U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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Written Testimony of Secretary Shaun Donovan
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Expanding Refinancing Opportunities to Improve the Housing Market
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Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for this opportunity to testify about the Administration's initiatives to help American homeowners refinance their mortgages and rebuild equity in their homes.

As this Committee knows, in the three months prior to President Obama taking office America's economy was shedding 761,000 jobs per month. Housing prices had fallen for thirty straight months. And foreclosures were surging to record levels month after month. This hearing comes at what the President has called "a make or break moment for the middle class" – but also one in which our housing market appears to be turn a corner following the best winter of home sales since the crisis began.

Today, because the Obama Administration moved to keep interest rates low and took aggressive steps to stabilize the housing market, more than 14 million homeowners have refinanced their mortgages since April 2009 – putting nearly $27 billion a year in real savings into the hands of American families and into our economy. Today, because we worked with lenders to develop a range of options for families struggling to hold onto their homes, more than 5.8 million loan modifications have been started in the last three years and foreclosure notices are down 50 percent since early 2009. Because we helped communities struggling with concentrations of foreclosures, three-quarters of those in which we've made targeted investments have seen vacancy rates go down -- and two-thirds have seen home prices go up. Most important of all, our economy has added private sector jobs for 26 straight months, totaling 4.2 million jobs.

Mr. Chairman, this represents important progress. But to create the economy built to last as the President described in his State of the Union address, we need to do more. Indeed, as the President laid out in that speech, and as I discussed with this Committee in February, one of the challenges that prevents our housing market—and our economy—from fully recovering is that a range of barriers in the market is preventing struggling borrowers from getting economic relief that they and the economy need at this pivotal moment. It is time to finally remove those barriers so that we can turn the corner to recovery.

Millions of responsible homeowners, who have done the right thing paying their mortgages through these tough economic times, can't benefit from today's low interest rates because they face substantial obstacles to refinancing. For instance, homeowners with good credit and clean payment histories are rejected because home values in their neighborhood have plummeted and their mortgages are underwater.

For instance, consider Judy in Tucson, Arizona. Judy and her husband purchased their home in 2007 through one of the largest banks which continues to service their loan. However, because they now face the burden of a 7.0% interest rate on a mortgage increasingly underwater, they can't refinance and lower their monthly payment through today's low rates. That is not because Judy is delinquent. In fact, Judy has never been late on a mortgage payment. It is simply because her servicer sold her loan to a securitization trust – something she and her husband had nothing to do with and they never thought would preclude them from refinancing. And even though they've been customers of the bank for almost 40 years, that bank is unwilling to assume the risk of such a high loan-to-value (HLTV) mortgage.

If Judy had a loan insured by the FHA or guaranteed by Fannie Mae and Freddie Mac (GSEs), she would likely have some relief. This is because recent changes, announced by President Obama, to the Federal Housing Administration (FHA) and the GSEs have increased the opportunities for borrowers with underwater mortgages to refinance. These changes include the development of Streamline Refinance at FHA and HARP 2.0, which improve upon the original HARP established in 2009 but they are only available with those who have FHA or GSE loans Additional refinancing help is also being provided through the historic federal-state Attorney General Servicer Settlement announced earlier this year which will provide $3 billion in refinance assistance for borrowers with underwater mortgages currently held on the balance sheets of the largest five banks. However, that still leaves millions of borrowers whose mortgages are held in securitization trusts or on the balance sheet of banks not subject to the settlement.

While we have made substantial progress and the Administration has taken action administratively to make millions of Americans eligible for lower interest rates, more needs to be done. But these additional steps require Congress to take action. With mortgage interest rates at their lowest in 50 years, refinancing can provide substantial benefits to millions of homeowners. We must do more so that every current borrower – no matter where their loan is located – has the opportunity to refinance. 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 is why the President is calling on Congress to open up opportunities for refinancing to responsible borrowers who are current on their payments. These proposals will help "Judy" and the millions of Americans like her who not only have done the right thing, but also refuse to consider going delinquent on their obligations in hopes of obtaining relief.

Providing Non-FHA & Non-GSE Borrowers Access to Simple, Low-Cost Refinancing

Under the President's broad-based refinance proposal, borrowers with standard non-FHA and non-GSE loans would have access to refinancing through a new program operated by the FHA. The refinancing program would be open to all borrowers who are current on their mortgage payments and have standard, non-jumbo loans that are not currently insured by FHA or the GSEs.

The program will feature simple and straightforward eligibility criteria.

- *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 conforming loan limits in their area*: Currently, FHA limits vary geographically with the median area home price – set at $271,050 in 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.

Borrowers will apply through a streamlined process designed to make it simpler and less expensive for borrowers and lenders to complete the refinance transaction. Borrowers will not be required to submit a new appraisal or tax return. To determine a borrower's eligibility, a lender need only confirm that the borrower is employed and meets the eligibility criteria outlined above. Those who are not employed may still be eligible if they meet the other requirements and present limited credit risk. However, a lender will need to perform a full underwriting of these borrowers to determine whether they are a good fit for the program.

In addition, the proposal includes parameters to reduce program cost, including the following, risk mitigating measures:

- *Establishing loan-to-value limits for these loans*. The proposal would restrict refinancing to loans up to a loan to value (LTV) ratio of 140. Lenders interested in refinancing deeply underwater loans would therefore need to write down the balance of these loans before they would qualify. This would reduce the risk associated with the program and relieve the strain of negative equity on the borrower.

- *Creating a separate insurance 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 existing Mutual Mortgage Insurance Fund (MMIF).

The cost will be driven in part by additional design choices and we are cognizant that we must ensure that FHA has adequate capacity to implement this program effectively. We are interested in working with Congress to design appropriate limits that meet the objectives of the program, including walling off any risk from the MMI fund and containing costs to a level that will not increase the deficit or impose additional costs on taxpayers.

There may be questions about this program significantly expanding the FHA's balance sheet, and potentially increasing the credit risk held by the government, and moving in the opposite direction of the Administration's stated interest in stepping back from the housing market. To those concerns, I would like to reiterate that the program will be limited to those homeowners who have been making their payments on time for the better part of a year and in most cases considerably longer. These are responsible borrowers who have a demonstrated ability and willingness to pay and thus represent relatively low credit risk. Second, the program is designed to limit and contain any incremental credit risk to the FHA. Third, it is important that we work with Congress to offset the costs associated with this program, minimizing the incremental risk that these borrowers represent to taxpayers or the health of the FHA. Finally, while the Administration believes that over time the government's footprint in the nation's housing market must decrease, it is imperative at this time that we do what is necessary to ensure the continued recovery of the housing sector and broader economy. If we fail to take the steps necessary to speed the recovery, then the FHA's scaling back will take considerably longer, as private capital continues to wait on the sideline for a healthier market.

Steps Taken to Strengthen FHA:

I also understand that there is some concern over whether FHA has the capacity to implement this program given the current state of the Mutual Mortgage Insurance Fund (MMIF). To be clear, stresses on the MMIF are a result of legacy books of business originated before mid-2009, not the books of business taken on today. In fact HUD moved expeditiously to limit risk going forward and strengthen the FHA's performance. Immediately upon taking office, this Administration acted quickly and aggressively to protect FHA's MMI Fund and to ensure its long term viability. We have taken more steps since January 2009 to eliminate unnecessary credit risk and assure strong premium revenue flows in the future than any Administration in FHA history. These actions coupled with the strength of FHA's recent books of business have significantly improved FHA's long-term outlook. FHA's improved trajectory is the result of a three-part strategy: systematic tightening of risk controls, increased premiums to stabilize near-term finances and expanded usage of loss mitigation workout assistance to avoid unnecessary claims.

Because we are very aware that stresses on the MMI Fund remain, we have also followed these efforts with significant additional steps tto strengthen the Fund. In the 2013 Budget we announced a 10 bps annual premium increase on all FHA insured loans in accordance with legislation passed by Congress late last year, as well as an additional 25 bps annual premium increase on jumbo loans making the total increase for these larger loans 35 bps. And recently, we announced a series of premium changes that will further increase receipts to FHA by $1.48 billion in fiscal years 2012 and 2013, beyond the receipts already included in the President's budget submission. We have also taken significant additional steps to increase accountability for FHA lenders. We recently published a final rule that clarifies the bases upon which FHA will require indemnification from lenders participating in our Lender Insurance program, making clear the rules of the road for lenders and giving FHA a solid basis upon which to require indemnification by lenders for violations of FHA guidelines.

In addition, we continue to seek expanded authority from Congress to further enable us to protect the MMIF from unnecessary and inappropriate losses associated with lenders who violate our requirements. The House is currently considering a bill that includes some provisions sought by FHA, and we look forward to working with this Committee on legislation to help manage the risk to FHA's portfolio arising from non-compliance on the part of FHA-approved lenders.

And as we have discussed, we have held lenders accountable for violating our rules and putting our fund at greater risk in the recently announcement settlement with America's largest lenders. Through these settlements, FHA will receive approximately $900 million in compensation for losses associated with loans originated outside of FHA requirements, or for which FHA's servicing requirements were violated.

Opening Up Access Through FHA While Maintaining Careful Risk Management

FHA has made great strides in reducing barriers to low cost refinancing through its FHA Streamline Refinance program. The Streamline Refinance program allows borrowers with loans insured by the FHA 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. This program benefits current FHA borrowers – particularly those whose loan value may exceed the current value of their home – and by lowering a borrower's payment, also 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 also make changes to the way in which streamline refinance loans are displayed in the Neighborhood Watch Early Warning System (Neighborhood Watch). By reducing lender concern about the potential impact associated with taking responsibility for loans they have not underwritten, lenders will be more willing to offer these loans to borrowers who are current on mortgages already insured by FHA.

In addition to making these refinance loans more widely available, FHA has reduced the upfront mortgage insurance premium (MIP) to 0.01 percent and the annual MIP to 0.55 percent for all Streamline Refinance transactions that are refinancing FHA loans endorsed on or before May 31, 2009. This change will ensure that borrowers benefit from a net reduction in their overall mortgage payment and reduce the risk to FHA.

FHA has a long track record of enabling millions of American families to purchase or refinance their homes, and coupled with its improved risk management system, is well positioned to provide refinancing to responsible non-FHA and non-GSE borrowers. We see this program as part of a broader effort to return the housing market to health, and along with the proposal described below, will speed the recovery of the market, benefiting homeowners and investors alike.

Fully Streamlining Refinancing for GSE-Insured Loans

Progress and Challenges of HARP:

In his address before Congress last September, President Obama charged HUD and Treasury to work with the Federal Housing Finance Agency (FHFA) 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. These changes have become known as HARP 2.0.

With HARP previously limiting refinancing to borrowers with high loan-to-value ratios of up to 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 works to eliminate the LTV ceiling, reduce certain risk-based loan-level g-fees, also referred to as loan level pricing adjustments, or LLPAs, extend the program's end date by 1 ½ years to December 2013, streamline Automated Valuation Model (AVM) coverage and forego appraisal requirement when AVM is available, and provide additional representations and warranties relief.

Eliminating the LTV cap allows borrowers who have been responsible in paying their underwater mortgages 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 allow lenders to only be concerned about making the new HARP loan terms as advantageous as possible for the borrower.

We understand that most lenders have had their HARP 2.0 operations fully up and running since the end of March. These changes have met with a very positive response from homeowners, particularly in deeply underwater states where so many families have been locked out of the refinance market for years. Already, servicers report that they are processing applications from nearly a half-million families who 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.

Further Action is Necessary to Increase scope and improve Efficiencies.

Significant changes have been made to HARP to improve access, but additional changes can be made to increase participation and improve its effectiveness, as detailed in the bill proposed by Senator Menendez and Senator Boxer. Namely, significant uptake could be achieved by evaluating automated valuation models as approval alternatives to appraisals, removing operational barriers that preclude or hinder cross-servicer refinances, and extending the current program to those borrowers with LTVs under 80 percent. More specifically, the bill would:

- *Extending streamlined refinancing for all GSE borrowers:* The President's plan would extend these steps to streamline refinancing for homeowners to all GSE borrowers. Those who have significant equity in their home – and thus present less credit risk – should benefit fully from all streamlining, including lower fees and fewer barriers. This will allow more borrowers to take advantage of a program that provides streamlined, low-cost access to today's low interest rates – and make it easier and more automatic for servicers to market and promote this program for all

GSE borrowers. Specifically, this would eliminate the restriction on borrowers who have loans with an LTV of less than 80% LTV, applying the HARP changes to GSE borrowers irrespective of their loan to value ratio.

- *Increasing competition so borrowers get the best possible deal:* Today, lenders looking to compete with the current servicer of a borrower's loan for that borrower's refinancing business continue to face barriers to participating in HARP. This lack of competition means higher prices and less favorable terms for the borrower. The President's legislative plan would direct the GSEs to require the same streamlined underwriting for new servicers as they do for current servicers, leveling the playing field and unlocking competition between banks for borrowers' business. Specifically, this would eliminate the requirement of any lender to assume representations and warranties that are not required of same servicers. Additionally, the GSEs could not charge any loan level pricing adjustments (LLPAs), post-settlement delivery fees, adverse delivery charges or other similar up-front fees.

- *Eliminating appraisal costs for all borrowers*: Borrowers who happen to live in communities without a significant number of recent home sales often have to get a manual appraisal to determine whether they are eligible for refinancing into a GSE guaranteed loan, even under the HARP program. Under the Administration's proposal, the GSEs would be directed to use mark-to-market accounting or other alternatives to manual appraisals for any loans for which the loan-to-value cannot be determined with the GSE's Automated Valuation Model. This will eliminate a significant barrier that will reduce cost and time for borrowers and lenders alike.

Allowing Borrowers to Rebuild Equity Expeditiously

All underwater borrowers who decide to participate in either HARP or the 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 rebuild 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 rebuild equity in their homes, we recommend that the legislation provide funding for the closing costs of borrowers who choose this option – a value averaging about $3,000 – to be paid for on behalf of the borrower by either the FHA or GSEs. 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 GSE, depending on the entity involved.

For example, a borrower has a 6.5 percent $214,000 30-year mortgage originated in 2006. It now has an outstanding balance of $200,000, but the house is worth $160,000 (a loan-to-value ratio of 125). The monthly payment on this mortgage is $1,350.While this borrower is responsibly paying her monthly mortgage, she is locked out of refinancing. By refinancing into a 4.25 percent 30-year mortgage loan, this borrower will reduce her monthly payment by $370. However, after five years her mortgage balance will remain at $182,000. Under the rebuilding equity program, the borrower would refinance into a 20-year mortgage at 3.75 percent and commit her monthly savings to paying down principal. After five years, her mortgage balance would decline to $152,000, bringing the borrower above water.

This program would provide a path out from an underwater position over a reasonable period of time to borrowers who qualify for either of the two programs set forth above rather than only those who are particularly distressed or for whom principal reduction is clearly NPV positive. We are focused on the broader group not only because of its importance to the continuing recovery of the housing markets, but because we frankly do not believe that only those who are distressed in their mortgages should have an opportunity to work their way above water.

Strengthening Communities through NSP and Project Rebuild

At the same time we provide relief to responsible homeowners and keep families in their homes, we also need to address the overhang of foreclosed properties that continue to drag down home prices. While the legislative proposals described above seek to reduce barriers to refinancing and afford homeowners the opportunity to save thousands of dollars per year, we cannot simply stabilize neighborhoods by refinancing one mortgage at a time. Aside from addressing challenges associated with concentrated foreclosures, the Neighborhood Stabilization Program (NSP) has played an important role in halting the slide in home values in neighborhoods, and as a result helped preserve homeowner's equity.

NSP has helped improved sale prices and vacancy rates in areas with concentrated investments. . Indeed, according to HUD data, three-quarters of neighborhoods that received targeted investments through the first two rounds of NSP showed increased home prices – largely as a result of improved vacancy rates. And, furthermore, he $7 billion that has been allocated under the three phases of NSP will support nearly 90,000 jobs by the time the funding is fully spent.

This success is why President Obama has proposed Project Rebuild to further stabilize neighborhoods and communities, an initiative that would create 200,000 jobs in the places that need them most. I am pleased that Senator Reed has introduced legislation to establish this program, and I urge Congress to move forward on the bill.

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. 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.

A Make or Break Moment for the Middle Class

Mr. Chairman, we have made significant progress in recent months to get our housing market back on track. With the changes made to date to existing refinance programs, we have helped tens of thousands of additional families refinance. we have not only helped them save on their monthly payments, we've also set the foundation for the provision of fair and equitable treatment by servicers of many of these new and existing loans with the servicing settlement -- establishing critical consumer protections that hold powerful institutions that service nearly 2 out of every 3 mortgages accountable for their actions. Through the settlement and subsequent efforts, these institutions are being required to take action to address problems uncovered during our investigations and help our housing market recover, giving every homeowner the dignity, respect and fair treatment they deserve.

In spite of all this progress, we aren't done. As President Obama said in his State of the Union, this is "a make or break moment for the middle class and those trying to reach it" and the defining issue of our time is how to build a nation where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same rules.

Mr. Chairman, the millions of families who will benefit from these proposals are playing by the rules. They're doing more than their fair share. They haven't walked away from their obligations – and we can't walk away from ours.

And that starts with making sure every responsible family in America has the opportunity to refinance in an open and competitive market. Achieving success on this front will be a significant step in the direction of 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 Americans and their families. I look forward to working with Congress to make it possible. Thank you.