U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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State of the Housing Market: Removing Barriers to Economic Recovery, Part II
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Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for this opportunity to testify about how the Administration's housing initiatives are helping remove barriers to economic recovery. This hearing comes at an important moment – a moment President Obama described in his State of the Union as "a make or break moment for the middle class and those trying to reach it." In that address, he said that what's at stake is the survival of the basic American promise – the idea that if you work hard, you can do well enough to raise a family, own a home, and put a little away for retirement.

Mr. Chairman, I couldn't agree more. As the President said, the defining issue of our time is how to keep that promise alive—to build a nation where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same rules. And nowhere is that challenge clearer than in the homes where we live – from when we buy a home—and make the biggest financial decision of our lifetimes—to our ability to refinance that loan, to the way banks treat us as customers should we ever lose a job or experience a medical crisis that puts our homes at risk.

Indeed, as this Committee knows well, too often in the years leading up to the crisis, mortgages were sold to people who couldn't afford or understand them. Banks made huge bets and bonuses with other people's money. The resulting recession cost more than 8 million jobs and our economy and the world plunged into a crisis from which we are still recovering.

Thanks in part to the partnership of this Committee, today we face a very different environment than the one we faced when President Obama took office. Back in January 2009, America's economy was shed 818,000 jobs alone. Housing prices had fallen for thirty straight months. And foreclosures were surging to record levels month after month after month.

Today, because the Obama Administration moved to keep interest rates low and restore confidence in Fannie Mae, Freddie Mac and the Federal Housing Administration, more than 13 million homeowners have refinanced their mortgages since April 2009 – putting nearly $22 billion a year in real savings into the hands of American families and into our economy.

Today, because we provided a range of solutions to responsible families fighting to hold on to their homes, more than 5.6 million families have been able to reduce their payments and modify their loans to more sustainable terms and foreclosure notices are down nearly 50 percent since early 2009. Because we provided resources for communities struggling with concentrated foreclosures, today we are on track to help them fund better uses for almost 100,000 vacant and abandoned properties through our Neighborhood Stabilization Program. Most important of all, because of our commitment to economic growth and recover, our economy has added private sector jobs for 23 straight months, totaling 3.7 million jobs.

Mr. Chairman, this represents important progress. But we know there is much more to be done. Three key barriers prevent our housing market—and our economy—from fully recovering.

While the number of homeowners at risk of losing their home is down significantly, there are still too many families that face hardships and are underwater – and their unaffordable monthly payments put them at an increased risk of default, dragging down markets, reducing labor mobility and consumer spending alike.

While targeted support to markets struggling with foreclosures, blight and abandonment has reduced vacancy rates, increased home prices and shrunk the inventory of homes for sale, an overhang of properties at risk of or in foreclosure continues to drag down property values and harm the hardest-hit communities.

While we put an end to the worst abuses that caused this crisis and stabilized the market, it is too difficult to get a mortgage today – largely because of uncertainty over making loans attributable to lack of clarity around mortgage servicing, and continued market volatility

And so today, I want to talk about the new tools we are providing to overcome these three key barriers—keeping people in their homes, the shadow inventory and access to credit—and the steps we still need to take to move forward.

Relief for Responsible Homeowners, Keeping People in Their Homes

First and foremost, we needed to ramp up our efforts to keep people in their homes and provide relief for homeowners who've done the responsible thing time every month when that mortgage bill arrives in their mailbox.

Mr. Chairman, millions of responsible homeowners who are current on their mortgages and could benefit from today's low interest rates face substantial barriers to refinancing through no fault of their own. Sometimes homeowners with good credit and clean payment histories are rejected because their mortgages are underwater. In the end, these responsible homeowners are stuck paying higher interest rates, costing them thousands of dollars a year.

Indeed, as economist Mark Zandi said, "There is no better way to quickly buoy hard-pressed homeowners than helping them take advantage of the currently record low fixed mortgage rates and significantly reduce their monthly mortgage payments."

That's why, on February 1st, President Obama announced a package of administrative actions and legislative proposals to help responsible homeowners save thousands of dollars through refinancing. Under his proposal, borrowers with loans insured by Fannie Mae or Freddie Mac (GSE-insured loans) would have access to streamlined refinancing through the GSEs. Borrowers with FHA insured loans will be able to take advantage of an enhanced FHA streamline refinance program. And borrowers whose loans are held by private banks or are securitized in private label securities would have access to refinancing through a new, low-cost, streamlined refinance program that would be facilitated by the FHA.

Allow me to explain each of these efforts in detail.

Refinance Assistance for Borrowers with GSE Loans – HARP 2.0

In his jobs speech to Congress last September, President Obama charged HUD and Treasury to work with the Federal Housing Finance Agency to lower barriers to refinancing. Following weeks of intensive discussions with lenders, mortgage insurers, regulators and investors, FHFA announced changes to help borrowers whose loans were purchased or guaranteed by Fannie Mae or Freddie Mac and who are located in areas suffering from house price declines.

With the Administration's Home Affordable Refinancing Program previously limiting refinancing to borrowers with high loan-to-value ratios (LTVs) of 125% and responsible for less than a million refinances, the need to pick up the pace was clear. Announced in October 2011, HARP 2.0 eliminates the LTV ceiling, reduces certain risk-based loan-level guarantee fees (also referred to as loan level pricing adjustments, or LLPAs), extends the program's end date to December 2013, streamlines automated valuation model (AVM) coverage and foregoes appraisal requirement when AVM is available, and provides representations and warranties relief.

Eliminating the LTV cap will allow those GSE borrowers who have been responsible in paying their mortgage, but happen to be deeply underwater, the opportunity to take advantage of unprecedented mortgage interest rates. The extension of the program for two years will allow lenders to hire staff and upgrade systems to assure all eligible borrowers will have the opportunity to take advantage of the HARP program. It will minimize the amount of funds borrowers would be required to obtain for a refinance because the GSEs reduce the fees that borrowers have to pay on 30-year fixed rate loans with an LTV over 80% from 2% to .75% of the loan amount. And by ensuring that the GSEs do not require the HARP originator to take responsibility for the quality of the loan that is being refinanced, it will expand the universe of responsible borrowers to whom they offer the refinancing option.

In addition to these changes, the Administration continues to work with FHFA on ways to increase uptake. Specifically, the Administration is evaluating automated valuation models as approval alternatives to manual appraisals, removing operational barriers that preclude or hinder cross-servicer refinances, and seeking to extend HARP 2.0 to those borrowers with LTVs under 80% so that more responsible, current homeowners have the opportunity to refinance.

We expect most lenders will have their HARP 2.0 operations fully up and running by the end of March. These changes have met with a very positive response from homeowners. Already, according to an informal survey almost 300,000 families have filed applications for refinancing and stand to save on average $2,500 per year—the equivalent of a pretty good-sized tax cut—speeding our efforts to help responsible families stay in their homes and start to rebuild the wealth they lost in the economic crisis.

We look forward to working with Congress to further reduce the barriers to refinancing under HARP 2.0, including easing costs associated with mortgages that have greater equity than 80%, easing underwriting standards, and easing appraisal requirements.

Refinance Assistance for FHA Borrowers – FHA Streamlined Refinance

FHA Streamline Refinances allow borrowers with loans insured by the Federal Housing Administration who are current on their mortgage to refinance into a new FHA-insured loan at today's low interest rates without requiring additional underwriting, allowing these borrowers to reduce their mortgage payments in a low-cost, simple manner. This program benefits current FHA borrowers – particularly those whose loan to value may exceed the current value of their home. This both lower's a borrower's payment and reduces risk to FHA. As part of our efforts to help responsible homeowners who are current on their mortgages and because we see potential for more widespread use of this product, FHA will make changes to the way in which streamline refinance loans are displayed in the Neighborhood Watch Early Warning System (Neighborhood Watch), so that these lenders are not on the hook for loans they did not originate and thus will be more willing to provide the refinancing.

In addition to taking steps to make these refinance loans more widely available, FHA is working on adjusting the premium structure for all Streamline Refinance transactions that are refinancing FHA loans endorsed on or before May 31, 2009, to further incentivize refinance activity. These changes will ensure that borrowers benefit from a net reduction in their overall mortgage payment while still ensuring FHA has the resources to pay any necessary claims.

Broad Based Refinancing for non-GSE, Non-FHA Borrowers

Lastly, the President has called on Congress to open up opportunities to refinancing for responsible borrowers who are current on their bills and paying their mortgage but whose loans aren't GSE or FHA-insured. Under the proposal, borrowers with standard non-GSE, non-FHA loans will have access to refinancing through a new program run through the FHA. For these responsible borrowers, there will be no more barriers and no more excuses.

Key components of this plan include:

Providing non-GSE, non-FHA Borrowers Access to Simple, Low-Cost Refinancing:
The program will be simple and straightforward. Any borrower with a loan that is not currently guaranteed by the GSEs or insured by FHA can qualify if they meet the following criteria – each of which is designed to help reduce risk to the taxpayer:

- *They are current on their mortgage:* Borrowers will need to have been current on their loan for the past 6 months and have missed no more than one payment in the 6 months prior.
- *They meet a minimum credit score.* Borrowers must have a current FICO score of 580 to be eligible. Approximately 9 in 10 borrowers have a credit score adequate to meet that requirement.
- *They have a loan that is no larger than the current FHA loan limits in their area*: Currently, FHA limits vary geographically with the median area home price – set at $271,050 in the lowest cost areas and as high as $729,750 in the highest cost areas

- *The loan they are refinancing is for a single family, owner-occupied principal residence*. This will ensure that the program is focused on responsible homeowners trying to stay in their homes.
- *They are currently employed.* To determine a borrower's eligibility, a lender need only confirm that the borrower is employed.

Borrowers will apply through a streamlined process designed to make it simpler and less expensive for both the borrower and the lender. The President's plan includes additional steps to reduce program costs, including:

- *Establishing loan-to-value limits for these loans*. The Administration will work with Congress to establish risk-mitigation measures which could include requiring lenders interested in refinancing deeply underwater loans (e.g. greater than 140 LTV) to write down the balance of these loans before they qualify. This would reduce the risk associated with the program and relieve the strain of negative equity on the borrower.
- *Creating a separate fund for new streamlined refinancing program*. This will help the FHA better track and manage the risk involved and ensure that it has no effect on the operation of the existing Mutual Mortgage Insurance (MMI) Fund, which is FHA's already established insurance fund

Cost-Savings to the Borrowers who Participate in this New Program: Given today's record low interest rates, we estimate that on average, borrowers who participate in this program would reduce their monthly payments by between $400 and $500 a month.

Option to Rebuild Equity in their Homes through this Program: All underwater borrowers who decide to participate in this refinancing program through the FHA outlined above will have a choice: they can take the benefit of the reduced interest rate in the form of lower monthly payments, or they can apply that savings to rebuilding equity in their homes. The latter course, when combined with a shorter loan term of 20 years, will give the majority of underwater borrowers the chance to get back above water within five years, or less.

To encourage borrowers to make the decision to rebuild equity in their homes, we are proposing that the legislation provide for the closing costs of borrowers who chose this option – a value averaging about $3,000. To be eligible, a participant in this option must agree to refinance into a loan with a term of no more than 20 years and with monthly payments roughly equal to those they make under their current loan. For those who agree to these terms, their lender will receive payment for all closing costs directly from the FHA or another entity involved.

A Separate FHA Fund: The broad based refinance program will have a separate fund that is funded through premiums established and direct funding provided under this program with its net cost offset by the financial crisis fee. The program's premium structure will be designed in a way to ensure that homeowners have the incentive for lower monthly payments through the program. By maintaining a separate fund and funding source for this program the broad-based refinance will not be contingent on appropriations action and will have no impact on FHA's MMI Fund which, as the Committee knows, has been strained in recent years.

We look forward to working with members of this committee to craft legislation to accomplish these goals and offset the costs associated with establishing a broad-based refinance program.

Further easing refinancing through HARP 2.0, the FHA streamlined refinance, and expanding refinance options for homeowners with non GSE and non FHA loans finally ties together a critical patchwork of refinance programs. By working together with Congress, we can ensure that every family can have the opportunity to take advantage of today's historically low interest rates. This will save homeowners thousands of dollars a year, and as a result provide much needed payment relief and further strengthen the economy.

HAMP Changes and Extension

In February 2009, the Obama Administration introduced the Making Home Affordable Program and the Home Affordable Modification Program (HAMP) to stabilize the housing market and to help struggling homeowners get relief and avoid foreclosure.

As I noted at the beginning of my testimony, since that time more than 5.6 million families have received mortgage modifications with affordable monthly payments – which include more than 1.7 million HAMP trial modification starts. HAMP is managed primarily by Treasury.

There is no question that HAMP has had a positive impact on the private market. Before President Obama took office, as many of you know, many mortgage modifications actually *increased* costs for borrowers. HAMP has not only helped keep families in their homes – it's also helped set a standard for affordability in the private market, where families today save an average of $333 per month.

And we've made changes to respond to evolving challenges. For instance, when foreclosures began to migrate from the subprime to the prime market because of unemployment, we expanded our focus to offer more help for unemployed homeowners – requiring servicers participating HAMP to give borrowers a minimum of 12 months to catch up on payments while they are looking for work.

In addition, last month, the Administration took a series of steps to expand the eligibility for HAMP and maximize its impact.

Expanded Eligibility

To ensure HAMP reaches a broader pool of distressed homeowners, we opened the program up to those who struggle with secondary debt, such as second liens, medical bills and credit cards.

In particular, the Administration has created a second tier that would provide modification relief to borrowers not currently eligible. This tier would include:

- Mortgages secured by properties that are currently tenant occupied or properties that are vacant but which the borrower certifies intention to rent.
- Borrowers failing to satisfy the 31% debt-to-income (DTI) test, unable to achieve the target monthly mortgage payment ratio without excessive forbearance or who have received a negative net present value (NPV) test due to other factors.

These changes will not only not only help homeowners, but also stabilize neighborhoods struggling with foreclosures by helping hundreds of thousands of owners who rent their properties avoid foreclosure – in turn, keeping more families in their homes.

Principal Reduction

Still, it's not enough to lower the barriers to participation in HAMP – we also need to increase its impact. HAMP has made a real difference for the families who have received a modification – saving an average of more than $500 per month. But to rebuild the equity these families have lost, lowering payments isn't enough.

That's why we are also increasing incentives for cost-effective mortgage modifications that include a write-down of the borrower's principal balance through HAMP.

With these changes to the Principal Reduction Alternative (PRA), whereby investors are eligible for financial compensation incentives whenever the servicer provides a borrower with a permanent modification that reduces mortgage principal, we are tripling the incentives provided to encourage modifications that rebuild equity.

Specifically, with respect to loans which were less than or equal to six months past due at all times during the 12-month period prior to the NPV evaluation date, investors will be entitled to receive, effective in May 2012:

- $0.63 per dollar of principal reduction equal to or greater than 105% and less than 115% mark-to-market LTV (MTM) ratio;
- $0.45 per dollar of principal reduction equal to or greater than 115 percent and less than or equal to 140 percent MTMLTV ratio; and
- $0.30 per dollar of principal reduction in excess of 140 percent MTMLTV ratio

With respect to loans which were more than six months past due at any time during the 12-month period prior to the NPV evaluation date, irrespective of MTMLTV (mark-to-market loan-to-value) ratio range, investors will be paid $0.18 per dollar of principal reduction and will not be eligible for incentives in the above extinguishment schedule. These improvements to HAMP augment incentives in a meaningful way for investors to allow for a greater degree of principal reduction of loans underlying the securities they own, thus keeping more people in their homes with mortgages they can afford.

To further increase the amount of principal reduction provided to borrowers, we are also working to expand it to those with loans guaranteed by the GSEs. Borrowers with GSE loans have been unable to benefit from the PRA modification due to FHFA restrictions on the use of principal reduction in modifications. So homeowners couldn't benefit solely because they had a GSE loan. In order to ensure consistency throughout the HAMP program, and to ensure that homeowners can be considered for rebuilding equity modifications, we have notified FHFA that Treasury will pay these incentives to the GSEs if they participate in the program.

Sunset Extension

Lastly, we have extended HAMP's sunset deadline. Originally slated to sunset at the end of 2012, HAMP has been extended to December 31, 2013, which conforms to the recently extended deadline for HARP and provides an expanded window of time for homeowners to gain relief which investors provide while preserving their investments.

Strengthening FHA's Mutual Mortgage Insurance Fund

The books of business in the few years before 2009 have largely driven the high number of claims to the MMI Fund. This was driven by overall economic and unemployment trends as well as by the combined effects of poor underwriting, unscrupulous and non-compliant practices on the part of lenders, and a seller-funded downpayment assistance program that allowed many borrowers to obtain mortgages that they shouldn't have or without a meaningful down payment. As a result, the books of business FHA insured prior to the start of this Administration have severely impacted the health of FHA's MMI Fund. But thanks to our efforts, I can say confidently that FHA is moving in another direction, and that the long term outlook for FHA and the Fund are now much better than they were in 2009. Through systematic tightening of risk controls, increased premiums to stabilize near-term finances and expanded usage of loss mitigation workout assistance to avoid unnecessary claims, the efforts of this Administration have led to the highest quality of loans FHA has seen in its history.

And still, we continue to take steps to further strengthen the Fund. In the FY 2013 Budget submission we included 10 bps annual premium increase passed late last year by Congress on all FHA insured loans mandated by law in December, as well as an additional 25 bps annual premium increase on "jumbo" loans making the total increase for these larger loans 35 bps. And, just last yesterday, we announced a series of premium changes that will further increase receipts to FHA by $1 billion in fiscal years 2012 and 2013, beyond the receipts already included in the President's budget submission. In addition, we have also taken significant additional steps to increase accountability for FHA lenders discussed in more detail below.

Yet, despite the unprecedented efforts of the Administration to alter the trajectory of FHA, considerable risks remain. The FHA Mutual Mortgage Insurance (MMI) Fund has two components: the Financing Account, which holds enough money to accommodate expected 30 year losses on FHA's insured portfolio as of the end of the current fiscal year; and the Capital Reserve Account, which is required to hold an additional amount equal to 2 percent of the insurance in force. Since 2009, the Fund's capital reserve ratio has been below that 2 percent level.

Annually, the President's Budget includes estimates regarding the status of the capital reserve at the end of the current fiscal year. This prediction is based on estimates and projections of future economic conditions, including house prices and other economic factors. The 2013 Budget estimate for the FHA Capital Reserve account in fiscal year 2012 did not include the added revenue from the further increased premiums and the proceeds from the recently announced settlements with FHA-approved lenders. With these additional revenues accounted for, the Capital Reserve is estimated to have sufficient balances to cover all future projected losses without triggering a mandatory appropriation under the Federal Credit Reform Act. What's more, the Budget estimates, FHA will add an additional $8 billion to the Capital Reserve Account in 2013, and will return to the congressionally mandated capital reserve ratio of 2 percent by 2015.

As we undertake efforts to strengthen FHA and lay the foundations for the return of private capital, it is important to recognize the critical role that FHA has and continues to play in times of stress on the housing market. One of the critical purposes of the FHA is to stand as a bulwark of liquidity in a time when capital has fled the market, and in such times the FHA will inevitably grow beyond the size that we would be comfortable with, taking on more risk that we would normally be comfortable with. We are in such a time now. So while we will continue to take the steps needed to ensure an FHA that is as strong as we can make it, and we will gradually take the steps needed to pull the FHA back from the market to crowd in more private capital, we must not forget that it is playing an absolutely critical role today, ensuring access to capital in an environment when capital is extremely difficult to come by. As we discuss and consider ways to strengthen FHA and to create an environment for the return of private capital, we must be mindful of its continued critical role inherent in its mission – providing homeownership opportunities to families that do not have access to traditional financing, and to serve as vital source of credit, when the broader market undergoes stress.

Reducing the Overhang and Shadow Inventory

At the same time we provide relief to responsible homeowners and keep families in their homes, we also need to attack the second barrier to our housing recovery: the shadow inventory – the overhang of properties that are at risk of or already in foreclosure.

REO to Rental

With the rental market recovering faster, we need to think creatively about ways we can dispose of this shadow inventory.

With the purchase market continuing to be dragged down by the glut of vacant foreclosed properties and rental rates rising as those who lose their homes to foreclosure seek rental housing, there is an unprecedented imbalance of supply and demand between the purchase and rental markets.

When there are vacant and foreclosed homes in neighborhoods, it undermines home prices and stalls the housing recovery. As part of the Administration's effort to help lay the foundation for a stronger housing recovery, the Department of Treasury and HUD have been working with the FHFA on a strategy to transition REO properties into rental housing. Repurposing foreclosed and vacant homes will reduce the inventory of unsold homes, help stabilize housing prices, support neighborhoods, and provide sustainable rental housing for American families.

With about a quarter of a million foreclosed properties owned by HUD and the GSEs, this August, HUD joined with FHFA and Treasury to issue a "Request for Information" to generate new ideas for absorbing excess inventory and stabilizing prices. In all, about 4,000 submissions were received.

Over the past several months, the interagency task force has been reviewing the submissions and formulating strategies based on the best practices gathered from the RFI. Throughout this process, the task force has continuously met with industry members, community groups and other key stakeholders to make sure they are heard in the strategy development process.

We expect a range of strategies to emerge; however the most commonly discussed centers around selling REO properties to buyers who will convert and market them as rental units.

Recently, the FHFA, in conjunction with Treasury and HUD, announced that investors may pre-qualify for the first major pilot sale of foreclosed properties repurposed into rental housing. This marks the first of a series of steps that the FHFA and the Administration are taking to develop a smart national program to help manage REO properties, and ease the pressure of these distressed properties on communities and the housing market.

We plan to learn and leverage all we can from this initial pilot as we work towards conducting a series of additional pilots throughout the rest of the year.

Project Rebuild

While expanding REO-to-Rental is a critical tool, in the hardest-hit markets, where prices have dropped most and the most vacant and abandoned buildings are found, more needs to be done to jumpstart construction and reduce vacancy rates.

As I mentioned earlier, the Neighborhood Stabilization Program (NSP) has helped improved sale prices and vacancy rates in areas with concentrated investments. In fact, three-quarters of communities across the country with targeted neighborhood stabilization investments have seen vacancy rates go down – and two-thirds have seen home prices go up compared to surrounding communities. Further, the $7 billion that has been allocated under the three phases of NSP will support an estimated 88,000 jobs by the time the funding is fully spent. These jobs are created in a variety of fields including housing construction, infrastructure construction, maintenance and repair, management, technical consulting services, real estate, state and local government.

In Hernando County, Florida, our NSP investments have helped families move in to once-foreclosed homes in hard-hit places. Just as importantly, they've helped keep construction workers on the job and given real estate agents the opportunity to show and sell homes once again. Indeed, in the La Puente community, a predominately Hispanic suburb outside Los Angeles, these efforts have helped increase home prices by nearly 15 percent.

However, even in these NSP investment clusters, NSP has been able to reach only 46 percent of the census tracts in the United States that are hardest hit by the foreclosure and unemployment crisis. That is why President Obama has proposed Project Rebuild to further stabilize neighborhoods and communities, an initiative which would create 200,000 jobs in the places that need them most.

Nearly two thirds of the $15 billion Project Rebuild funding will be provided to States and local governments by formula as specified in the American Jobs Act. The remaining third will be allocated by competition –which is open to state and local governments, non-profits, and for profit entities and consortia of these parties. Project Rebuild proposes important modifications to the NSP model to extend the benefits of the program beyond affordable housing, enabling greater job creation, and a broader positive impact on neighborhoods.

Recognizing that it's not just abandoned homes that can drag down an entire neighborhood, but also vacant commercial properties, Project Rebuild broadens eligible uses to allow commercial projects and other direct job creating activities, capped at 30 percent of funds. Up to 10 percent of formula grants may be used for establishing and operating jobs programs to maintain eligible neighborhood properties. Formula funding will go directly to states and entitlement communities across the country. Competitive funds will be available to states, local governments, for-profit entities, non-profit entities and consortia of these entities.

Each state will receive a minimum of $20 million of the $10 billion in formula funds. Funds will be targeted to areas with home foreclosures, homes in default or delinquency, and other factors, such as unemployment, commercial foreclosures, and other economic conditions. Project Rebuild also will expand the ability of the private sector to participate with localities – ensuring there is the expertise and capacity to bring these neighborhoods back in a targeted way. I urge the committee to join with the Administration in working toward the enactment of this proposal.

Reducing Uncertainty, Improving Access to Credit

Of course, underlying many of the issues in our housing market is a lack of certainty – of a clear understanding of the rules of the road lenders need to do business and our housing market needs to recover. And one way to reduce uncertainty is to clear away barriers to recovery – to resolve these matters in a way that holds those responsible accountable, but moves us forward by creating conditions more conducive for lending.

Lender Indemnification

As part of FHA's continued efforts to protect and strengthen the MMI Fund, facilitate access to mortgage credit for qualified borrowers and provide clarity to our lending partners, last month FHA issued final rule governing the process for receiving and maintaining approval to participate in the Lender Insurance (LI) process. These new regulations will provide greater clarity regarding our expectations for our LI lending partners, as well as the actions we will take to prevent losses when those standards are not met.

The regulations reiterate FHA's commitment to ongoing quality assurance reviews of lenders with LI authority. In addition, the rule sets a standard for what constitutes a "serious and material violation" of FHA origination requirements. Serious and material violations, as well as instances of fraud or misrepresentation, will require indemnification by LI mortgagees. In providing a standard for these violations, along with a clear process by which FHA will require indemnifications for loans that do not meet these standards, FHA is providing a level of certainty to our partners with regard to the types of violations which are actionable under HUD policy.

It is significant, however, that FHA currently has the ability to exercise this indemnification authority with respect to only one of our two classes of FHA approved lenders. FHA Direct

Endorsement (DE) Lenders are currently not subject to the same regulations with regard to indemnification. In order to protect the MMI Fund and ensure the term viability of the FHA, the Administration continues to pursue legislation to allow FHA to pursue indemnifications from these DE lenders.

In addition, we believe it is important for the Federal Housing Finance Agency to work with Fannie Mae and Freddie Mac to make clear the rules of the road for GSE lenders with straightforward and well defined representations and warranties that will further reduce uncertainty around repurchase risk. Equipping banks with a better understanding of what mortgages they can be held responsible for can yield positive externalities with respect to REO inventory overhang and the damaging impact of foreclosures on house prices.

Homeowner Bill of Rights

Consumers need certainty and clarity most of all. The Homeowners Bill of Rights recently announced by President Obama would guarantee consumers access to a simple mortgage disclosure form, so borrowers understand the loans they are taking out; full disclosure of fees and penalties; guidelines to prevent conflicts of interest that end up hurting homeowners; support to keep responsible families in their homes and out of foreclosure; and, protection for families against inappropriate foreclosure, including right of appeal.

Tackling All Three Barriers: Mortgage Servicing Settlement

All three of the barriers I have described—keeping people in their homes, the shadow inventory, and uncertainty—are addressed by the historic mortgage servicing settlement the Obama Administration and a bipartisan coalition of attorneys general from 49 states reached providing at least $25 billion on behalf of American homeowners.

The product of sixteen months of intensive negotiations between the five banks and an unprecedented coalition of state attorneys general and federal agencies, including the Departments of Justice, Treasury, and HUD, that spanned partisan lines, the settlement helps families keep their homes and reduces the shadow inventory by providing relief to homeowners, in part by forcing banks to reduce the principal balance on many loans, refinancing loans for "underwater" borrowers. In addition the settlement will pay billions of dollars to states stabilize communities and cover the costs associated with the foreclosure crisis and consumers who have been foreclosed upon.

And it reduces uncertainty by providing clear servicing standards going forward for these five institutions which currently service over 70% of all mortgages – standards that can set the stage for servicing standards going forward.

Background

In the summer of 2010, HUD initiated a large-scale review of the FHA's largest servicers, devoting thousands of hours to reviewing servicing files for thousands of FHA-insured loans. While we began with a focus on failure to engage in loss mitigation, the scope of this review encompassed a long list of mortgage servicing issues, such as lost paperwork, long delays and missed deadlines. As HUD's Office of the Inspector General found, the country's five largest loan servicers routinely signed foreclosure related documents without really knowing whether the facts they contained were even correct.

In effect, many of the very same financial institutions responsible for selling loans to people who couldn't afford them and then packaging those mortgages to make profits, effectively fueling the housing crisis, were actually making it worse – harming families, neighborhoods and our economy.

Following revelations of widespread use of "robo-signed" affidavits in foreclosure proceedings across the country, the federal-state working group launched an investigation into the problem and confronted the 5 largest servicers, representing more than 80% of the loans serviced, about these problems. These banks soon acknowledged that individuals had been signing thousands of foreclosure affidavits without reviewing the validity or accuracy of the sworn statements. Several national banks then agreed to stop their foreclosure filings and sales until corrective action could be taken.

Other servicer-related problems were identified as well, including deceptive practices in the offering of loan modifications (for example, telling consumers that a loan modification was imminent while simultaneously foreclosing). These performance failures resulted in more than just poor customer service. Unnecessary foreclosures occurred due to failure to process homeowners' requests for modified payment plans. And where foreclosures should have been concluded, shoddy documentation led to protracted delays. This misconduct not only harmed homeowners – but communities, our housing market and economy.

Relief for Homeowners

The settlement imposes monetary sanctions on the banks while providing immediate and continuing relief to homeowners. The single largest federal-state civil settlement ever agreed to—and the largest financial recovery from the banks during this crisis—the accord will enable hundreds of thousands of distressed homeowners to stay in their homes through enhanced loan modifications. It will also fund payments to victims of unfair foreclosure practices and provide support for housing counseling and state-level foreclosure prevention programs.

One of the most important features of the settlement is the $17 billion in consumer relief options that will offer homeowners a variety of home retention and home disposition alternatives. Because the banks will receive credit for employing these options at specified credit rates (e.g. a deficiency waiver carries a 10% credit, so for every dollar supplied by the bank, it would only count 10 cents), this $17 billion has the potential to provide as much as $32 billion in relief.

Much of this relief will come in the form of principal reduction for distressed homeowners. Enabling these families to restructure their debt and start building equity again not only improves their prospects – but also those of their neighbors who have watched property values plummet by $5,000-10,000 simply because there are foreclosures on their block.

In addition, it provides:

- $3 billion for refinances for current homeowners who, because their home values are underwater, would not be able to refinance their mortgages into lower interest rate loans.

- Approximately $2.6 billion to states which can choose to apply funds to repay public funds lost as a result of servicer misconduct, fund housing counselors, legal aid, and other similar purposes determined by state attorneys generals.
- A $1.5 billion Borrower Payment Fund for borrowers who were foreclosed upon on or after January 1, 2008. Banks must notify those borrowers of their right to file a claim. Payout is anticipated to be approximately $2,000 per person, depending upon levels of claim and whether they meet some relatively basic criteria. Borrowers receiving claims will not have to waive any legal rights or claims against the banks, and can seek additional relief.

With specific regard to the Borrower Payment Fund, as I noted earlier, when HUD initiated a large-scale review of the FHA's largest servicers in the summer of 2010, we found that families who should not have gotten into trouble—and who should have been able to get some help early on that was both good for them and good for the lender—didn't get that help – help that in many cases banks were legally obligated to provide.

These $2,000 payments will be made to families who suffered from these kinds of errors– where borrowers were charged fees that they shouldn't have been or had dropped calls or lost paperwork when they sought help with their mortgages.

For families who suffered much deeper harm—who may have been improperly foreclosed on and lost their homes and could therefore be owed hundreds of thousands of dollars in damages—the settlement preserves their ability to get justice in two key ways:

First, if a borrower can document that they were improperly foreclosed on, they can receive every cent of the compensation they are entitled to through a process established by federal banking regulators. The agreement also preserves the right of homeowners to take their servicer to court. Indeed, if banks or other financial institutions broke the law or treated the families they served unfairly, they should pay the price – and with this settlement they will.

I would note that these funds are paid entirely by the banks. The taxpayer doesn't pay a dime.

And homeowners aren't the only ones who will see the benefits of this settlement. So, too, will the taxpayer who has paid a steep price for financial institutions' failure to follow the law when it came to families who had FHA-insured loans. In addition to the steps I mentioned earlier that FHA is taking to protect its MMI fund, approximately $900 million from this settlement will help shore up the FHA's finances, preserving this critical resource for the future and protecting taxpayers' investment.

Residential Mortgage Backed Security Group

While this historic settlement will offer significant help to those who suffered the most harm and provide a path toward stability for our housing market and our broader economy, it isn't designed to address all the issues of the housing crisis. While it resolves certain violations of civil law based on the banks' mortgage loan servicing activities, the United States and the state attorneys general preserved the right to pursue claims in a number of important areas, including criminal authorities, securities claims, and loan origination claims.

Indeed, in some ways, just as important as what this settlement accomplishes is what it does not do. It will not prevent state attorneys general or regulators from pursuing criminal cases or conducting investigations that get to the bottom of the crisis. Last month, Attorney General Holder and I joined New York Attorney General Schneiderman and several other state attorneys general in announcing a working group comprised of representatives from DOJ, HUD, SEC and the State AGs focused on investigating the conduct of financial servicers that broke the law and contributed to the crash of the housing market, including securities- and origination-related cases.

New Customer Service Standards

That's why this agreement forces the banks that service nearly 2 out of every 3 mortgages to take action to address the problems uncovered during our investigations.

In particular, these standards prohibit robo-signing, improper documentation and lost paperwork; clarify what servicers have to do on foreclosures and modifications, including requiring strict oversight of foreclosure processing, including of third-party vendors; make foreclosures a last resort by requiring servicers to evaluate homeowners for other loan mitigation options first; restrict banks from foreclosing while the homeowner is being considered for a loan modification; and establish procedures and timelines for reviewing loan modification applications, and give homeowners the right to appeal denials. Having to satisfy these requirements, banks are also more certain of the costs associated with them.

These standards will set the stage for clear, national servicing rules for all servicers which the new Consumer Financial Protection Bureau, under the leadership of Director Richard Cordray, and along with an interagency team comprised of independent regulators as well as Treasury and HUD, are working to craft These national standards are an aggressive and critical first step in a broader administration effort to provide a single, straightforward set of commonsense rules that are in keeping with Homeowner Bill of Rights that families can count on when they're buying a home and paying their mortgage. The standards in this settlement will serve as benchmark for the development of these uniform rules, giving people the confidence that lenders and servicers are following a long list of rights should they ever lose a job or have a medical emergency that puts their home at risk.

Lastly, the settlement's release of limited origination claims with both Bank of America and Citibank which, coupled with the Lender Insurance indemnification rule discussed earlier, provides clarity for lenders on when the FHA will take action, reducing concerns over lawsuits and additional reputational risk. In the same way, clarifying representations and warranties at the GSE level will help to achieve a well-defined and well understood buyback policy that fosters a degree of uniformity and certainty across the government-backed space.

An Economy Built to Last

And so, Mr. Chairman, as you can see, we have made very important, significant progress in recent months to get our housing market back on track – helping tens of thousands of additional families refinance, putting in place the most significant principal reduction effort in history and establishing critical consumer protections that hold powerful institutions accountable for their actions, help our housing market recover and give every homeowner the dignity, respect and fair treatment they deserve.

But for all this progress, we can't declare victory and go home. We still need Congress to act to ensure that every responsible family in America, regardless of who services their loan, has the opportunity to refinance.

We still need to continue our work together to create a robust private system of housing finance and protect the FHA fund for the future.

And we still need a balanced national housing policy that ensures Americans have access to credit for those in a position for sustainable homeownership, assistance for those who feel the strain of high housing costs, rental options near good schools and good jobs, and above all – choices in housing that make sense for them and for their families.

That is the goal of all this work – and it is fundamental to creating an economy built to last. And I look forward to working with Congress to make it possible. Thank you.