

TESTIMONY OF

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ON BEHALF OF

THE MORTGAGE INVESTORS COALITION

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

JULY 16, 2009

Mortgage Investors Coalition Testimony

Thank you for inviting me to testify today. My name is Curtis Glovier and I am a Managing Director at Fortress Investment Group. I am also a member of the Mortgage Investors Coalition, which was organized to develop investor consensus on current public policy initiatives and to provide policy makers with the mortgage investor's point of view. I am testifying today in my capacity as a member of the Mortgage Investors Coalition.

Allow me to start, Chairman Dodd, by commending you, Ranking Member Shelby and the other members of the Committee for your leadership for well over two years, going back to before the financial crisis, in trying to pursue every possible action to help keep Americans in their homes. We share your frustration with the slow pace of efforts to help homeowners get out of bad mortgages and into mortgages that will allow them to stay in their homes and build equity at the same time.

I also want to thank you particularly, Mr. Chairman, for co-authoring with Chairman Frank a letter last week highlighting the need to help families keep their homes and avoid foreclosure. We agree with your diagnosis of the Hope for Homeowners program ("HFH") and offer our support to assist American families' participation in this program, so they may be able to keep their homes and build equity. The discounted refinance program offered by HFH provides the best long term solution for the homeowner and for the recovery of the U.S. housing market.

My testimony today represents the views of the Mortgage Investors Coalition, as well those of other mortgage investors whose thoughts I have obtained through numerous conversations I have

had in the course of my professional dealings and my participation in industry groups. The Mortgage Investors Coalition was formed in April 2009 and currently has 11 member firms with about \$200 billion in total assets under management and over \$100 billion in current outstanding principal balance of investments in residential mortgage backed securities. In my testimony, I will briefly describe the composition of the mortgage market and some of the inherent conflicts that could be contributing to the difficulty in showing sufficient progress in stemming foreclosures

Investors in private-label (non-Federal agency) mortgage-backed securities include asset managers, charitable institutions, endowments, foundations, hedge funds, insurance companies, investment banks, municipalities, mutual funds, pension funds, trusts, sovereign wealth funds, universities and others. Thus, many of the beneficiaries of these investments are ordinary American citizens – people with pensions, people with life insurance policies or mutual fund investments, and people who benefit from services provided by charities, universities, and state and local governments.

First, I'd like to briefly describe the residential mortgage market. The mortgage market consists of approximately \$11 trillion in outstanding mortgages. Of that \$11 trillion, \$5.4 trillion are held on the books of the GSE's as agency mortgage-backed securities (issued by one of the agencies) or in whole loan form. Another \$3.6 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which \$1.1 trillion are second liens (home equity loans/lines of credit or closed end second mortgages). Of the \$1.1 trillion outstanding second mortgages, only 3.7% of the total (or \$41 billion) is held in securitized form. The remaining \$1.8 trillion in first

lien mortgages reside in private label mortgage-backed securities. The Residential Mortgage Backed Securities (RMBS) market has efficiently provided mortgage financing for millions of American families and has served as a means to extend credit throughout the American economy and the world. While the Federal government's actions to bolster Fannie Mae and Freddie Mac and to broaden the FHA's mandate have proven to be critical stopgap measures during the housing and economic crisis, a revival of the RMBS market and a return of private investors to that market is seen by many as a prerequisite to the recovery of the U.S. housing market and a return to normalcy in the capital markets. The Federal government cannot by itself provide the liquidity necessary to finance the national housing markets.

The process by which residential mortgage-backed securities are created begins when a borrower obtains a mortgage loan from a lender. After the loan is made, the loan is pooled together with other mortgage loans and placed into a trust. The trust is administered by a trustee and one or more servicers, who are the face of the trust to homeowners. Investors in the trust generally have no interaction with the homeowners, and also have extremely limited decision-making authority with respect to modifications, foreclosures and other servicing actions. Very often, the original lender, or its affiliate, acts as servicer once the loans are securitized. Loan servicing is relatively concentrated. Roughly 88% of subprime loans and 69% of all residential mortgage loans are serviced by 18 servicers, and 55% of all mortgages are owned by or serviced by the 4 largest banks.

Returning homeowners to a positive equity position provides significant opportunity and motivation for at-risk homeowners to remain in their homes and communities. A short

refinancing under HFH solves both the affordability and negative equity problems plaguing homeowners at risk of foreclosure today. The program was created to reduce principal on the existing senior lien mortgage and to eliminate the existing subordinate second lien, which can prevent unnecessary foreclosures. The Mortgage Investor Coalition believes that a properly implemented Hope for Homeowners program will not only provide stability for homeowners, but will help stem the declines in the housing markets and provide certainty for the fixed income capital markets, which will bolster financial markets in general and promote increased lending and reinvestment in mortgages. We believe the program will prevent additional foreclosure inventory from adding to the overhang of bank owned properties in the residential real estate market, thereby helping to establish a floor for housing prices.

I would like to reiterate what we, the Mortgage Investors Coalition, have been stating -- from Capitol Hill, to the Departments of Treasury and Housing and Urban Development, and with Community Housing Advocates. The best solution to our nation's mortgage crisis is to significantly forgive principal on first and second lien mortgage debt in connection with the refinancing of the overextended homeowner into a new, low interest rate mortgage through the Hope for Homeowners program. The burden of solving the housing crisis should not fall squarely on the shoulders of any one stakeholder, and investors are willing to do our part by making a significant sacrifice in reducing mortgage principal.

Investors seek a sustainable mortgage restructuring program that works in the best interest of all parties and addresses the multiple factors that have contributed to homeowner re-defaults. The solutions that have been offered to date have been sub-optimal for the homeowner in that they

fail to address the entire consumer debt burden, and overlook the pernicious effects of negative equity. Compared to a short refinance program such as HFH, a modification approach, such as the Making Home Affordable Program, has a notable shortcoming: by not addressing negative equity, homeowners are trapped in a mortgage that cannot be refinanced and a house that cannot be sold. When the program ends in five years, the interest rate on both the first and second mortgage will reset higher, the outstanding balance of the combined mortgage debt is likely to still exceed the value of the home, and there could be a meaningful risk of a re-default. The low prices of securities in the mortgage market today in part reflect the great uncertainty of future cash flows and values associated with such modified loans.

It is our understanding that the Committee would like to examine the reason more Hope for Homeowners refinancings have not occurred. The following is our analysis of what has happened since this Committee created and Congress passed the Helping Families Save Their Homes Act, modifying the Hope for Homeowners program.

While there are still operational hurdles to overcome in implementing a more effective program, the major impediment to the viability of the program is the volume of second mortgages or second liens outstanding. The second lien problem exists because many banks and their affiliated servicers offered additional forms of financing to consumers, such as home equity loans and second mortgages. As indicated earlier, while a small percentage of second mortgages were sold to investors, the vast majority remain on the balance sheets of our nation's largest financial institutions. In fact, the four banks that service approximately 55% of mortgages held roughly \$441 billion of second liens on their balance sheets as of December 31, 2008. Banks

have favored loan modification programs such as Making Home Affordable that defer the recognition of losses on the second lien portfolios. That program improves the cash flow available to the second mortgage at the expense of the first mortgage and defers the immediate loss that would be recognized in a foreclosure, short sale or short refinance. In these negative equity scenarios, the second lien would receive no proceeds in a foreclosure action; on the other hand, the modification program allows this uncollateralized obligation to remain outstanding and on the books of the financial institution as a performing asset, even though the homeowner has no equity in their home. The second lien is subordinate to the first lien and often has a higher interest rate. In the vast majority of cases, when a first mortgage is delinquent, so is the second lien. Our analysis of 44.1 million first lien loans from a primary credit bureau database indicated that of all second lien mortgages, only 3% are current with a corresponding first lien mortgage that is delinquent.

We believe the current accounting treatment of second liens on the banks' balance sheets makes them particularly unwilling to take this loss to complete a refinance, resulting in 1) unsuccessful modifications that are prone to quickly re-default and 2) more importantly, only a handful of Hope for Homeowners refinances. The ideal scenario for a borrower who owns a home that is worth less than its outstanding mortgage debt, referred to as being "underwater", is to refinance into a Hope for Homeowners mortgage. Such a refinancing would result in the Borrower having a new, affordable mortgage with an equity investment in his or her home and an incentive to stay in the home and build additional equity. In addition this homeowner could eventually sell the home in a normal market transaction as opposed to the selling into the current market of bank auctions and foreclosure sales.

As I previously explained, the refinancing of mortgages through Hope for Homeowners is the preferred solution for borrowers and investors in mortgage loans. Given that investors want more mortgage refinancings and an increased use of the Hope for Homeowners program, why can't investors just tell the servicers to refinance more loans?

Unfortunately, even though the loans backing the investments are held for the benefit of investors, the investors are limited in the influence they can exert over those who administer the trusts. The contracts governing the administration of the trust that issued the mortgage-backed securities were generally written in a manner that creates various barriers to investor control. Thus, although investors want servicers to be more responsive to borrowers and to significantly increase the penetration of the Hope for Homeowners program, forcing that behavior on the servicers is extremely difficult.

What is the solution? It is an effort that will require participation and sacrifice by all interested parties to succeed. The government, financial institutions and investors all share an important stake in the recovery of the American homeowner and must contribute equitably to forge a healthier, more stable housing market, financial market and economy. The solution lies in providing positive equity and affordable payments for homeowners. Investors stand ready to make the sacrifice necessary to re-equitize the homeowners at risk of foreclosure.

The Congress and the Administration should be diligent in their prodding of bank-affiliated servicers to offer HFH refinancings. HUD and Treasury are actively working to reach out to all

stakeholders, including the banks and servicers who hold second liens, to arrive at a solution that can lead to more refinancings under the Hope for Homeowners program. It is unclear at this point whether HUD and Treasury have made progress on the second lien issue.

If necessary, additional capital could be allocated to this effort as TARP funds are repaid to the government. When the Emergency Economic Stability Act of 2008 first passed, a significant portion of the TARP money was to have been reserved for foreclosure avoidance. Government funds could be used to more aggressively compensate second lien holders as their investments are extinguished in the short refinance process of HFH.

Fundamentally, for this problem to be solved, everyone must share the burden. Solutions cannot be a windfall for certain stakeholders and terrible for others. We must get homeowners out of underwater mortgages and into mortgages that have positive equity and are properly underwritten, affordable, fair, and sustainable. Contributions must be made by all participants.

Based on all the available options, it seems the best solution is the Hope for Homeowners program. This means that investors like us will have to be prepared to take an immediate and substantial hit on the outstanding principal amount of the mortgage as loans are refinanced out of the securitization trust at a discount. It is necessary for borrowers to emerge from their underwater positions and begin to build positive equity for the housing market to recover. Given today's unprecedented economic conditions, mortgage investors stand ready to contribute to the re-equitization of homeowners by reducing principal on first lien mortgage debt to facilitate the refinance of these loans into stable thirty-year, amortizing, fixed-rate government loans.

In creating the Hope for Homeowners program, Congress has created the framework for a successful solution to the housing crisis, and the funding necessary to provide sustainable mortgages for many American families at risk of losing their home to foreclosure. Mortgage Investors are prepared to make the appropriate contributions to preserve homeownership and call on the Committee to provide support in effectuating a workable program with the other stakeholders, including financial institutions that control the servicing and origination of residential mortgages.

Mr. Chairman, we thank you for the opportunity to testify today – and for your and your colleagues’ efforts to help families not only achieve the American dream but also to keep their homes and avoid foreclosure during these turbulent times. We look forward to working with you to provide hope for homeowners and to doing our part to solve the housing and mortgage market crisis.