Center for American Progress

Statement of Julia Gordon
Center for American Progress

Before the Senate Committee on Banking, Housing and Urban Affairs
Subcommittee on Housing, Transportation and Community Development
"Inequality, Opportunity and the Housing Market"

December 9, 2014

Good morning Chairman Menendez, Ranking Member Moran, and members of the committee. 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 homeownership 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 homeownership, 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 homeownership 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

[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

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.
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 homeownership rate has dropped from close to 70 percent to 64 percent. Cash investors made 29 percent of all purchases in

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[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/

[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

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, homeownership 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 homeownership years – have a homeownership 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 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, homeownership 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

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[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, "US 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.

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

numbers of Latinos and African Americans buying homes spells trouble for the housing market for decades to come.[14]

The drop in homeownership 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-

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[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

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 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]

[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.
[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

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 homeownership 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 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

II. Increase Access to Safe and Affordable Credit

Ironically, even as home prices experienced historic declines over the past six 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 homeownership, 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 homeownership; 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 homeownership. 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.

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[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

[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/

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 non-compliance. Additionally, while we commend regulators involved in the so-called QRM rulemaking for choosing not to impose a down payment requirement, which we believe would have unfairly excluded lower-wealth households from homeownership, 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 six 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 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.

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

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 six 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.

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[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

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 activities, including grants to and partnerships with high-performing non-profits 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 pro-cyclical), 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.

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[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/

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 three percent down under certain circumstances. Properly underwritten, low-down-payment mortgages with long-term, fixed interest rates have performed well even throughout the Great Recession. The predatory mortgages that brought down Wall Street's house of cards sometimes included low down payments, 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

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[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

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

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% 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.

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[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: Medical 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, & 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.

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.

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.

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[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

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

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 three-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 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 down payment 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 homeownership. 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 homeownership. 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

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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), available at http://neighborworks.issuelab.org/resource/pre_purchase_counseling_impacts_on_mortgage_performance_empirical_analysis_of_neighborworks_americas_experience; Marvin M. Smith et al., "The Effectiveness of Pre-Purchase Homeownership Counseling and Financial Management Skills," (Philadelphia: Federal Reserve Bank of Philadelphia, 2014), available at http://www.philadelphiafed.org/community-development/homeownership-counseling-study/2014/homeownership-counseling-study-042014.pdf; Kenneth M. Temkin et al., "National Foreclosure Mitigation Counseling Program Evaluation: Final Report, Rounds 3 Through 5," (Washington: Neighborworks and the Urban Institute, 2014), available at http://neighborworks.issuelab.org/resource/national_foreclosure_mitigation_counseling_program_evaluation_final_report_rounds_3_through_5

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]

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% 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 homeownership, 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

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[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—Renewal 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/

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]

III. 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 two 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.

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% 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% of those families remained in their homes, and 21% 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.

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[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

[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

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 two 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 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.

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

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

[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

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.

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

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

[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

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 non-profit 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 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 co-homeowner.

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

[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.

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

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

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 two years until the end of 2015 so at least one year would have the full benefit.

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

In 2012, 75% 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

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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

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 non-profits 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, 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 homeownership, 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 homeownership, 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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[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/