NFHA
National Fair Housing Alliance

"Inequality, Opportunity and the Housing Market"

Hearing of the Transportation, Housing and Community Development Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs

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Good morning, Mr. Chairman and members of the Subcommittee. Thank you for the opportunity to testify here today on "Inequality, Opportunity and the Housing Market." My name is Debby Goldberg, and I am a Special Project Director at the National Fair Housing Alliance (NFHA). Founded in 1988, and headquartered in the District of Columbia, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights groups, and individuals from 37 states and the District of Columbia. Through comprehensive education, advocacy and enforcement programs, NFHA seeks to provide equal access to housing for millions of people.

The title for this hearing is one that resonates with NFHA and its members. We work at the intersection of housing and opportunity, and we are very mindful of the impact that where people live has on so many aspects of their lives. It determines whether they have access to good schools, good jobs, quality healthcare, good transportation, a healthy environment, and so much more – the kinds of resources and opportunities that we all need to flourish. As Americans, we believe strongly that everyone should have access to opportunity, regardless of the color of their skin, their gender, their ancestry, the language they speak, where they worship or whether they have children. Unfortunately, the reality often differs from this ideal, as we can see clearly in the housing market.

My testimony today will focus on widespread problems in the maintenance and marketing of foreclosed properties, particularly in communities of color, and the long-term impact of those problems. It is based on a five year investigation conducted by the National Fair Housing Alliance. I will also describe some of the patterns and practices that, over many decades, created the conditions in which these problems could take root. Finally, I will draw some lessons for future policies and programs that are suggested by the conclusions of our investigation.

Why Homeownership Matters

Homeownership has long been the key to opportunity in this country - a path into the middle class. Homeownership has provided millions of families the means to create economic stability and build wealth. Families have used the equity in their homes to send their kids to college, start or expand small businesses, weather economic hardships, fund retirement, and pass along wealth to the next generation.

But homeownership rates in the U.S. vary tremendously by race and national origin, and have done so for many decades. According to the Census Bureau[1], in 1994, some 70 percent of White households were homeowners, while for both Black and Hispanic households the rate was closer to 42 percent. In 2004, the White homeownership rate hit a high of 76 percent, while the rates for Black and Hispanic households rose to 49 percent. At the end of the third quarter of this year, the White homeownership rate had fallen to 72.6 percent, and the rates for Blacks and Hispanics were 42.9 percent and 45.6 percent, respectively. As these figures illustrate, while homeownership rates have risen and fallen for all homeowners, the gap between homeownership rates for White households and others has remained remarkably constant. Households of color have not experienced the benefits of homeownership to the same degree as their White counterparts.

There are many factors that explain these differences. They include policies of the federal government, enacted many decades ago, that provided access to affordable homeownership for White families while denying it to their Black counterparts. Foremost among these were the early policies of the Federal Housing Administration (FHA). FHA fueled the expansion of the suburbs in the post-World War II era, insuring construction loans for companies building new subdivisions, as long as they agreed not to sell any of the houses to Black families. Similarly, FHA's insurance for individual mortgages made long term,

[1] See "Quarterly Homeownership Rates by Race and Ethnicity of Householder: 1994 to present," available at http://www.census.gov/housing/hvs/data/histtabs.html.

fixed rate, low down payment loans available to White families of modest means, but excluded Black families from obtaining similar mortgages.[2] This practice came to be known as "redlining."FHA has long since changed its policies, and has become an important source of mortgage financing for many families, including families of color. But the policies it adopted in its early years laid the foundation for the differences in homeownership rates that we see today. And the policy changes alone have not eliminated the gap.

These federal government policies were adopted by those in the private sector, and for decades, inner city communities, communities of color, and low- and moderate-income communities were redlined – denied access to affordable, sustainable mortgages from mainstream financial institutions.

During this past decade, communities of color that had previously been starved for credit were flooded with subprime and other unsustainable mortgages, a phenomenon that some have called "reverse redlining." According to the Federal Reserve Board, in 2005-2006 – the peak subprime lending years – more than 53 percent of the home purchase loans made to African Americans nationwide were subprime loans, as were more than 49 percent of the refinance loans made to these borrowers. African American borrowers were 3 times more likely to get a subprime home purchase loan and 2 times more likely to get a subprime refinance loan than White borrowers. During those same years, more than 46 percent of the home purchase loans made to Latino borrowers were subprime, as were more than 34 percent of the refinance loans made to Latinos. They were 2.5 times more likely to get a subprime home purchase loan and more than 1.5 times more likely to get a subprime refinance loan than White borrowers.[3]

These differences cannot be explained by the credit worthiness of the borrowers. A Wall Street Journal analysis of subprime loans made in 2005-2006 found that more than half of the borrowers (55 percent in 2005, 61 percent in 2006) would

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[2] For a more detailed description of the racially exclusionary policies of the FHA and other government agencies, see Richard Rothstein, "The Making of Ferguson: Public Policies at the Root of its Troubles," Economic Policy Institute, October 15, 2014, available at http://www.epi.org/publication/making-ferguson/.

[3] Avery, Robert B., Kenneth P. Brevoort and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data, Federal Reserve Bulletin, available at http://www.federalreserve.gov/pubs/Bulletin/2006/hmda/default.htm; and "The 2006 HMDA Data," Federal Reserve Bulletin vol. 93, December 21, 2007, available at http://www.federalreserve.gov/pubs/bulletin/2007/07index.htm.

have qualified for a prime mortgage.[4] Evidence from several fair lending cases brought by the Department of Justice found that some lenders steered thousands of African American and Latino borrowers into subprime loans even though they were qualified for prime mortgages.[5]

These subprime loans, and other exotic mortgage products offered during the early and mid-2000s proved to be expensive and unsustainable. They contained many risky features, such as high upfront costs, negative amortization and adjustable payments that caused monthly payments to rise rapidly. They were targeted and heavily marketed to borrowers for whom they were not a suitable product, particularly borrowers of color. And they defaulted at historic rates. Research from the Federal Reserve Bank of San Francisco found that more than 35 percent of the subprime first lien mortgages originated in 2006 defaulted within the first 24 months, compared to just over 10 percent of prime first lien mortgages originated in the same year.[6]

The result has been a deluge of foreclosures – an estimated 5 million since 2008.[7] Just as subprime lending was concentrated in communities of color, so have foreclosures been concentrated in these communities. Neighborhoods that were targeted for subprime lending have become neighborhoods with high rates of foreclosure. In 2011, the Center for Responsible Lending (CRL) found that, "Nearly 25 percent of loans in low-income neighborhoods and 20 percent of loans in high-minority neighborhoods have been foreclosed upon or are at high risk of default."[8] CRL's research also found that, "Approximately one quarter of all Latino and African-American borrowers have lost their home to foreclosure or are seriously delinquent, compared to just under 12 percent for white borrowers." As these statistics suggest, in many communities of color, there are now large numbers of vacant, foreclosed properties, also known as REOs (Real Estate Owned properties).

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[4] Brooks, Rick and Ruth Simon, "Subprime Debacle Traps Even Very Creditworthy," Wall St. Journal, December 3, 2007.

[5] See, for example, the cases brought by DOJ against Bank of America's Countrywide unit and Wells Fargo. Details available at http://www.justice.gov/crt/about/hce/whatnew.php.

[6] Amromin, Gene and Anna L. Paulson, "Default Rates on Prime and Subprime Mortgages: Differences & Similarities," in Profitwise News and Views, Federal Reserve Bank of San Francisco, September, 2010.

[7] CoreLogic estimates that 4.4 million foreclosures were completed between 2008 and May, 2013. It estimates another 594,000 foreclosures were completed between June, 2013 and May, 2014. See CoreLogic National Foreclosure Report, May, 2013, available at http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-may-2013.pdf, and CoreLogic National Foreclosure Report, May, 2014, available at http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-may-2014.pdf.

[8] Bocian, Debbie Gruenstein, Wei Li, Carolina Reed, and Roberto G. Quercia, , "Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures," Center for Responsible Lending, November 2011.

NFHA's REO Investigations

Several years into the foreclosure crisis, NFHA began to hear complaints about the neglect of REO properties and the negative impact of those properties on the surrounding neighborhoods. This prompted us to begin investigating the REO maintenance and marketing practices of major lenders and the Government Sponsored Enterprises (GSEs). Since April, 2009, in partnership with 17 of our members, NFHA has inspected 3,726 foreclosed properties in 29 metropolitan areas and 22 states. Some of these properties are located in predominantly White neighborhoods. Others are located in predominantly Black and/or Hispanic neighborhoods. Many of these neighborhoods are stable communities where the rate of homeownership is high. At each house, our investigators evaluate more than 30 aspects of maintenance and marketing, including curb appeal, structural integrity, signage, indications of water damage and the condition of the paint, siding, gutters and downspouts.

Our Findings

The findings of our investigation are detailed in the report, "Zip Code Inequality: Discrimination by Banks in the Maintenance of Homes in Neighborhoods of Color," a copy of which is attached to my testimony. This is the third report NFHA has issued since our investigations began in 2009, and unfortunately, the findings described in this report are as troubling as our earlier ones. What we found in many cases was that the system for managing REO properties in communities of color was broken. The companies that were hired to do the on-the-ground work of maintaining and marketing foreclosed properties failed to do their jobs properly. The banks, owners and investors who hired those on-the-ground companies failed to manage and oversee their work. And, for the most part, the federal agencies with supervisory responsibility in this area failed to provide the guidance and oversight needed.

The problem was particularly acute in communities of color, with a negative impact on the families who lost their homes to foreclosure, the families in the surrounding homes, and the cities in which those homes were located. In all of these ways, these neglected properties are a drag on our broader economic recovery.

Because the problems are most acute in communities of color, they constitute a violation of the federal Fair Housing Act, which prohibits discrimination in all aspects of housing, including marketing and maintenance, on the basis of race, color, religion, sex, national origin, family status or disability. The Fair Housing Act also requires federal agencies with housing and community development programs and activities to administer those programs and activities in a manner "affirmatively to further" the purposes of the Act. That is, in a manner to combat the problems associated with segregation and take steps to overcome them. The Fair Housing Act provides both a mandate and a tool for dealing with the kinds of problems we found with foreclosed homes in communities of color across the country.

Some of the highlights of our findings are described below.

We found that REO properties in White neighborhoods were well-cared for and well-marketed. They were more likely to have neatly manicured lawns, securely locked doors, and attractive, professional "For Sale" signs out front. These properties tended to be maintained to the standards of other homes in the neighborhood and attractive to real estate agents and potential homebuyers. Someone driving down the street would likely never know that the property was for sale because of a foreclosure.

In contrast, REO properties in communities of color were more likely to have overgrown yards, trash on the premises, unsecured doors, and broken or boarded windows. These properties were not maintained to the standards of nearby homes. They appeared abandoned, blighted and unappealing to potential homebuyers, even though they were located in stable neighborhoods where the surrounding homes were well maintained.

Overall, our investigation found that, compared to REO properties in White communities, REOs in communities of color were:

- 2.2 times more likely to have significant amounts of trash and debris on the premises;
- 2.3 times more likely to have unsecure, broken or damaged doors;
- 2.0 times more likely to have damaged, broken or boarded windows;
- 2.1 times more likely to have holes in the structure; and
- 1.3 times more likely to lack a professional "for sale" sign

In some cities, the disparities were much starker. For example:

- In Memphis, TN, REOs in communities of color were 8.8 times more likely to have significant amounts of trash and debris littered throughout the property than REOs in White communities.

- In Hampton Roads, VA, REOs in communities of color were 6 times more likely to have unsecured, damaged, or boarded doors than REOs in White communities.
- In Miami, FL, REOs in communities of color were 3.7 times more likely to have overgrown grass or dead leaves on the property than REOs in White communities.
- In Kansas City, MO/KS, REOs in communities of color were 3.6 times more likely to have damaged, broken or boarded windows than REOs in White communities.

Further, these maintenance deficiencies were cumulative. That is, REOs in communities of communities of color were more likely to have a greater number of deficiencies than those in White communities. In our investigation, 43.2 percent of REOs in White communities had fewer than 5 deficiencies, compared to only 21.7 percent of those in communities of color. Conversely, 32 percent of the REOs we inspected in communities of color had 10 or more deficiencies, compared to only 12.4 percent of those in White communities.

In other words, REOs in communities of color were much more likely to have a great many deficiencies – such as large quantities of trash, broken or unsecured doors and/or windows, holes in the roof, missing or damaged gutters and downspouts, overgrown lawns and invasive plants, graffiti, damaged siding, and exposed or damaged utilities – than those in White communities.

Poor Maintenance Causes Many Problems

These cumulative deficiencies lead to a host of problems. For example, they can cause health problems, both physical and mental. REOs with unsecured doors and windows invite trespassers and vandals, as well as rodents, insects, cats, dogs and wildlife. These, in turn, can increase the risk of disease, and may also be triggers for asthma for nearby residents. There are other health consequences, as well. Recent research published by the American Heart Association found that living near a foreclosed home that remains vacant for some period of time increases a person's chance of developing high blood pressure. People who live near vacant properties may feel an increased sense of social isolation, affecting their psychological well-being. They are also less likely to walk, run and play outside, with further health consequences.

Poorly maintained REOs may also cause safety problems. They attract vagrants and criminal activity, and may be fire and safety hazards. Some of the REOs visited in NFHA's investigation have become the houses where people party on the weekends or engage in illicit activities, or where squatters take over. They also contribute to violent crime in a community. Research shows that for every 1 percent increase in the foreclosure rate in a census tract, violent crimes increase by 2.33 percent.[9]

All of these problems place an increased burden on municipal fire, police, health care and other resources. At the same time, their poor condition depresses the value not only of these properties, but also the surrounding homes, even those that are occupied and well-maintained. This results in lower tax revenues for municipalities, even as they must expend more resources to cope with the problems created by the REOs. It is not surprising that a number of cities have taken legal action in an effort to recoup the increased costs they experience in dealing with vacant, poorly maintained REOs. One example is the City of Los Angeles, which has sued both Deutsche Bank and US Bancorp over their failure to comply with municipal building codes in their maintenance of foreclosed homes in that city.

Investor Purchases of REOs

The poor maintenance and ineffective marketing of REO properties in communities of color also have an impact on who ultimately purchases these properties. In order to understand this relationship better, NFHA tracked the sales of REOs that were part of its earlier investigations in two Maryland Counties, Montgomery and Prince George's, and in Memphis, TN. In Maryland, we found that investors purchased 59 percent of REO properties that were poorly maintained (had 10 or more deficiencies), compared to 36 percent of those that were well maintained. Owner-occupants purchased 46 percent of the well maintained REOs, compared to only 12 percent of those that were poorly maintained. Because of the higher incidence of poor maintenance in communities of color, 52 percent of the REO properties whose sales we tracked in those communities were purchased by investors, compared to 33 percent of those in White communities.

We found similar outcomes in Memphis. There, 70 percent of the REOs with 10 or more deficiencies were sold to investors, compared to 46 percent of those that were well-maintained. 51 percent of the well maintained properties were sold to

[9] Immergluck, Dan, "The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime," Vol. 21, No. 6 in Housing Studies, 851-866, http://www.prism.gatech.edu/~di17/HousingStudies,pdf.

owner-occupants, compared to only 20 percent of the poorly maintained REOs. In communities of color, 70 percent of the REOs were sold to investors, compared to 18 percent in White communities. 24 percent of REOs in communities of color were sold to owner-occupants, compared to 78 percent in White communities.

The Role of the Fair Housing Act

The federal Fair Housing Act requires banks, trustees, investors, servicers, and any other responsible party to maintain and market properties that are for sale or rent without regard to the race or national origin of the residents of a neighborhood. It is illegal to treat a neighborhood differently because of the race or national origin of the residents. Moreover, the law obligates banks, trustees, investors and servicers to monitor the actions of vendors engaged in performing housing-related transactions to ensure that those third party entities comply with fair housing laws and obligations. Banks, trustees, investors and servicers who fail to ensure that the REOs they own and for which they are responsible are maintained and marketed without regard to the race or national origin of the residents of the neighborhood may be violating the Act.

The Fair Housing Act also requires federal agencies (including those with regulatory or supervisory responsibility over financial institutions) with programs or activities related to housing and community development to conduct those programs and activities in a manner that affirmatively furthers the purposes of the Act. Those purposes are two-fold: to eliminate discrimination from the housing market, and to overcome the negative effects of entrenched segregation. The subprime lending that was targeted to communities of color and the subsequent surge in foreclosures in those communities has exacerbated the problems related to segregation. Failure to maintain and market these properties properly makes the problems even worse.

The federal agencies responsible for overseeing the activities of banks, other investors and the GSEs have both the authority and obligation to ensure that they do not violate the Fair Housing Act in their maintenance and marketing of REO properties. Effective oversight can help stem this problem. To date, only the Federal Reserve Board has taken action in this area. It has provided guidance to the institutions it supervises about the liability to which they may be exposed for failure to ensure effective management of their REOs in communities of color.[10] Further, the Board is incorporating this issue into the risk assessments it conducts for institutions in advance of an on-site examination. To NFHA's knowledge, none of the other federal agencies with fair housing responsibilities have taken similar action.

Recommendations

Based on the results of our investigations into the management, maintenance and marketing of REO properties, NFHA recommends that a number of steps be taken to prevent the kinds of problems we identified. These are detailed in our report, and I provide some highlights below.

- **Better Oversight from Federal Regulators and Congress** – Many of the entities that have engaged in discriminatory practices in the REO market are federally regulated. Federal regulators, including the Federal Housing Finance Agency, Federal Reserve and others must be vigilant in their supervision to ensure that banks and the GSEs do not implement practices that harm neighborhoods of color or homeowners from protected classes under the Fair Housing Act. The CFPB also has a role to play as the key regulator of mortgage servicing. It does not have authority under the Fair Housing Act, but does have authority under the Equal Credit Opportunity Act. Congress must hold hearings to investigate discrimination in the REO arena so that neighborhoods of color and the businesses that support these neighborhoods are not left behind in the economic recovery.

- **Sales Practices Should Help Stabilize Communities** – banks and other owners of REOs should not allow the homes to sell at auction for prices significantly below the market value of other homes in the neighborhood.

- **Selection and Management of REO Vendors** – all of the vendors selected to work on the disposition of REOs should receive high-quality fair housing training, should not be the subject of pending discrimination complaints, and should have resolved any past complaints of discrimination successfully.

[10] See Federal Reserve Board Supervision and Regulation Letter SR 12-10 / CA 12-9, Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned (OREO)June 28, 2012 available at http://www.federalreserve.gov/bankinforeg/srletters/sr1210a1.pdf

- **Marketing and Disposition Practices** – brokers selected to list REO properties for sale should have an office in close proximity to the property, have the capacity to closely manage and oversee the treatment of the REO, and should not have any discrimination actions pending or any past complaints that were not resolved satisfactorily. Further, banks and other REO owners should implement better incentives for their brokers to sell to owner-occupants rather than investors and should severely restrict bulk sales. They should also make sure that some of these homes are made available to non-profit community development organizations, community land trusts, and other community-based and community-minded institutions that have a vision for rebuilding healthy and vibrant neighborhoods.

- **Quality Control Measures** – Banks and other owners must implement better quality control measures across the board, with swift and severe penalties for vendors who fail to do their work in a professional manor. Special attention must be directed to neighborhoods that have been found to be vulnerable to poor work by vendors, including neighborhoods that are predominantly African-American, Latino or Asian-American, as well as low- and moderate-income neighborhoods.

- **Transparent, Accurate and Accessible Information about REO Ownership** – Every bank or REO owner should maintain a public database containing all of its REO listings, including the name and contact information of those responsible for the maintenance or sale of the property. Neighbors and local advocates must have access to clear ownership records that are updated in an accurate and timely manner. Local governments should continue to implement Vacant Property Registries, monitor these registries, and routinely address any violations.

- **Create a Path Back to Homeownership** – Five million families have lost their homes to foreclosure since September, 2008. Evidence from federal enforcement actions tells us that many of these families were steered into loans that were more risky and more costly than their financial qualifications should have dictated. Others have been caught between record high levels of sustained unemployment and falling home prices that have made it impossible for them to sell or refinance their homes. Offering these families a path back to homeownership is an important component of rebuilding stable, vibrant communities. Because so many of these families have been families of color, it is also a fair housing issue.

Loss of Wealth Due to Foreclosures and Implications for the Future

The foreclosure crisis has drained enormous wealth from communities across the country – an estimated $2.2 trillion, according to CRL. Half of that amount, $1.1 trillion, has been lost by communities of color.[11] To be clear, this is not the direct cost to families who have lost their homes to foreclosure, but rather the loss to families in nearby homes due to the decline in the value of their homes. The Pew Research Center reached similar findings. Between 2005 and 2009, according to Pew, blacks and Hispanics lost 53 percent and 66 percent of their household wealth, respectively, due to declining property values. In contrast, white households experienced a 16 percent loss in median household wealth. Thus, while the typical White household had $113,149 in wealth in 2009, the typical Black household had only $5,677. For the typical Hispanic household, that figure was $6,325.[12]

This loss of wealth has tremendous implications for the future. It limits the ability of families of color to tap the equity in their homes in the way that so many others have done: to send their kids to college, to start or expand a small business, to weather financial difficulties, to fund retirement, and to pass along wealth to the next generation. In other words, it limits their options and opportunities.

This, in turn, has tremendous implications for the housing market and the economy as a whole. Seven out of ten new households formed over the next decade will be households of color.[13] By 2025, people of color will make up nearly half of the typical first-time homebuyer population.[14] If this group cannot afford to buy homes, the housing market may stall. Current homeowners may have difficulty selling their existing homes, whether to downsize as they age or to meet other needs. In order to maintain a robust housing market and a thriving economy, we must ensure that we address the lingering problems in

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[11] "2013 Update: The Spillover Effects of Foreclosures," Center for Responsible Lending, August 19, 2013, available at http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosure-spillover-effects-final-aug-19-docx.pdf.

[12] Kochhar, Rakesh , Richard Fry and Paul Taylor, "Twenty to One: Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics," Pew Research Center, July 26, 2011, available at http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[13] See the Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing: 2013," available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013.pdf.

[14] See The Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing: 2014," available at http://www.jchs.harvard.edu/research/state_nations_housing

communities hard hit by foreclosures and provide access to affordable, sustainable credit for borrowers of color.

Lessons for Other Policies and Programs

NFHA's investigations into the management of REOs provide a window into the devastation caused by the foreclosure crisis, to the housing market, the overall economy, and especially to communities of color. It is a reminder of the importance of taking effective action to prevent abusive lending practices from causing this kind of devastation in the future. Full recovery will also require us to take affirmative steps to help people affected by foreclosure get back on their feet and to revitalize the hardest hit communities. Congress has an important role to play in this effort, as it shines a light on housing problems in hearings like this and as it oversees the work of relevant federal agencies.

Reforming the Mortgage Market

One way to prevent a recurrence of the foreclosure crisis is to ensure that the risky mortgage products and lending practices that characterized the subprime boom do not creep back into the mortgage market, either in the forms we saw during the 2000s or in new and different forms. By enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, with its prohibitions against the riskiest features of the types of mortgages and lending practices that caused the crash, Congress took an important step toward eliminating abusive mortgage lending practices. The regulations that the Consumer Financial Protection Bureau has issued to implement those statutory provisions will help ensure that Congressional intent is carried out. However, abusive practices can only be fully eliminated when strong regulations are accompanied by strong oversight and effective enforcement. In this, all of the federal agencies with responsibilities for oversight of the mortgage market have important roles to play in policing the marketplace, as does Congress in its role as overseer.

While it is important to shore up the regulatory system to prevent risky and abusive products and practices, it is critical to balance this risk reduction effort with the need to preserve access to affordable, sustainable credit for creditworthy borrowers. This means we should eliminate the features that, when layered together, made loans unsustainable – such as high points and fees, negative amortization, rapidly rising monthly payments, and the like. At the same time, we must be careful not to impose requirements, such as large down payments, that bear little relationship to risk but have the effect of eliminating a great many creditworthy potential borrowers, particularly borrowers of color, from eligibility for a mortgage. Similarly, we must ensure that the pricing policies adopted by the GSEs and FHA do not unfairly and unnecessarily shut these borrowers out of the market.

Another way to ensure that borrowers and communities are not further harmed by widespread foreclosures is to prevent those foreclosures that can be avoided, both now and in the future. This requires reforms to mortgage servicing. The CFPB has issued regulations to begin this process, and has further regulations in this area out for public comment now. The testimony of Julia Gordon, from the Center for American Progress, addresses these regulations and NFHA endorses her comments on this subject.

Sale of Non-performing Loans

There are a great many borrowers currently at risk of foreclosure, whose loans are in default. Many of these loans are owned or backed by entities under federal control. The Federal Housing Administration has more than 311,000 mortgages that are 90 days delinquent,[15] and the two GSEs have another $100 billion of seriously delinquent loans.[16] Both are taking steps to minimize their losses by selling pools of these non-performing loans to investors rather than putting them through the foreclosure process. FHA has created the Distressed Asset Stabilization Program (DASP), and this past summer, FHFA authorized a bulk sale of non-performing loans by Freddie Mac, which is expected to be the first in a number of such sales by both GSEs. In theory, selling these loans for an amount below the unpaid principal balance creates the opportunity for a win-win-win situation. The agencies that own or back these loans get an immediate return on the sales and eliminate their exposure to future risk. The investors who purchase these loans get a bargain and the opportunity to restructure the loan and create a stream of income for the future. The homeowner gets a shot at a restructured loan, which may include a reduced loan balance, which is affordable and sustainable and allows them to stay in the home. This avoids a foreclosure, which is costly to all parties. It avoids the potential problems that NFHA's investigation into REO maintenance and marketing identified, and it

[15] Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2014, US Department of Housing and Urban Development, Federal Housing Administration, November 17, 2014.
[16] Chrisman, Rob, "Non-Performing Loan Market On Fire; Rates Back to June 2013 Levels But Production May Drag," Mortgage News Daily, August 18, 2014.

helps to stabilize the community, preserving the value of other loans in the same area that are owned or backed by the agency.

In order to achieve this triple bottom line, however, the sales of loan pools must be structured to accomplish all of these goals. To the extent possible, pools should be sold to mission-driven non-profits or mission-minded for-profits that are committed to preserving homeownership for the largest possible number of borrowers. The desired outcomes and program parameters should be explicit, and purchasers should be required to report on the outcomes they achieve. The programs should be transparent, with information about outcomes made available to the public. And steps must be taken to ensure that borrowers of color are treated fairly and have the same opportunity to save their homes as other borrowers.

In addition, before any loan is sold, it is critical to ensure that all of the required loss mitigation steps have been taken. Servicers should document the steps they have taken, and the responsible agency should verify the accuracy of that documentation. Borrowers should be notified in advance that their loan may be sold, and should be informed of the loss mitigation steps their servicer says it has taken. In this way, the borrower can help with the verification process.

HUD is moving in the right direction with its DASP program, but that program can and should be strengthened. Provisions like these were not built into the non-performing loan sales that Freddie Mac conducted last summer, and to date, it is not clear whether or how FHFA will structure future sales by the GSEs to accomplish these goals. This is another area where Congressional oversight would be useful.

Conclusion

We have made substantial progress in dealing with the foreclosure crisis, but there is more work to do to restore a robust housing market and ensure that all communities have an opportunity to share in the recovery. NFHA's investigation into the management of REO properties shines a spotlight on some of the persistent problems that remain to be solved. It also underscores the importance of using all of the government's tools to their best effect to eliminate inequality and restore opportunity in our nation's housing market.

Thank you for the opportunity to testify here today. I will be happy to answer your questions, and look forward to working with you in the months ahead.