The bid on the whole pool is the sum of each of the bids on the individual units.
- **Investors must agree to hold 80% of the properties for a minimum of 3 years before flipping. This will keep this supply of homes off the market for a period of time.**

If properties in an MSA are sold in bulk, what ensures that the government/Fannie Mae/Freddie Mac will get the best price? We believe it would because selling in bulk would allow a large scale buy-to-rent organization to obtain critical mass in a geographic area, making it economically feasible to build out the organizational structure necessary to support the operation (rental agents, property managers etc.). Thus, these organizations would have a much stronger bid for larger packages than for smaller packages, and there would be competition between these buy-to-rent organizations.

Would pricing for homes sold in bulk be more favorable than selling each property individually or as part of a small group? The appeal to selling each property individually is that it could be sold to the single entity with the highest bid. The disadvantages are: (1) not all properties will move on this basis, and (2) it takes much longer to move homes one by one, resulting in a lower price. It is critical to realize the longer a property remains in a "distressed" state—either abandoned or occupied by an owner that has no vested interest in keeping up the property (as he is no longer paying his mortgage and knows it is only a matter of time before he is foreclosed on)—the more the property deteriorates and is apt to sell for a lower price. The property also detracts from the neighborhood, driving down values for other homes in the area. There are a few other points to consider. If home prices continue to deteriorate, the government is worse off the longer it takes to sell the properties. Moreover, the slower the liquidations, the longer it will take to eliminate the overhang, providing a further drag to the housing market and to the economy.

Financing

We view the inability to accumulate large blocks of distressed properties in a given area to be the single largest obstacle to investor participation on a larger scale. However, financing would serve to stimulate investor demand and further cushion home price declines. An example will make this clearer. Assume the net distressed rental yield was 7%, this would be the unlevered yield to the investor. Assume further that an investor was able to obtain financing on 60% of the

purchase amount, at a 4.5% rate, the return to investors would rise to 10.75%. This would make the purchase of distressed homes a much more attractive proposition, making for stronger investor bids. Again, while this type of program could be structured with or without financing, we believe that conservative government financing (60–75% of purchase price) would result in bids that are at least 20% higher. The risk to the government is remote. For example, if investors were able to finance 60% of the purchase price, home prices must decline another 40% from today's level before the taxpayer is exposed, a very unlikely event given that housing is already quite affordable.

Where would this financing come from? We have three alternatives:

1. Expand the number of properties Fannie and Freddie are willing to finance. Currently, Freddie Mac will not allow investors to finance more than 4 homes, Fannie has a 10 home limit. Clearly, an expansion of these limits would be necessary to provide financing for bulk purchases. However, since the package is purchased in bulk, it would be necessary to "assign" a value to each home for mortgage purposes; this amount would be the price on the individual asset that is contained in the winning bid.
2. Implement this program under the auspices of the Fannie/Freddie multi-family financing programs. Currently, single family homes in a given geographic program, purchased at the same time (scattered sites), would not qualify for this channel. The program specifications could be changed.
3. Financing could be made available through FHAs 223(f)/207 multifamily program. This allows for investor loans, but does not allow for scattered sites. Again, minor tweaks would need to be made to FHA program specifications to allow for this.

Will investors participate if there isn't government help? Absolutely! However, to build out a large scale property management company requires the ability to buy a large number of properties in a given geographic area. Unless investors participate on a much larger scale than has been the case to date, it is unlikely that the necessary amount of supply will be absorbed. Financing would allow for broader investor participation and would allow investors to pay a higher price for the properties, cushioning further home price declines.

If this is so profitable, why don't the GSEs retain equity in the real estate, and do this as a joint venture? We think that this is a good idea, and a program could be structured accordingly. Managed and cash flow generating real estate would trade for quite a bit more than where distressed home are trading today. The right program could capture significant upside for the GSEs and thus the taxpayers. The FDIC's sale, investment and financing program that they have used for the liquidation of secured bank loans offers a valuable model. The program combines private investor capital, matched by an FDIC investment and FDIC financing. We understand the prices achieved on the loans are much higher than they would have been if the loans were sold without the FDIC financing.

Is this the complete solution to the housing crisis? No, not all homes will fit for this program. Higher priced homes generally do not work, because the rent is not high enough to be appealing to investors. That is, a $500,000 home does not rent for 5x as much as a $100,000 home. Moreover, in some communities the rental demand is exceedingly weak and investors are unlikely to be able to rent the homes (e.g. Detroit).

Conclusion

The housing market remains very vulnerable. By our estimates, nearly 1 borrower out of every 5 is in danger of losing their home. As currently configured, the market cannot absorb this excess supply of housing. 19% of all borrowers who owned a home in 2007 no longer qualify for a mortgage by virtue of payment history alone. The demand for home ownership has further contracted because credit availability is very limited. (Many borrowers lack either the cash down payment or the necessary FICO score to meet ever tighter mortgage standards.) Every single governmental action seems to be moving toward limiting credit availability still further. To work our way through this crisis, we need both supply side measures (making mortgage modifications more successful, in particular through principal reductions) and measures to increase the demand for housing.

We strongly believe that investors are the key (actually, they are the only realistic alternative) to increase the demand for housing. Many of these distressed properties must be absorbed by investors and turned into rental properties. The benefit of this is that it will put a floor on housing prices, stop the vicious cycle in which deteriorating home prices cause borrowers to default, which in turn causes more deterioration in home prices and more defaults. It would also introduce much needed supply in the rental market, keeping rents lower and more affordable than would have otherwise been the case.

A successful program must have four objectives: (1) it must be scalable enough to have an impact, (2) it must hold homes off the "for sale" market for several years, (3) it must place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers, and (4) it must maximize the economics for the GSEs and the taxpayers.

How do we accomplish these objectives?

- ***Provide opportunities for bulk purchases of REO properties and non-performing loans.*** If each auction focused on a narrow geographic area we believe it would maximize the economics for the GSEs. We would require, as a condition of sale, that most of the properties be held off the market for a reasonable period to time, to allow the market to stabilize. This would clearly place the risk and responsibilities of owning the real estate with financially strong and operationally sound managers.
- ***Enhancing financing for investors, which will allow a higher rate of return on invested equity.*** That should encourage more investor participation, and higher bids from participating investors.

Again, thank you for the opportunity to appear before the Subcommittee. We look forward to working with you on practical solutions that will help to ease the housing crisis and promote housing market stability.

Appendix—Sizing the Housing Crisis

Exhibit 1 is an attempt to size the eventual number of 1–4 family units that will be forced to liquidate over time. We have incorporated data from the private label securitizations (PLS) market, computed from the CoreLogic Securitized databases; the information on these loans is fairly complete. This is combined with data from the CoreLogic Prime Servicing Database, which provides information on GSE, FHA/VA and bank portfolio loans (to avoid double counting, we filtered out loans in private label securitizations). The prime servicing database, a contributed set of data, covers the majority of the market, but that coverage is not complete. We gross up the non-PLS number, assuming that the rest of the loan universe looks like the loans of the CoreLogic contributors (the largest servicers).

As we noted in the testimony, if no further action is taken, we reasonably expect 10.4 million units to liquidate, with an 8.3 million unit lower bound. To derive these results, we classify the outstanding loans into 5 groups. In total, we estimate that out of the 55 million homes with a mortgage, there are 4.5 million non-performing loans, 3.9 million re-performing loans, 2.6 million always performing loans with a mark-to-market LTV (loan-to-value) ratio >120, 5.4 million always performing loans with a mark-to-market LTV of 100–120, and 38.6 million always performing loans with a mark-to-market LTV of ≤100. To size the problem, we make estimates on the eventual default rate of each group of loans.

The non-performing loans (NPLs; those 60+ days past due) have a low probability of paying off according to their original terms (or even modified terms). This can be best seen in the top half of Exhibit A1 (below), by looking at the fate of loans that were non-performing 12 and 24 months ago (the bottom two lines of the top section of the exhibit). We essentially did a "Facebook" look-up on these loans, asking "where are you now?" Note after 2 years (bottom line of the top half of the exhibit), 16.8% of these loans were "successful"— *i.e.*, either re-performing (16.7%) or voluntarily prepaid (0.1%). The vast majority of "successful" loans are re-performing loans what can still default at some point in the future. Many of

Exhibit A1: Performance Of Non-Performing/Re-Performing Loans After 12 And 24 Months

Non-Performing Loans by Product Type

Product	Category	Liquidated	Non-Performing	Re-Performing	Voluntarily Prepaid	Total	% Success (Prepaid + RPL)
Prime	NPLs 12 Months Ago	26.5%	57.9%	15.5%	0.2%	100.0%	15.6%
	NPLs 24 Months Ago	45.4%	37.2%	17.1%	0.4%	100.0%	17.4%
Alt A	NPLs 12 Months Ago	24.6%	61.4%	14.0%	0.1%	100.0%	14.1%
	NPLs 24 Months Ago	46.7%	38.2%	15.0%	0.1%	100.0%	15.1%
Option ARM	NPLs 12 Months Ago	23.3%	68.1%	8.5%	0.0%	100.0%	8.5%
	NPLs 24 Months Ago	45.2%	44.3%	10.5%	0.0%	100.0%	10.5%
Subprime	NPLs 12 Months Ago	16.8%	65.2%	18.0%	0.0%	100.0%	18.0%
	NPLs 24 Months Ago	34.3%	45.4%	20.3%	0.1%	100.0%	20.3%
All	NPLs 12 Months Ago	21.1%	64.1%	14.8%	0.0%	100.0%	14.8%
	NPLs 24 Months Ago	40.5%	42.7%	16.7%	0.1%	100.0%	16.8%

Re-Performing Loans by Product Type

Product	Category	Liquidated	Non-Performing	Re-Performing	Voluntarily Prepaid	Total	% Success (Prepaid + RPL)
Prime	RPLs 12 Months Ago	1.7%	18.7%	76.5%	3.1%	100.0%	79.6%
	RPLs 24 Months Ago	7.4%	27.6%	55.8%	9.2%	100.0%	65.0%
Alt A	RPLs 12 Months Ago	1.2%	21.7%	76.2%	1.0%	100.0%	77.1%
	RPLs 24 Months Ago	8.0%	34.4%	55.0%	2.6%	100.0%	57.6%
Option ARM	RPLs 12 Months Ago	1.2%	26.9%	71.4%	0.5%	100.0%	71.9%
	RPLs 24 Months Ago	10.0%	42.8%	46.1%	1.1%	100.0%	47.1%
Subprime	RPLs 12 Months Ago	0.9%	27.0%	71.5%	0.6%	100.0%	72.1%
	RPLs 24 Months Ago	5.7%	37.3%	55.4%	1.6%	100.0%	57.0%
All	RPLs 12 Months Ago	1.1%	25.0%	73.0%	0.9%	100.0%	73.9%
	RPLs 24 Months Ago	6.8%	36.8%	54.3%	2.1%	100.0%	56.4%

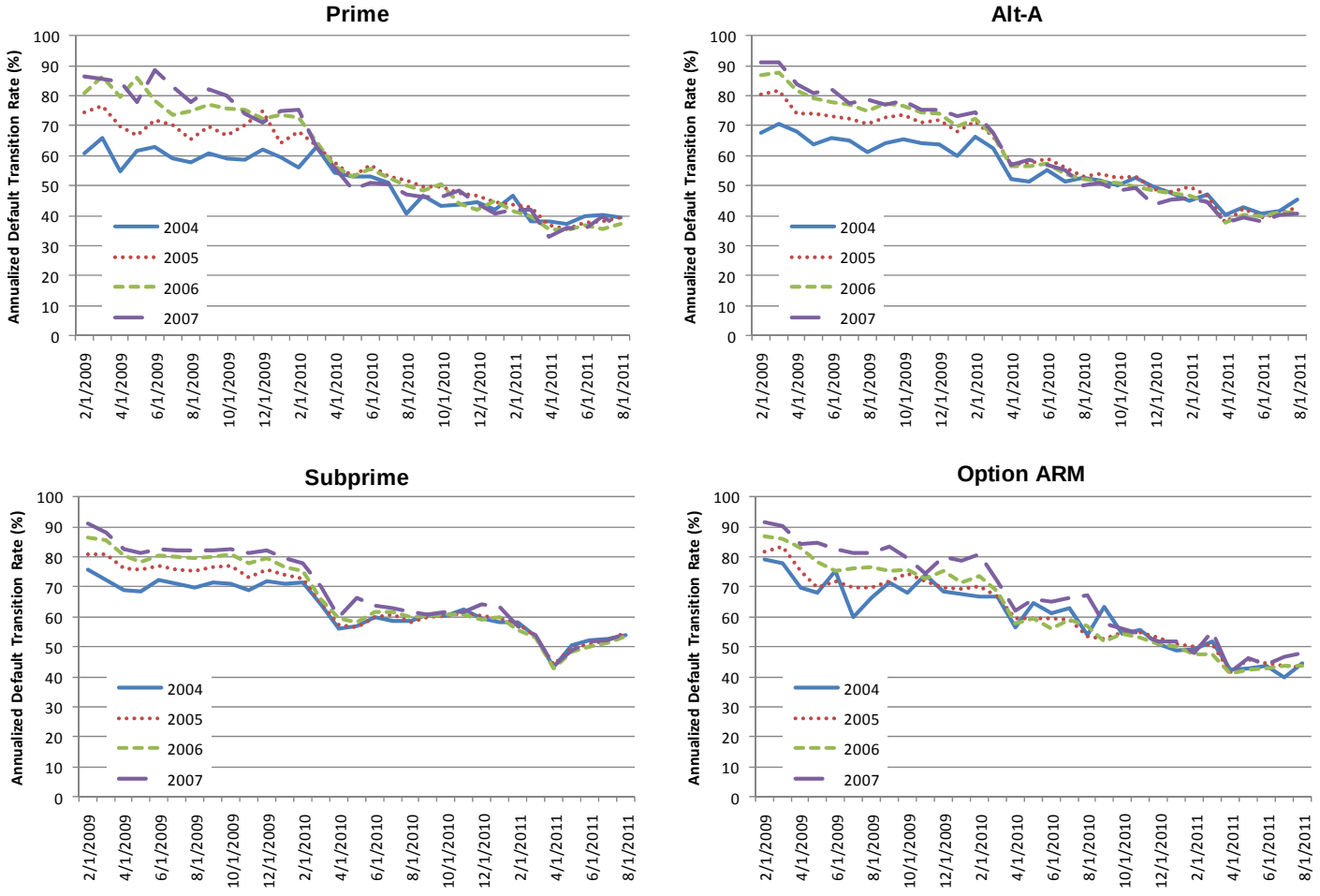
Source: CoreLogic, Amherst Securities as of August 2011

these loans were recently modified; see our discussion below for the re-default of modified loans. The remaining loans were either liquidated or remain non-performing. We generously assume a "reasonable" long-term "success" rate of 10%; thus 90% of these loans will eventually default (and an 80% default rate as our lower bound).

The re-performing loans (RPLs) have a reasonably high chance of re-defaulting. Note that over the past 3 months, 47.2% of the re-performers (on an annualized basis) have again transitioned to delinquent status. This is shown in the column labeled "3Mo cTr" (in Exhibit 1), as it measures the constant transition rate at which these borrowers again become 60+ days delinquent. These re-performing loans voluntarily prepay very slowly ("3Mo vPr", or voluntary Prepayment Rate). Mortgage loans rarely pay on schedule all the way to the end or their lives; they customarily either prepay or default. The column "3Mo D/TV" measures the ratio of defaults to (defaults + prepayments). Thus, if 47.2% of the loans transition to non-performing status (where they have a high likelihood of eventual default) and 2.6% of the loans prepay, it suggests that 94.7% of the loans would eventually default [47.2/ (47.2+2.6)]. Intuitively, if a loan does not default or prepay in year 1, and these ratios remain unchanged, the loan again has a 47.2% chance of default and a 2.6% chance of prepay in year 2, *etc*. Thus, over the life of the loan, 94.7% of the borrowers would default if these ratios remain unchanged. That is far too high a number, as transition rates have declined markedly, as shown in Exhibit A2 (below).

The bottom section of Exhibit A1 sheds more light on this. If we look at the fate of re-performing loans a year ago, 73.9% are successful in the sense that they have either remained re-performing (73%) or voluntarily prepaid (0.9%). Of the

Exhibit A2: Transition Rates of Re-Performers: 2004-2007 Vintages by Product Type



Source: CoreLogic, Amherst Securities

loans that were re-performing 24 months ago, 56.4% can be classified as "successful"—that is, the loans remain re-performing (54.3%) or voluntarily prepay (2.1%). Some of these loans are re-performing because they are on their second or third modification. So, if the success rate after 2 years is 56.4%, we assume a "reasonable" long-term success rate of 35% — *i.e.*, 65% of these mortgages will eventually default. Our lower bound estimate was 50%.

We separate the "always performing loans" (APLs; those loans that have never been 2 payments behind) into 3 groups, based on their equity status. The most underwater borrowers are the 2.8 million mortgages with LTVs >120. These borrowers have been transitioning to non-performing status (going 60+ for the first time) at 13.8%/year, and pre-paying at 5.0%/year. If the ratio of [defaults / (defaults+ prepays)] remains constant, then 73.6% of these borrowers would eventually default. But with credit burnout a reality, we assume this number will be considerably lower. We use a 40% default rate on this bucket as our "reasonable" scenario, with 25% as our lower bound.

The middle category of APLs (5.4 million) represents loans with a 100–120 mark-to-market LTV. These have been transitioning at 7.0%/year, and prepaying at 7.0%/year. If nothing changes, 49.9% will eventually default (the ratio of [defaults/(defaults + prepayments)]. Under our "reasonable" scenario, we scale this number back to 15% to account for credit burnout, and use 10% for our lower bound.

The largest category of borrowers is the 38.6 million APLs with an LTV ≤100. Readers should be aware that these borrowers do not necessarily have equity in their homes. That is, we have used mark-to-market LTV, *not* mark-to-market CLTV (combined loan-to-value) for this analysis. We do not have the CLTV information for the non-PLS universe. Thus a 95 LTV borrower could actually be a 120 CLTV borrower. The borrower will behave as if they have no equity. This group of loans is becoming 60+ days delinquent for the first time at 2.4%/year; voluntary prepays are running at 13.3%/month. If neither ratio changes, then 15.4% [2.4/ (2.4 + 13.3)] of these loans will eventually default. We use a 5% eventual default rate as our "reasonable" case, and 4% as our lower bound.

When you add these numbers together, as is done in Exhibit 1, we find that there are most likely 10.4 million units in danger of liquidation, with a lower bound of 8.3 million units.

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