B. Congressman Jeb Hensarling.

Although I appreciate the work the Panel and staff members have done in preparing the October report, I do not concur with the conclusions and recommendations presented and, accordingly, dissent from the adoption of the report. Foreclosure mitigation is mentioned in the Emergency Economic Stabilization Act, EESA (P.L. 110-343), so it is an important mission for the Panel to assess the effectiveness of loan modification programs as they relate to this objective as well as to taxpayer protection.

1. Executive Summary

While I acknowledge the extensive research that went into this report on foreclosure mitigation and wish to thank the Panel for incorporating some of my edits and ideas, I believe several areas are either overlooked completely or present challenges to conducting proper oversight. In the following, I hope to shine a light on key issues relating to the Panel's analysis of housing policy and the Administration's foreclosure mitigation programs.

A fair reading of the Panel's majority report and my dissent leads to one conclusion – HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure. The Administration's opaque foreclosure mitigation effort has assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.

While the Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs, instead of focusing its attention on taxpayer protection and oversight, the Panel's majority report implies that the Administration should commit additional taxpayer funds in hopes of helping distressed homeowners – both deserving and undeserving – with a taxpayer subsidized rescue.

While there may be some positive signals in our economy, recovery remains in a precarious position. Unemployment will hit 10 percent in 2010, if not this year. This is unfortunate because the best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

Regardless of whether one believes foreclosure mitigation can truly work, taxpayers who are struggling to pay their own mortgage should not be forced to bail out their neighbors through such an inefficient and transparency-deficient program. Both the Administration and the Panel's majority appear to prioritize good intentions and wishful thinking over taxpayer protection.

To date, despite the commitment of some $27 billion,[397] only about 1,800 underwater homeowners have received a permanent modification of their mortgage. If the Administration's goal of subsidizing up to 9 million home mortgage refinancings and modifications is met, the cost to the taxpayers will almost surely exceed the $75 billion already allocated to the MHA - Making Home Affordable - program,[398] and it is likely that most (if not all) of it will be not be recovered.

Taxpayers deserve a better return on their investment than what they are set to receive from AIG, Chrysler, GM and the Administration's flawed foreclosure mitigation efforts.

Professor Alan M. White, an expert retained by the Panel, notes in a paper attached to the Panel's report: "The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60 percent or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more."

Taxpayers – through TARP or otherwise – should not be required to subsidize mortgage holders or servicers when foreclosure mitigation efforts appear in many cases to be in their own economic best interests. The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP – Home Affordable Modification Program–and HARP – Home Affordable Refinancing Program – programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking assistance from the government.

Any foreclosure mitigation effort must appear fair and reasonable to the American taxpayers. It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs. Distinct from a moral hazard question there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble.

In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is: "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.

[397]U.S. Department of the Treasury, *TARP Transactions Report* (Oct. 2, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_10062009.pdf). This figure is defined by the current "Total Cap" for the Home Affordable Modification Program: $27,247,320,000.

[398] The Making Home Affordable program presently consists of the HAMP–Home Affordable Modification Program– and the HARP–Home Affordable Refinancing Program–programs.

Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates. Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, but they work against the majority who shoulder the tax burden and make mortgage payments on time.

The following are topics that I will cover in my response.

- The Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs.

- Determination of costs is especially important if, as Treasury Secretary Geithner has stated, TARP is interpreted to be a "revolving facility." Given the likelihood that he will extend TARP to October 31, 2010, it's possible that a substantial portion of the $700 billion TARP facility could be directed to foreclosure mitigation efforts.

- EESA charges the Panel with a clear duty to provide information on foreclosure mitigation programs, but with the caveat that it must be with an eye towards *taxpayer protection*. The October report places policy recommendations above this statutory duty.

- In order to better appreciate the total all-in costs of the Administration's various foreclosure mitigation efforts and to ensure taxpayer protection, and to compensate for the Panel's gaps in oversight, the Administration should promptly provide the taxpayers with a thorough and fully transparent analysis of the following matters:

  (i) the total amount of funds the Administration has advanced and committed to advance under its various foreclosure mitigation efforts (including, without limitation, under MHA, HAMP and HARP, the second lien programs, as well as the programs adopted by Fannie Mae and Freddie Mac);

  (ii) the total amount of funds the Administration reasonably expects to advance and commit to advance over the next five years under all of its present and anticipated foreclosure mitigation efforts; and

  (iii) the total anticipated costs to all financial institutions and other mortgage holders and servicers under all of the Administration's present and anticipated foreclosure mitigation efforts.

- Treasury should be held accountable for key performance metrics as well. With 360,000 trial modifications underway, only 1,800 permanent modifications in place, and at least $27 out of $50 billion committed to the MHA–Making Home Affordable–program for

loan modifications, by all appearances, Treasury is still a long way from its goal of assisting 3 to 4 million homeowners.

- All of the false starts with HAMP and the other government programs may have exacerbated the foreclosure mitigation process by keeping private sector servicers and mortgage holders on the sidelines waiting on a better deal from the government. By creating a perceived safety net, the foreclosure mitigation efforts advocated by the Administration may encourage economically inefficient speculation in the residential real estate market with its adverse bubble generating consequences.

- Housing GSEs–Government Sponsored Enterprises–Fannie Mae and Freddie Mac play key roles in the Administration's new housing policies. Funds from the Preferred Share Purchase Agreements, which allow the GSEs to draw up to $400 billion from Treasury, are being deployed for foreclosure mitigation and refinancing efforts. Since Fannie Mae and Freddie Mac are now under the conservatorship of the Federal Housing Finance Agency (FHFA), their concerns are now officially the taxpayer's concerns – any losses they experience through MHA should be a carefully considered part of a cost-benefit analysis.

- Fannie Mae and Freddie Mac should be more forthcoming with respect to their foreclosure mitigation efforts and use of taxpayer funds by addressing the questions that I pose later in the report.

- Due to flaws in the incentive structure for large-scale, loan modification programs, the Panel seems to support substituting federal bankruptcy judges for the traditional role performed by servicers and mortgage holders in loan modifications. Such a change in law will add to the increasing burden borne by the vast majority of homeowners who meet their mortgage obligations each month by encouraging non-recourse speculative investment in the residential housing market.

- Since one of Treasury's fundamental mandates is taxpayer protection, the incorporation of a shared appreciation right or equity kicker feature would appear appropriate. Homeowners should not receive a windfall at the expense of the taxpayers and mortgage lenders who suffered the economic loss from restructuring their distressed mortgage loans.

- Evaluation of a taxpayer-subsidized loan modification must consider the tremendous government interventions already underway. Private capital investment is scarce in today's housing market, replaced by recent, rapid growth in the government's share of the mortgage markets.

- Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, while working against the majority who shoulder the tax burden *and* make mortgage payments on time. Moral hazard is not just an issue of fairness – programs that give no consideration to the rightful, necessary link between risk and responsibility could potentially create additional housing "bubbles" and result in greater threats to stability.

- Overall, the Panel continues to place policy objectives above transparent and critical oversight. I recommend an oversight plan with several requirements be considered by the Panel.

2. Cost of the Foreclosure Mitigation Plans to Taxpayers

In order to have an informed debate on the foreclosure mitigation issue it's critical that the American taxpayers understand the all-in costs of all foreclosure mitigation efforts. This is particularly significant since approximately 95 percent of taxpayers meet their monthly rental and mortgage obligations and these taxpayers will be asked to subsidize the cost of any foreclosure mitigation efforts directed for the benefit of those who do not meet their obligations.

3. CBO–100 percent Subsidy Rate for HAMP; Calculation of Total All-In Cost

A key distinction between the TARP-funded Capital Purchase Program and Treasury's foreclosure mitigation efforts is that the latter will most likely carry a subsidy rate to the taxpayers of 100 percent – that is, a 100 percent rate of loss for the taxpayers from the Home Affordable Modification Program (HAMP).[399] The Congressional Budget Office (CBO) has applied a 100 percent subsidy rate to the $50 billion of TARP funds committed to HAMP. It has not performed subsidy rate analysis for non-TARP financing of HAMP. According to CBO:

> The Treasury has committed $50 billion in TARP funding for the Administration's foreclosure mitigation plan, under which the TARP will make direct payments to mortgage loan servicers to help homeowners refinance their loans. Because no repayments will be required from the servicers, the net cost of the program will be the full amount of the payments made by the government.

Under these conditions, a 100 percent subsidy rate will be applicable throughout the entire HAMP lifecycle. A 100 percent subsidy rate becomes particularly problematic if–as announced with respect to the MHA program–the Administration plans to refinance and modify up to 9 million mortgages. Absent meaningful input from Treasury, it's difficult to calculate the all-in cost of the foreclosure mitigation programs to both the taxpayers, and the holders of

[399] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009(*(June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

residential mortgages, investors in securitized mortgage obligations, other investors and mortgage servicers (which I refer to as the "financial community").

For example, under a HAMP modification the mortgage lender bears the cost of reducing each participant's monthly mortgage payment to 38 percent of DTI (the participant's debt-to-income), and the lender and the government share the cost of reducing the participant's monthly mortgage payment from 38 percent to 31 percent of DTI. The Panel's report notes that monthly principal and interest payments are reduced on average by $598 – from $1554 to $956 – following a HAMP modification. If you run the numbers over 12 months per year and for 4 million modifications, the annual cost equals approximately $29 billion. Over a five-year period the (non-discounted) cost equals approximately $145 billion. By adding, say, $9,000 of incentive payments for 4 million modifications the total all-in gross cost to the taxpayers and the financial community increases by $36 billion to approximately $181 billion ($145 billion, plus $36 billion-non-discounted). If, instead, the Administration elects to modify 9 million mortgages the total all-in gross cost to the taxpayers and the financial community jumps to approximately $407 billion (non-discounted). To these estimates must be added the billions of dollars already allocated to Fannie Mae and Freddie Mac as well as the write-offs already taken by private sector mortgage lenders, holders of securitized debt and servicers. These amounts reflect back-of-the-envelope estimates of gross costs and must be considered along with Professor White's cost-benefit testimony (discussed below) and the analysis of other experts. If the Administration promotes aggressive principal reduction, negative equity abatement and second lien programs, the estimates may, however, materially understate the all-in gross costs to the taxpayers and the financial community.

Based upon the Panel's report, it's difficult to determine how much of this cost will fall to the taxpayers and how much will be borne by the mortgage holders under the DTI formula. It is troubling that the Administration has made little effort to disclose the all-in cost of these programs to the taxpayers and the financial community. Did Treasury roll-out the MHA program with its promise of refinancing or modifying up to 9 million mortgages without providing a realistic estimate of the cost of the program to the taxpayers and the financial community? [400] Will Treasury commit to limit MHA to $50 billion of TARP funds?

4. Repaid TARP Funds Available For Foreclosure Mitigation

Although the HAMP program is presently limited to $50 billion of TARP funds, I am not aware of any constraint on the Secretary from allocating additional TARP funds to MHA or any other existing or future foreclosure mitigation efforts. Since the Secretary interprets TARP as a

[400] Any attempt to quantify the total costs and expenses that may be incurred in restructuring mortgage loans should consider the following: (i) fees paid to servicers, attorneys, appraisers, surveyors, title companies and accountants, (ii) principal reductions, (iii) interest rate reductions, (iv) second lien reductions, (v) negative equity reductions, and the like.

"revolving facility" and given the likelihood that he will extend TARP to October 31, 2010, it's possible that a substantial portion of the $700 billion TARP facility could be directed to foreclosure mitigation efforts. The MHA and the HAMP – Home Affordable Modification Program – and HARP–Home Affordable Refinancing Program – programs are subject to unilateral modification pursuant to which Treasury may restructure the programs to the detriment of the taxpayers. In addition, Treasury may introduce new programs that are funded in whole or in part by TARP. Along similar lines, it was recently reported that the Administration is close to committing up to $35 billion to state and local housing authorities to provide mortgages to low- and moderate- income families.[401] It's important to note again that CBO will most likely assign a 100 percent taxpayer subsidy rate to any new or expanded foreclosure mitigation programs thereby acknowledging the vast transfer of taxpayer funds from the taxpayers who meet their monthly mortgage and rental payments to those who do not.

5. Treasury Should Disclose the All-In Cost of the Foreclosure Mitigation Plans

In order to better appreciate the total all-in costs of the Administration's various foreclosure mitigation efforts, and to compensate for the Panel's gaps in oversight, I request that the Administration promptly provide the taxpayers with a thorough and fully transparent analysis of the following matters:

- the total amount of funds the Administration has advanced and committed to advance under its various foreclosure mitigation efforts (including, without limitation, under MHA, HAMP and HARP, the second lien programs, as well as the programs adopted by Fannie Mae and Freddie Mac);
- the total amount of funds the Administration reasonably expects to advance and commit to advance over the next five years under all of its present and anticipated foreclosure mitigation efforts; and
- the total anticipated costs to all financial institutions and other mortgage holders and servicers under all of the Administration's present and anticipated foreclosure mitigation efforts.

Like the recently completed "stress tests" conducted by Treasury and other financial regulators with respect to bank capital adequacy, the Administration should calculate the foregoing estimates under a "more adverse" scenario (i.e., where conditions materially deteriorate) as well as under current conditions. It is also imperative that the valuation models adopted by Treasury employ reasonable input assumptions and methodologies and make no effort to skew the results to the high or low range of estimates.

[401] Deborah Solomon, *$35 Billion Slated for Local Housing* Wall Street Journal (Sept. 28, 2009) (online at online.wsj.com/article/SB125409967771945213.html).

The analysis should acknowledge the extent to which the Administration's foreclosure mitigation efforts may create capital shortfalls within the financial community. It's somewhat ironic that at the same time the Administration is encouraging financial institutions and mortgage holders to boost their foreclosure mitigation efforts by restructuring home loans and writing down loan portfolios, the Administration is considering a new round of bailouts for the financial community.[402] Since money is fungible it's not unreasonable to conclude that the Administration may be in effect reimbursing–with taxpayer sourced funds–financial institutions that adopt and follow the Administration's foreclosure mitigation policies.

One key function of effective oversight is to determine if Treasury will be able to achieve its stated goals for the stated price–the refinancing or modification of up to 9 million mortgage loans for $75 billion. It's not possible to accomplish this task without a better understanding of the anticipated all-in cost of the several foreclosure mitigation programs.

6. Analysis by the Panel and Professor Alan M. White

In prior reports the Panel has retained the services of nationally recognized academics to value, for example, warrants issued to Treasury under the Capital Purchase Program as well as toxic assets held by banks and other financial institutions. In preparing the October report, I recommended that the Panel again retain the services of top-tier academics and other professionals to estimate the total cost to the taxpayers and the financial community of the various housing foreclosure mitigation plans and proposals including, without limitation, all refinancing, modification and second lien plans and proposals. Although the Panel's efforts do not reflect the same robust analysis undertaken in prior reports, I wish to thank Professor Alan M. White for his paper on the "potential costs and benefits" of the HAMP program.

In calculating the total cost of each mortgage modification to the taxpayers, Professor White concludes:

> To summarize, the total cost of the borrower, servicer and investor incentive payments for first and second mortgage HAMP payments is projected to be in the range of $16,000 to $21,000 average per first mortgage modification, including both successful and unsuccessful modifications. In other words, the cost per successful modification will be higher. Treasury should be in a position to report on actual per-modification costs by November or December, when several months of permanent modification data have been collected and some initial redefault statistics can be calculated.

[402] Daniel Wagner, *Fresh Bailouts for Smaller Banks Being Weighed*, The Observer (Sept. 25, 2009) (online at hosted.ap.org/dynamic/stories/U/US_SMALL_BANKS_BAILOUT).

Since these numbers apparently include up to $9,000 of incentive payments it appears that the total cost to the taxpayers of all interest rate and principal adjustments is approximately $10,000 per modification, or approximately $2,000 per year ($167 per month) for the full five-year HAMP modification period. Perhaps this is correct, but I question whether mortgage loans may be successfully modified at such a relatively modest cost to the taxpayers under the HAMP program. It appears that Professor White did not independently calculate these amounts, but, instead, generally relied upon estimates provided by Treasury. It is unclear what methodology Treasury employed except, perhaps, to divide the $50 billion of TARP funds initially allocated to HAMP by 2.5 million modifications, or $20,000 per mortgage modification. Such approach, although suggested by Professor White, hardly reflects the application of rigorous scientific methodology.

Professor White also expressly notes the effectiveness of non-subsidized voluntary foreclosure mitigation when he states:

> Nevertheless, there is convincing evidence that successful modifications avoided substantial losses, while requiring only very modest curtailment of investor income. In fact, the typical voluntary modification in the 2007-2008 period involved no cancellation of principal debt, or of past-due interest, but instead consisted of combining a capitalization of past-due interest with a temporary (three to five year) reduction in the current interest rate. Foreclosures, on the other hand, are resulting in losses of 50% or more, i.e. upwards of $124,000 on the mean $212,000 mortgage in default.

Significantly, he also quantifies the overall benefit of voluntary foreclosure mitigation to investors by concluding:

> The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60% or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more. Two million modifications with a 60% success rate could produce $160 billion in avoided losses, an amount that would go directly to the value of the toxic mortgage-backed securities that have frozen credit markets and destabilized banks.

If this is indeed the case, then why is it not in the best interest of each mortgage holder to modify the mortgage loans in its portfolio? Why would a mortgage holder risk breaching its fiduciary duties to its investor group by foreclosing on mortgaged property instead of restructuring the underlying loans? Why should the taxpayers subsidize the restructuring of mortgage loans–whether through the HAMP program or otherwise–if the mortgage holders may independent of such subsidy realize a net gain of approximately $80,000 per loan by voluntarily restructuring their distressed mortgage loans?

Professor White and the Panel seem to imply that without taxpayer-funded subsidies the mortgage servicers would be economically disinclined to modify distressed mortgage loans because of unfavorable terms included in typical pooling and servicing agreements–the contracts pursuant to which servicers discharge their duties to mortgage holders. Professor White writes:

> While modification can often result in a better investor return than foreclosure, modification requires "high-touch" individualized account work by servicers for which they are not normally paid under existing securitization contracts (pooling and servicing agreements or "PSA"s.)[403] Servicer payment levels were established by contracts that last the life of the mortgage pools. Servicers of subprime mortgages agreed to compensation of 50 basis points, or 0.5% from interest payments, plus late fees and other servicing fees collected from borrowers, based on conditions that existed prior to the crisis, when defaulted mortgages constituted a small percentage of a typical portfolio. At present, many subprime and alt-A pools have delinquencies and defaults in excess of 50% of the pool. The incentive payments under HAMP can be thought of as a way to correct this past contracting failure.
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> Because mortgage servicers are essentially contractors working for investors who now include the GSE's, the Federal Reserve and the Treasury, we can think of the incentive payments under HAMP as extra-contractual compensation for additional work that was not anticipated by the parties to the PSAs at the time of the contract.

Is the purpose of HAMP to bailout servicers from their "contracting failure" through the payment of "extra-contractual compensation"? The taxpayers should not be charged with such a responsibility and I am disappointed that the Administration, the Panel and Professor White would advocate such an approach. Notwithstanding the inappropriate complexity interjected into the foreclosure mitigation debate by the Administration, a solution appears relatively straightforward. If, as Professor White suggests, mortgage holders stand to realize a net gain of approximately $80,000 from restructuring each mortgage loan instead of foreclosing on the underlying property, the mortgage holders themselves should undertake to subsidize the "contracting failure" of their servicers out of such gains. I appreciate that mortgage holders may not wish to remit additional fees to their servicers, but, between mortgage holders and the taxpayers, why should the taxpayers–through TARP or otherwise–bear such burden? The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP and HARP programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage

[403] Standard & Poor's, *Servicer Evaluation Spotlight Report* (July 2009) (online at www2.standardandpoors.com/spf/pdf/media/SE_Spotlight_July09.pdf).

defaults in favor of seeking hand-outs from the government. It's difficult to fault mortgage holders and servicers for their rational behavior in accepting bailout funds that may enhance the overall return to their investors.

In addition, Professor White dismisses the importance of considering future decisions homeowners and others will make when entering into risky contracts when there is a perceived safety net. It is insufficient simply to say, "moral hazard from HAMP modifications is unlikely to play a significant role in borrower defaults," as viewed through the prism of "the cost of losses on mortgages that would otherwise perform but for the borrower's decision to default in order to benefit from the program." I appreciate that Professor White provides a definition to support his analysis, but it is an inadequate premise for such a sweeping conclusion. If the objective of the Administration's MHA program is to correct failures in the housing market so as to provide economic stabilization, then any estimate of total cost provided by Professor White or Treasury would by definition fail to consider the *additional* costs that will no doubt ensue when homeowners are saved from mortgage contracts they would not otherwise be able to shoulder without a government backstop. It would also exclude future risk-taking behavior that may necessitate future interventions. The MHA program in effect incorporates the failed policy of "implicit guarantee"– notoriously exploited by Fannie Mae and Freddie Mac – into yet another aspect of federal housing policy. By disregarding the distinct moral hazard risk, the MHA encourages speculation in the residential real estate market with its adverse bubble generating consequences.

7. Response to March Report on Foreclosures

In my response to the March Panel report, I commented on several aspects of the housing crisis that I felt were omitted or not thoroughly described by the Panel. These include further contributing causes, the universe of individuals in distress, the realized and unrealized costs of loan modification programs, and additional alternatives to government-subsidized foreclosure mitigation efforts.[404]

Below is a summary of some of the key points I discussed in response that are relevant to the current discussion on foreclosure mitigation:

- Foreclosure relief should be centered around borrowers in a fair, responsible, and taxpayer-friendly way.
- Policymakers should take care to avoid the trap of creating further market distortions that disrupt the law of supply and demand, which is designed to ensure that qualified borrowers have reliable access to mortgage products suitable to their needs.

[404] Representative Jeb Hensarling, *Foreclosure Crisis: Working Toward a Solution, Additional View by Representative Jeb Hensarling*, (Mar. 9, 2009) (online at cop.senate.gov/documents/cop-030609-report-view-hensarling.pdf).

- Government involvement in housing markets has already created significant disruptions, chiefly through highly accommodative monetary policy; federal policies designed to expand home ownership; the congressionally-granted duopoly status of housing GSEs, Fannie Mae and Freddie Mac; an anti-competitive government-sanctioned credit rating oligopoly; and mandates of certain policies and underwriting standards based on factors other than risk.[405]

- As the 2009 deficit reaches an estimated $1.6 trillion, evaluation of foreclosure plans must consider the all-in costs as well as the extraordinary federal assistance that has been provided in response to the financial crisis.

- The Panel should practice caution in estimating the redefault rates that will occur three months to a year after participation in the MHA–Making Home Affordable–program. Historical, yearly data show that redefault rates have been over 50 percent on modified loans.[406]

- Foreclosure rates are concentrated in specific states and areas, making one-size-fits all programs even more difficult to execute.

- It is important to remember that the number of individuals in mortgage distress reaches *beyond* individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs.[407]

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[405] One of the difficulties that some borrowers are facing has been the general federal objective of enabling and encouraging people to buy homes that were too expensive for them to otherwise afford. In a perfect world, the laws of supply and demand would be the fundamental driver of our mortgage markets, with qualified borrowers having reliable access to suitable mortgage products that best fit their needs. Yet, in reality, the cost of home ownership has in many places so thoroughly outpaced the ability of borrowers to afford a home that the government has chosen to intervene with various initiatives to defray parts of the cost of a mortgage. That intervention has taken many forms – affordable housing programs, federal FHA mortgage insurance, tax credits and deductions, interest rate policies, etc. – as part of a concerted effort to increase homeownership. For almost a decade, those efforts succeeded, pushing homeownership rates steadily up from 1994 through their all-time high in 2004. That increase in demand, in turn, contributed to a corresponding increase in home prices, which rose from the mid-1990s until hitting their peak in 2006. Yet those price increases created a cycle of government intervention – home price appreciation made homes less affordable, which in turn spurred further government efforts to defray more of their cost – and the involvement of the federal government in our housing markets only grew deeper.

Office of the Comptroller of the Currency and Office of Thrift Supervision *Mortgage Metric Report, First Quarter 2009* (online at www.occ.treas.gov/ftp/release/2009-77a.pdf) . See chart on page 7, which conveys a re-default rate of over 50 percent based on the most recent data available.

[407] These "life event" affected borrowers are noteworthy because relatively few object to efforts to find achievable solutions for trying to help keep these distressed borrowers in their current residences whenever possible. Similarly, another sympathetic group of distressed borrowers involves people who were legitimate victims of blatant manipulation or outright fraud by unscrupulous lenders who pressured them into homes they could not afford. To many, those legitimate victims are certainly equally deserving of assistance. Of course, such borrowers do have the

- Distinct from a moral hazard question there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble. In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair. [408]

- Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates.

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added burden proving that they were indeed victims of actual wrongdoing. However, they also have a potential remedy of pursuing legal action against fraudulent lenders, an option which is not available to others.

If the universe of individuals in mortgage distress included only borrowers from "life event" and fraud victims groups, the task of crafting an acceptable government-subsidized foreclosure mitigation plan would be much easier. However, the number of individuals in mortgage distress stretches far beyond those groups to include a much larger section of people who, for a wide variety of reasons, are no longer paying their mortgage on time. While certainly not an exhaustive list, that larger group includes:

- people who took out large loans to purchase more house than they could have reasonably expected to afford;
- borrowers who lied about their income, occupancy, or committed other instances of mortgage fraud;
- speculators who purchased multiple houses for their expected value appreciation rather than a place to live;
- individuals who decided to select an exotic mortgage loan with fewer upfront costs, lower monthly payments, or reduced documentation requirements;
- borrowers who took advantage of refinance loans to strip much or all of the equity out of their house to finance other purchases;
- those who simply made bad choices by incorrectly gambling on the market or overestimating their readiness for homeownership; and
- borrowers who have made a rational economic decision and, given their particular circumstance, it no longer makes sense to them to continue paying their mortgage.

Borrowers who fall into those categories are much less sympathetic in the eyes of many, and attempting to develop a government-subsidized foreclosure mitigation plan to assist them will inevitably raise significant moral hazard questions for policymakers.

A fundamental measure of the effectiveness of a foreclosure mitigation program is what steps the program has taken to sort those risky borrowers out from their more deserving counterparts to avoid the moral hazard of rewarding people or their bad behavior.

[408] After all, why should a person be forced to pay for their neighbor's mortgages when he or she is struggling to pay his or her own mortgages and other bills? To many people, this question is the most important aspect of the public policy debate. Given the massive direct taxpayer costs that have already been incurred through TARP and the potential costs that could be incurred through the assorted credit facilities and monetary policy actions of the Federal Reserve, I believe that it is difficult to justify asking the taxpayers to shoulder an even greater financial burden from yet another government foreclosure mitigation program that might not work.

- See the following link for my full response to the Panel's March report: http://cop.senate.gov/documents/cop-030609-report-view-hensarling.pdf.

8. Foreclosures and Macroeconomic Recovery

Indeed, the housing market is still on shaky ground and homeowners face the turmoil of potential waves of foreclosures. Although there are signs of life in the market – such as upward movement in housing starts and nationwide home values – unpredictable existing home sales figures[409] and continued increases in delinquencies and foreclosures mean underlying indicators are still problematic. Mortgage interest rates remain at low levels by historical standards, although much of this may be intertwined with the Federal Reserve's program to purchase up to $1.25 trillion in agency mortgage-backed securities. The future may be even more ominous for housing prices and recovery if concerns are realized about "shadow inventory," a term for the millions of homes that are waiting to hit the market either because they are in foreclosure or for other reasons.[410]

Even still, housing indicators cannot be studied in isolation. The best insurance policy to protect homeowners from foreclosure is having a job, and the best assurance of job security is the engine of economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. The Blue Chip Consensus and other forecasters predict that unemployment will hit 10 percent in 2010. Although a less-than-expected GDP drop for the second quarter is a positive signal, the path to economic recovery is expected to be sluggish, and further dragged down by record debt and deficit levels.[411]

Whether or not MHA will lead to economic stabilization or prevent further disruptions, two integral mandates of EESA, is open for debate. The Panel's report suggests that the housing market "has been at the center of the economic crisis, and until it is stabilized, the economy as a whole will remain in turmoil." It is undisputed that the collapse of housing prices ignited the financial crisis, which was linked to the risky undertakings of multiple players: government, lenders, borrowers and investors. Yet even if macroeconomic recovery were irrevocably dependent on the revival of the housing market – likely, the reverse is true – can this revival be spurred by a large-scale loan modification program that has committed $75 billion in taxpayer funding?

9. The Panel's Mandate With Respect to Taxpayer Protection

[409] Sara Murray, *Existing Home Sales Dropped In August*, Wall Street Journal (September 24, 2009) (online at online.wsj.com/article/SB125379520447237461.html#mod=WSJ_hps_LEFTWhatsNews).

[410] Jody Shenn, "*Housing Crash to Resume on 7 Million Foreclosures, Amherst Says*, Bloomberg News (September 23, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aw6_gqc0EKKg).

[411] U.S. Office of Management and Budget, *Mid-Session Review, Economic Assumptions* (August 2009) (online at www.gpoaccess.gov/USbudget/fy09/pdf/09msr.pdf).

Taxpayer protection is a guiding principle of EESA interwoven throughout the legislation, including for foreclosure mitigation efforts. I recommend that Treasury and the Panel define in measurable terms what is at stake – the costs and the benefits – for taxpayers in implementing the MHA plan.

EESA gives the Panel a clear duty to provide information on foreclosure mitigation programs, *but* with the following caveat. Reports must include:

> The effectiveness of foreclosure mitigation efforts and the effectiveness of the program *from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers*.[412] [Emphasis added.]

While the Executive Summary of the Panel's report discusses this mandate as if it were a major theme of the paper, the analysis that follows does not give due credence to taxpayer considerations. Professor White's analysis does not assuage concerns about taxpayer protection – in fact, it aggravates them by suggesting there is actually a $50 billion ceiling on HAMP costs and that investors stand to gain at the taxpayers' expense.

The Panel's March report applies eight criteria in its evaluation of loan modification programs, which is also included in the most recent report:

- Will the plan result in modifications that create affordable monthly payments?
- Does the plan deal with negative equity?
- Does the plan address junior mortgages?
- Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?
- Does the plan counteract mortgage servicer incentives not to engage in modifications?
- Does the plan provide adequate outreach to homeowners?
- Can the plan be scaled up quickly to deal with millions of mortgages?
- Will the plan have widespread participation by lenders and servicers?

While these are valid criteria, the list, which serves as the lynchpin for both the March and October reports, does *not* include taxpayer considerations. The Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the

[412] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 § 125.

Administration's foreclosure relief programs.[413] (It is reasonable to assume that the entire $75 billion program carries a 100 percent subsidy rate.) It also shows that the five-year MHA is not surprisingly a major driving force behind the extension of TARP costs well into 2013.[414] MHA is not an investment with a realizable return in the same sense as other TARP programs, such as the Capital Purchase Program, where at least a portion of the outlays are expected to be recouped, and many with interest. The $75 billion program funds the array of incentive payments to servicers and lenders/investors who participate in the MHA program. It will not be returned to the Treasury general fund as the program winds down, so in a sense, it is equivalent to a $50 billion increase in deficits as the debt level reaches $12.3 trillion by 2013.[415]

According to Treasury's program description for MHA, the payments to servicers, lenders and homeowners are as follows:[416]

- Treasury will share with the lender/investor the cost of reductions in monthly payments from 38 percent DTI to 31 percent DTI.
- Servicers that modify loans according to the guidelines will receive an up-front fee of $1,000 for each modification, plus "pay for success" fees on still-performing loans of $1,000 per year.
- Homeowners who make their payments on time are eligible for up to $1,000 of principal reduction payments each year for up to five years.
- The program will provide one-time bonus incentive payments of $1,500 to lender/investors and $500 to servicers for modifications made while a borrower is still current on mortgage payments.
- The program will include incentives for extinguishing second liens on loans modified under this program.[417]

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[413] U.S. Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

[414] U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2009) (online at www.cbo.gov/ftpdocs/85xx/doc8565/08-23-Update07.pdf).

[415] U.S. Office of Management and Budget, *Mid-Session Review*, (August 2009) (online at www.gpoaccess.gov/usbudget/fy10/pdf/10msr.pdf).

[416] U.S. Department of Treasury, *Making Home Affordable: Summary of Guidelines*, (March 4, 2009) (online at www.treas.gov/press/releases/reports/guidelines_summary.pdf).

[417] Announced in April, MHA's second lien program offers the following:

Pay-for-Success Incentives for Servicers and Borrowers:

The Second Lien Program will have a pay-for-success structure similar to the first lien modification program, aligning incentives to reduce homeowner payments in a way most cost effective for taxpayers.

- No payments will be made under the program to the lender/investor, servicer, or borrower unless and until the servicer has first entered into the program agreements with Treasury's financial agent.

- Similar incentives will be paid for Hope for Homeowner refinances.

Taxpayers and the Panel should demand no less than complete transparency and accountability of funds. If no financing will be repaid from the MHA program, Treasury must provide its own assessment of how it measures benefits and risks for *all* taxpayers, not just for participants of the program. For example, even were the program to work for a select group of homeowners, it may be working against the majority who shoulder the tax burden *and* make mortgage payments on time. If evidence can be provided to the contrary, it must be plausible enough to diminish the risks of entering into a $50 billion investment where direct funding will not be recovered.

10. Making Home Affordable Program – Making Sense of the Data

On March 4, 2009, the Department of the Treasury released a program description of "Making Home Affordable," or MHA, the Administration's multi-tiered plan to prevent foreclosure for "at-risk" homeowners. When it was announced, the advertised goal was to "offer assistance to as many as 7 to 9 million homeowners."[418] Based on the information provided so far by Treasury, only murky conclusions can be reached about the program's progress, especially when taxpayer funds spent or committed are considered.[419]

Servicers can be paid $500 up-front for a successful modification and then success payments of $250 per year for three years, as long as the modified first loan remains current.

Borrowers can receive success payments of up to $250 per year for as many as five years. These payments will be applied to pay down principal on the first mortgage, helping to build the borrower's equity in the home. U.S. Department of Treasury, *Making Home Affordable: Program Update* (April 28, 2009) (online at www.financialstability.gov/docs/042809SecondLienFactSheet.pdf).

[418] U.S. Department of Treasury, *Making Home Affordable: Updated Detailed Program Description* (March 4, 2009) (online at www.ustreas.gov/press/releases/reports/housing_fact_sheet.pdf).

[419] On October 8, GAO released its latest report on TARP, which included a table of Treasury's actions in response to major GAO recommendations. As an example, one recommendation is to "Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure."

It is worth nothing that the status of all of the GAO recommendations for HAMP is either "not implemented" or "partially implemented."

Government Accountability Office, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges* (October 2009) (GAO-10-16) (online at www.gao.gov/new.items/d1016.pdf).

11. Home Affordable Modification Program

The Administration committed $75 billion – $50 billion of TARP financing and $25 billion of "Housing and Economic Recovery Act of 2008" (HERA)[420] financing – to the HAMP program, a loan modification program aimed at reducing monthly interest payments for 3 to 4 million homeowners who are either close to defaulting on payments or are already delinquent. The TARP funds used for HAMP are solely for private-label loans, although Fannie Mae and Freddie Mac both have major roles in the program, with Fannie Mae serving as the "administrator" and Freddie Mac serving as the "compliance agent." HAMP uses HERA funding for loans owned or guaranteed by Fannie Mae or Freddie Mac.

Treasury has released some metrics on HAMP in its August Monthly Progress Report.[421] According to these data, just over 360,000, 3-month trial modifications have begun. Assistant Treasury Secretary Herb Allison testified at a Senate Banking Committee hearing on September 24, 2009, that only about 1,800 of the total modifications have become permanent.[422] Treasury believes, however, that the HAMP program will exceed the newly-set target of 500,000 trial modifications by November.[423]

The jury is still out on whether the program will ultimately accomplish its goals, how long this may take and what it will cost. There are many factors at work, including the ability of servicers to perform the necessary "counseling" role, the willingness of homeowners to participate, and much larger external forces such as the labor market. Borrowers may enter into the trial modification process only to be denied based on criteria like debt-to-income levels. Even those whose modifications become permanent for several months may redefault because of job loss, "back-end" debt such as credit card obligations (which is not factored into debt-to-income calculations) or other reasons that make mortgage payments unsustainable.

Were all 360,000 trial modifications to succeed in not only lowering payments but also in staving off foreclosure, Treasury is still a long way from its goal of assisting 3 to 4 million homeowners. Treasury's latest transaction report on TARP indicates that a maximum of $27 billion out of $50 billion in authority has been used for incentive payments, although it is unclear

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[420] Pub. L. No. 110-289.

[421] U.S. Department of Treasury, *Troubled Assets Relief Program: Monthly Progress Report – August 2009* (September 10, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105areport_082009.pdf).

[422] Senate Committee on Banking, Houseing and Urban Affairs, Testimony of U.S. Treasury Department Assistant Treasury Secretary, Herb Allison, *EESA: One Year Later* (September 24, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ff78e881-372e-41e3-915d-e4d5a93da22d).

[423] This target has only recently been announced and was not part of the MHA program's launch in March 2009.

how this corresponds to metrics on completed modifications.[424] Assistant Treasury Secretary Allison has said that "very little" of the funds have been spent, but unless the proper data are provided to link funds spent or committed to loan modifications that have become permanent, much is open to interpretation.

Are we to assume that the outcome of committing $27 billion in taxpayer funding has only yielded *at most* 360,000 loan modifications? If not, what are we to assume? Will Treasury commit additional TARP funds beyond the $50 billion in order to make the program work as advertised? Will it use the essentially boundless[425] HERA authority as a back-door approach to financing expansions in HAMP? What other measures may be taken to deliver on the promise to reach millions of homeowners? Will Treasury adjust the criteria?

12. Home Affordable Refinance Program for Agency Mortgages

A separate platform of the Administration's MHA plan, the "Home Affordable Refinance Program," or (HARP), targets up to 4 to 5 million homeowners with loans owned or guaranteed by Fannie Mae and Freddie Mac. Homeowners can qualify who are up to 125 percent "underwater" on their mortgages – a situation where the borrower owes more on the loan than the value of the home – but must have a track record of making payments on time. Although Treasury has given assurances that no TARP funds will be intermingled with HARP,[426] the program's ability to prevent millions of foreclosures and stabilize the housing market is nevertheless intertwined with the TARP-funded program, HAMP, and must be considered by the Panel.

The HERA statute established the authority for Treasury to purchase preferred stock in Fannie Mae and Freddie Mac in amounts it or the GSEs deem necessary, providing the two housing companies with equity injections. Although this authority technically expires on December 31, 2009, Treasury may increase the limit to any level through the expiration date. Part of the Administration's housing plan involves *doubling* the size of the purchase agreements from a maximum of $200 billion to a maximum of $400 billion,[427] which did not require

[424] U.S. Department of the Treasury, *Troubled Assets Relief Program: Transactions Report for Period Ending September 18, 2009* (Sept. 22, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_09222009.pdf).

[425] See following section.

[426] Letter from Assistant Treasury Secretary for Financial Stability Herb Allison, to the Honorable Jeb Hensarling, United States Congressman (Sept. 14, 2009).

[427] U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description*, (Mar. 4, 2009) (online at www.ustreas.gov/press/releases/reports/housing_fact_sheet.pdf).

Congressional approval or budgetary review. So far, Fannie and Freddie have drawn $95.6 billion in capital from the agreements.[428]

The powers granted by the HERA statute have been used to fund the Administration's loan modification efforts through HAMP and HARP, but there is no clear way to segregate the costs of new housing policies from other expenditures as well as from losses on Fannie's or Freddie's books of business (discussed further in later section). Very few metrics on the success of HARP have been released to date. Fannie Mae and Freddie Mac executives testified before this Panel on September 24, 2009, and although they did speak to the number of total refinances performed by the agencies this year, they did not discuss HARP specifically. Treasury and the GSEs should be held accountable for making any loan modification program or refinancing program as transparent as possible, since it involves a minimum of $25 billion of taxpayer dollars and there is no clear way to understand whether or not programs supporting Fannie- or Freddie-guaranteed mortgages will require additional funds.

13. Issues Enlisting Servicer Support of MHA

The Panel's October report spotlights several obstacles to launching a massive loan modification program. One is whether HAMP servicers will have the capacity or expertise to successfully carry it out. Another involves whether they can handle the volume of modifications MHA creates in a profitable manner.

What the report does not emphasize is simply whether or not the program can provide appropriate incentives that will outweigh both the risk of borrower redefault as well as what may be the enhanced return from foreclosure and sale to a solvent buyer. Along these lines the report seems to accept without comment the need for government sponsored-foreclosure mitigation programs and generally disregards private sector efforts without sufficient analysis. It's quite often in the best interest of private sector servicers and mortgage holders to restructure distressed loans but I am concerned that the confusing array of government sponsored programs may have chilled many creative private sector initiatives. Instead of being proactive, private sector servicers and mortgage holders may have been enticed to sit on their hands and wait for higher fees, servicing payments, and interest and principal subsidies courtesy of HAMP or some other government-sponsored foreclosure mitigation program. Without these programs and the expectation of future subsidies, servicers and mortgage holders would have had little choice but to implement independent private sector programs. It's ironic, but all the false starts with HAMP and the other government programs may have exacerbated the foreclosure mitigation process by

[428] Fannie Mae, Second Quarter 2009 Form 10-Q (Aug. 6, 2009) (online at phx.corporate-ir.net/phoenix.zhtml?c=108360&p=irol-secQuarterly&control_SelectGroup=Quarterly%20Filings); Freddie Mac, Second Quarter 2009 Form 10-Q (Aug. 7, 2009) (ir.10kwizard.com/files.php?source=1372&welc_next=1&XCOMP=0&fg=23).

keeping private sector servicers and mortgage holders on the sidelines waiting on a better deal from the government.[429]

Such behavior is entirely rational if the servicers and mortgage holders have a reasonable expectation that Treasury will dedicate more TARP or other funds to foreclosure mitigation efforts. Since Treasury asserts that repaid TARP funds may be recycled to new programs it's not unrealistic to expect that Treasury will offer more favorable programs to servicers and mortgage holders in the relatively near future. Since servicers perform their duties pursuant to complex contractual arrangements that mandate they maximize the return to the mortgage holders, it's quite possible that servicers risk default under their contracts if they fail to capture the greatest subsidy rate offered by the government. In addition, servicers themselves may of course benefit by waiting for enhanced payments. The only way to convince servicers and mortgage holders that they will not forego additional governmental largess is for Treasury to state clearly that the MHA program will not be expanded and that no additional TARP or government funds will be allocated to foreclosure mitigation efforts.

In addition, there is simply no way of knowing whether or not larger institutions receiving TARP funds were pressured into participating in government-supported loan modification programs against the best interest of other performance goals (which would have the potential to restrict credit extension elsewhere). Bank of America and Wells Fargo, receiving a combined $70 billion in TARP aid, stepped up the rate of loan modifications as part of MHA by 60 percent in August after receiving criticism from lawmakers for "not doing enough."[430]

14. Bankruptcy Cram Down

The report makes several supportive references to substituting federal bankruptcy judges for the traditional role performed by servicers and mortgage holders in loan modifications. Under these plans bankruptcy judges would be granted the unilateral right to change–that is, cram down–the terms of mortgage loans over the express objections of mortgage holders as part of a bankruptcy proceeding. Although Congress rejected a bankruptcy cram down proposal a few months ago, I am troubled that the Panel continues to ignore the unintended consequences of such approach, especially the fee potential homeowners will be asked to pay due to enhanced risks to lenders of entering into mortgage contracts that could unilaterally be unwound. The Mortgage Bankers Association estimates that if bankruptcy cram down were to become law, mortgage rates would increase by approximately 1.50 percent resulting in annual *additional* mortgage payments of approximately $3,970, $3,346 and $2,989 for typical homeowners in

[429] HOPE Now, a public-private foreclosure mitigation alliance in existence since 2007, for example, has performed as many as 140,000 loan modifications per month. Since HARP is a first stop for at-risk homeowners, programs like HOPE Now may be put on the back burner.

[430] Bloomberg, Banks Step Up Loan Modifications Under Obama Program (Sept. 9, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aDFdlC9CYQEQ).

California, Washington, D.C. and New York, respectively.[431] These phantom taxes will add to the increasing burden borne by the vast majority of homeowners who meet their mortgage obligations each month. It seems profoundly unfair to ask these homeowners to subsidize the costs of any bankruptcy cram down plan. The bankruptcy cram down proposal would also adversely skew the typical rent v. buy analysis undertaken by individuals and families.

15. State Anti-Deficiency Laws and Bankruptcy Cram Down May Encourage Counterproductive Real Estate Speculation by Home Purchasers

An individual's or family's decision to rent or purchase a residence requires a thoughtful balancing of an array of economic factors. Renting provides flexibility with annual or even month-to-month rental obligations while purchasing requires a longer-term financial commitment. Rental payments are not tax deductible but mortgage interest expense and property taxes arising from an owned residence are deductible subject to limitations. Renting offers scant investment opportunity (absent long-term below market leases), yet home ownership often yields favorable inflation adjusted returns. In addition, beginning in the mid-1990s with the gradual relaxation of underwriting standards and due diligence analysis historically conducted by Fannie Mae, Freddie Mac, private mortgage lenders and securitizers, many renters were encouraged to opt in favor home ownership.

The seeming advantages of home ownership are nevertheless tempered by the nature of the contractual agreements most home purchasers undertake with their mortgage lender. While home purchasers may consider themselves "owners" of their homes they explicitly understand that if they fail to make their monthly principal and interest payments on a timely basis they run the distinct risk of losing the right to continue their ownership. Such an appreciation of economic reality requires little if any financial sophistication and few Americans would challenge the overall fairness or necessity of such consequences. From an historical perspective a substantial majority of individuals and families have made the rent v. buy decision with these factors in mind and, as such, have acted in a rational manner by not overextending their financial commitments.

Over the past several years, however, the rent v. buy decision process has been arguably altered as homeowners have become aware of the economic implications arising from applicable "anti-deficiency" and "single-action" laws and other rules adopted in many states that permit, if not indirectly encourage, homeowners to avoid their contractual mortgage obligations. In their basic form, anti-deficiency and single-action statutes limit the debt collection efforts that mortgage lenders may employ so as to render mortgage loans effectively non-recourse obligations to the borrowers. Absent these laws, mortgage lenders may sue their borrowers and receive enforceable judgments for any deficiency arising from the spread between the

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[431] Mortgage Bankers Association, Stop the Bankruptcy Cram Down Resource Center (online at www.mortgagebankers.org/stopthecramdown) (accessed Oct. 8, 2009).

foreclosure sales price of the pledged collateral and the outstanding balance of the mortgage loan. As such, in jurisdictions where these laws do not apply, borrowers understand that by signing mortgage loans they are contractually responsible for the entire indebtedness even if the fair market value of their home materially drops in value. If anti-deficiency and single-action statutes are applicable, it is not implausible to argue that the laws convert mortgage contracts into put option agreements pursuant to which borrowers may elect to satisfy their monthly mortgage obligations so long as they hold equity in their homes, but walk away from–or put–their mortgage obligations to their mortgage holders with relative impunity if negative equity develops.

16. Homeowners React in a Rational Manner to Economic Incentives

These laws create significant moral hazard risks that will be exacerbated if Congress passes a cram down amendment to the bankruptcy code. With these laws in effect, the risk-reward mix underlying each mortgage and home equity loan will be bifurcated with lenders assuming substantially all of the risks regarding the underlying value of the mortgaged property and homeowners receiving substantially all of the rewards. These laws may have the unintended consequence of encouraging homeowners to reject their contractual responsibilities and service their mortgage obligations only when it's in their economic self-interest. Since option contracts are inherently more risky to lenders than traditional mortgage contracts, lenders may have little choice but to incorporate such risks into the interest rates and fees charged on mortgage loans. The Panel should refrain from suggesting that Congress enact legislation that encourages individuals and families to invest in the housing market for speculative purposes while permitting them to avoid their contractual obligations upon the occurrence of adverse market conditions.

It is worth noting that the decision of individuals and families to speculate in the housing market, while perhaps unwise, is not entirely irrational. While some may contend that the average consumer is too unskilled to comprehend seemingly sophisticated financial products, I would argue to the contrary. With anti-deficiency, single-action and, perhaps, bankruptcy cram down laws in effect it does not take a Ph.D. in corporate finance or an expert in bankruptcy law to appreciate that borrowers will receive the bulk of any equity appreciation while lenders will bear substantially all of the risk of loss arising from home mortgage loans. Most consumers are rational and react favorably to incentives that reward particular behavior. Providing economic and legal incentives that encourage inappropriate speculation in the housing market is unwise and fraught with adverse unintended consequences. That a bankruptcy cram down law could help re-inflate a housing bubble by encouraging reckless speculation and cause lenders to raise mortgage interest rates and fees justifies its rejection.

17. Shared Appreciation Rights and Equity Kickers Missing in Administration's Foreclosure Mitigation Programs at the Expense of Taxpayer Protection

It is my understanding that the foreclosure mitigation programs announced by Treasury do not provide Treasury or the mortgage lenders with the ability to participate in any subsequent appreciation in the fair market value of the properties that serve as collateral for the modified or refinanced mortgage loans. For example, a $100,000, 6 percent home mortgage loan may be modified by reducing the principal to $90,000 and the interest rate to 5 percent. If the house securing the mortgage loan subsequently appreciates by, say, $25,000, the taxpayers and the mortgage lender who shared the cost of the mortgage modification will not benefit from any such increase in value. Such result seems inappropriate and particularly unfair to the taxpayers. By modifying the mortgage loan and avoiding foreclosure the taxpayers and the mortgage lender have provided a distinct and valuable financial benefit to the distressed homeowner which should be recouped to the extent of any subsequent appreciation in the value of the house securing the modified mortgage.

Homeowners should not receive a windfall at the expense of the taxpayers and the mortgage lenders and should graciously share any subsequent appreciation with those who suffered the economic loss from restructuring their distressed mortgage loans. Since one of Treasury's fundamental mandates is taxpayer protection, the incorporation of a shared appreciation right or equity kicker feature would appear appropriate.

18. Tremendous Federal Support of the Housing Market

Evaluation of a government-subsidized loan modification plan cannot occur in a vacuum as if in the context of a case study. Private capital has fled the housing market scene and we have seen recent, rapid growth in the government's share of the mortgage markets. This has yet to fully play out but is sure to have adverse consequences if continued crowding out private-sector participation. In addition, there are already extraordinary measures being taken not only by Treasury, but also by the Federal Reserve and others to provide stability in the housing sector. While there are short-term gains to such interventions, the longer-term hurdle of unwinding government support creates many challenges for returning to sustainable activity in the absence of such support.

19. Fannie, Freddie and FHA

In the market for new origination, Fannie, Freddie and the Federal Housing Authority (FHA) are the dominant forces, supporting 94 percent of mortgages.[432] Loans backed by Fannie and Freddie have grown from about 39 percent in 2006 to 72 percent in the first quarter of 2009.[433] FHA loans, requiring as little as 3.5 percent down, now account for 22 percent of

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[432] Source: *Inside Mortgage Finance.* Data on mortgage origination by product as percentage of total Ex-HELOC, first quarter 2009.

[433] Source: *Inside Mortgage Finance.*

market share, up from just 3 percent in 2006.[434] While Fannie and Freddie currently have an automatic line of credit to Treasury, there are reports that FHA may soon require a bailout (which the agency denies), as its reserve fund dwindles below the legal requirement.[435]

20. The Federal Reserve

The Federal Reserve has made an exceptional commitment to purchase up to $1.25 trillion in agency mortgage-backed securities, of which it has bought about $680 billion. Currently, the Fed buys around 80 percent of all new issuance, which is believed to play a significant role in keeping interest rates low. *The Wall Street Journal* estimates that the Fed MBS program has lowered spreads over Treasuries by about 70 basis points (so if the current mortgage interest rate is 5.2 percent, it estimates that without Fed purchases it would be around 5.7 percent).[436] Although Fed Chairman Ben Bernanke has indicated the central bank will be slowing its purchases, there are concerns about the effect slowing or stopping will have on rates.

21. Summary of Government Programs

In addition to crisis-oriented programs, there are multiple government initiatives that already facilitate mortgage credit and provide other types assistance to homeowners. Below is a table of major government actions and programs.

Interventions in the Mortgage Markets[437]	**Description**
The Federal Reserve	Commitment to purchase a total of $1.45 trillion of agency MBS and housing-agency bonds Use of Section 13(3) of Federal Reserve Act authority to provide FRBNY financing for Maiden Lane LLC, consisting of mortgage-related securities, commercial mortgage loans and associated hedges Bear Stearns Use of Section 13(3) to provide FRBNY financing for Maiden Lane II LLC, consisting of residential mortgage-backed securities from AIG Smaller-scale loan modification program for Maiden Lane LLC run by

[434] Source: *Inside Mortgage Finance*

[435] Alan Zibel, *Government Home Loan Agency Faces Cash Squeeze*, Associated Press (Sept. 18, 2009).

[436] Mark Gongloff, *Decision on Ending Housing Prop Can Wait,* The Wall Street Journal (Sept. 22, 2009) (online at online.wsj.com/article/SB125357555750029391.html).

[437] Some background provided by GAO, "Analysis of Options for Revising the Housing Enterprises' Long-term Structures," September 2009.

	Blackrock and Wells Fargo
Fannie Mae and Freddie Mac [GSEs]	Guarantee mortgages in the secondary market so that investors will receive their expected principal and interest payments Put into conservatorship under the Federal Housing Finance Agency [FHFA] in September 2008 Total combined portfolios of $5.46 trillion, [438] which includes mortgage-backed securities and other guarantees, as well as gross mortgage portfolios CBO brought Fannie and Freddie onto the budget and estimates they will cost taxpayers $390 billion over 10 years, with a $248 billion cost occurring at the time of conservatorship[439] Now represent 72 percent of the loan origination market[440]
Federal Housing Agency [FHA]	Provides mortgage insurance on loans made by private lenders Located in HUD; loans were typically for low-income, first-time homebuyers and minorities FHA now insures 5.3 million mortgages, and represents 22 percent of the loan origination market[441]
FDIC's IndyMac Program	The FDIC conducts a comprehensive program to provide loan modifications and other assistance to borrowers who have a first mortgage owned or securitized and serviced by IndyMac This program has served as one model for the Administration's MHA

[438] Fannie Mae, *Monthly Summary* (July 2009)(online at www.fanniemae.com/ir/pdf/monthly/2009/073109.pdf;jsessionid=B4Q4GWTY555N3J2FECISFGA);, Freddie Mac, *Monthly Summary* (July 2009) (online at www.freddiemac.com/investors/volsum/pdf/0709mvs.pdf).

[439] Congressional Budget Office, The Budget and Economic Outlook: An Update (August 2009) (online at www.cbo.gov/ftpdocs/85xx/doc8565/08-23-Update07.pdf).

[440] Source: *Inside Mortgage Finance*

[441] Source: *Inside Mortgage Finance*

	program The FDIC became the conservator of failed IndyMac bank and still holds roughly $11 billion in assets, many mortgage-related
Federal Home Loan [FHL] Bank System	12 FHL Banks borrow funds in debt markets and provide loans to members Loans are typically collateralized by residential mortgage loans and government and agency securities
Veterans Affairs [VA] United States Department of Agriculture [USDA] / Rural Development [RD]	VA guarantees housing loans for veterans and their families USDA/RD guarantees loans for moderate-income individuals or households to purchase homes in rural areas.
Ginnie Mae	Corporation within HUD that guarantees MBS with the full faith of the government Guarantees 90% of FHA loans; 80% of Ginnie Mae's portfolio is made up of FHA loans
Additional HUD / FHA Programs, such as HOPE for Homeowners	HOPE for Homeowners is an example of a HUD-run program that allows homeowners to refinance into an FHA mortgage, with certain restrictions on debt-to-income ratios and loan limits Borrowers pay a premium of 3% of the original mortgage amount and an annual premium of 1.5% of the outstanding mortgage amount Fannie and Freddie reimburse costs to FHA not covered by premiums HOPE has fallen significantly short of the goal of renegotiating mortgage terms for 400,000 homeowners (<100 served)
Community	Passed in 1977 to prevent "redlining," a term that refers to the practice

Reinvestment Act	of denying loans to neighborhoods considered to be higher economic risks, by mandating that banks to lend to the communities where they take deposits The current CRA law requires the OCC, OTS, Federal Reserve and FDIC as regulators to assess each bank and thrift's lending records pursuant to CRA and to apply this in evaluating applications for charters, mergers, acquisitions and expansions
Mortgage Interest Tax Deduction	Allows all homeowners to deduct interest paid on mortgages on income tax returns
$8,000 First-time Homebuyer Credit	Refundable tax credit equal to 10 percent of the purchase price up to a maximum of $8,000 Only eligible for single taxpayers with incomes up to $75,000 and married couples with combined incomes up to $150,000 Passed as part of the "American Recovery and Reinvestment Act of 2009," but extension currently being considered in Congress
Treatment of Capital Gains	Exemption from paying capital gains tax on the first $250,000 for individual filers ($500,000 for joint filers) of capital gains from the sale of a primary residence
Mortgage Revenue Bonds	State or local agencies issue tax-exempt bonds and use the proceeds to offer mortgages below the market interest rate for first-time homebuyers of certain income levels

22. Role of Fannie Mae and Freddie Mac in Administration's Housing Plan

The Administration's MHA plan aims to lower mortgage rates by "strengthening confidence in Fannie Mae and Freddie Mac."[442] "Strengthening confidence" seems to mean increasing the size of the taxpayer's commitment in Fannie and Freddie significantly by $200 billion to $400 billion (not to mention their portfolio limits), as well as making the GSEs a centerpiece of housing policy. As mentioned, Fannie and Freddie have already received $95.6 billion in capital injections from Treasury to fill "holes" in their balance sheets where liabilities exceed assets.[443] The companies are required to pay annual interest of 10 percent on the

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[442] U.S. Department of Treasury, *Making Home Affordable: Updated Detailed Program Description* (March 4, 2009)(online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

[443] Through September 30, 2009.

injections, although this amounts to a sum that is larger than the historical profits made by the GSEs (during years where they made profits).

Just as a history of bad management decisions did not preclude GM and Chrysler from receiving TARP funds, the same is true of Fannie Mae and Freddie Mac. It should be noted that their financial insolvency materialized after years of mismanagement – and after years of enjoying the gold seal of the government's implicit guarantee. As I wrote in the March addendum to the Panel's report:

> Fannie and Freddie exploited their congressionally-granted charters to borrow money at discounted rates. They dominated the entire secondary mortgage market, wildly inflated their balance sheets and personally enriched their executives. Because market participants long understood that this government created duopoly was implicitly (and, now, explicitly) backed by the federal government, investors and underwriters chose to believe that if Fannie or Freddie touched something, it was safe, sound, secure, and most importantly "sanctioned" by the government. The results of those misperceptions have had a devastating impact on our entire economy. Given Fannie and Freddie's market dominance, it should come as little surprise that once they dipped into the subprime and Alt-A markets, lenders quickly followed suit. In 1995, HUD authorized Fannie and Freddie to purchase subprime securities that included loans to low-income borrowers and allowed the GSEs to receive credit for those loans toward their mandatory affordable housing goals. Fannie and Freddie readily complied, and as a result, subprime and near-prime loans jumped from 9 percent of securitized mortgages in 2001 to 40 percent in 2006. In 2004 alone, Fannie and Freddie purchased $175 billion in subprime mortgage securities, which accounted for 44 percent of the market that year. Then, from 2005 through 2007, the two GSEs purchased approximately $1 trillion in subprime and Alt-A loans, and Fannie's acquisitions of mortgages with less than 10-percent down payments almost tripled. As a result, the market share of conventional mortgages dropped from 78.8 percent in 2003 to 50.1 percent by 2007 with a corresponding increase in subprime and Alt-A loans from 10.1 percent to 32.7 percent over the same period. These non-traditional loan products, on which Fannie and Freddie so heavily gambled as their congressional supporters encouraged them to "roll the dice a little bit more," now constitute many of the same non-performing loans which have contributed to our current foreclosure troubles.[444]

In addition, GAO also noted in a September 2009 report:

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[444] See Congressional Oversight Panel, *March Oversigh Report: Foreclosure Crisis: Working Toward a Solution*, "Additional View by Representative Jeb Hensarling," (online at cop.senate.gov/documents/cop-030609-report-view-hensarling.pdf).

> While housing finance may have derived some benefits from the enterprises' activities over the years, GAO, federal regulators, researchers, and others long have argued that the enterprises had financial incentives to engage in risky business practices to strengthen their profitability partly because of the financial benefits derived from the implied federal guarantee on their financial obligations.[445]

In September 2008, Treasury put Fannie Mae and Freddie Mac into conservatorship under the Federal Housing Finance Agency [FHFA], effectively making taxpayers liable for their portfolios which now total about $5.46 trillion (including mortgage-backed securities and other guarantees, as well as gross mortgage portfolios.[446] According to CBO, the current estimate of the cost of bringing Fannie's and Freddie's books of business onto the federal budget is $390 billion.[447]

In addition, the GSEs' support of Treasury's MHA loan modification program is expected to amplify the risk of an already-leveraged taxpayer investment. The following excerpt from Freddie's second quarter 2009 filing to the SEC mentions the dire financial situation, the probable need for additional Treasury capital, and the possible negative effect on financials caused by the MHA program:

> We expect a variety of factors will place downward pressure on our financial results in future periods, and could cause us to incur GAAP net losses. Key factors include the potential for continued deterioration in the housing market, which could increase credit-related expenses and security impairments, adverse changes in interest rates and spreads, which could result in mark-to-market losses, and our efforts under the MHA Program and other government initiatives, some of which are expected to have an adverse impact on our financial results. We believe that the recent modest home price improvements were largely seasonal, and expect home price declines in future periods. Consequently, our provisions for credit losses will likely remain high during the remainder of 2009 and increase above the level recognized in the second quarter. To the extent we incur GAAP net losses in future periods, we will likely need to take additional draws under the Purchase Agreement. In addition, due to the substantial dividend obligation on the

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[445] Government Accountability Office, *Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, September 10, 2009 (online at www.gao.gov/new.items/d09782.pdf).

[446] Fannie Mae, *Monthly Summary*, July 2009 (online at www.fanniemae.com/ir/pdf/monthly/2009/073109.pdf;jsessionid=GZALNHE45QP0LJ2FECISFGI) ; Freddie Mac, *Monthly Summary*, July 2009 (online at www.freddiemac.com/investors/volsum/pdf/0709mvs.pdf).

[447] Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2009 (online at www.cbo.gov/doc.cfm?index=10521). The Administration still considers Fannie Mae and Freddie Mac to be off-budget entities.

senior preferred stock, we expect to continue to record net losses attributable to common stockholders in future periods."[448]

GAO has also discussed specifically the impact to the GSEs of participation in HAMP and HARP:

> While these federal initiatives were designed to benefit homebuyers, in recent financial filings, both Freddie Mac and Fannie Mae have stated that the initiative to offer refinancing and loan modifications to at-risk borrowers could have substantial and adverse financial consequences for them. For example, Freddie Mac stated that the costs associated with large numbers of its servicers and borrowers participating in loan-modification programs may be substantial and could conflict with the objective of minimizing the costs associated with the conservatorships. Freddie Mac further stated that loss-mitigation programs, such as loan modifications, can increase expenses due to the costs associated with contacting eligible borrowers and processing loan modifications. Additionally, Freddie Mac stated that loan modifications involve significant concessions to borrowers who are behind in their mortgage payment, and that modified loans may return to delinquent status due to the severity of economic conditions affecting such borrowers. Fannie Mae also has stated that, while the impact of recent initiatives to assist homeowners is difficult to predict, the participation of large numbers of its servicers and borrowers could increase the enterprise's costs substantially.66 According to Fannie Mae, the programs could have a materially adverse effect on its business, financial condition, and net worth.[449]

Since the GSEs are now under the conservatorship of the Federal Housing Finance Agency [FHFA], their concerns are now officially the taxpayers' concerns. Any losses the GSEs experience through MHA programs should be a carefully considered part of a cost-benefit analysis.

In addition, as noted in the March report additional views, for well over twenty years, federal policy has promoted lending and borrowing to expand homeownership, through incentives such as the home mortgage interest tax exclusion, the FHA, discretionary HUD spending programs, and the Community Reinvestment Act [CRA]. CRA is an example of a program with the best of intentions having adverse, unintended consequences on exactly the population it hopes to serve. It was initially authorized to prevent "redlining," a term that refers to the practice of denying loans to neighborhoods considered to be higher economic risks, by

[448] Federal Home Loan Mortgage Corporation, *Form 10-Q to the Securities and Exchange Commission*, quarterly period ending June 30, 2009 (online at www.freddiemac.com/investors/er/pdf/10q_2q09.pdf).

[449] Government Accountability Office, *Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, September 2009 (online at www.gao.gov/new.items/d09782.pdf).

mandating banks lend to the communities where they take deposits. Since its passage into law in 1977, however, CRA has advanced at least two undesirable outcomes: (1) some financial institutions completely avoided doing business in neighborhoods and restricted even low-risk forms of credit, and (2) many institutions went the other way and relaxed underwriting standards to meet CRA guidelines, thus opening the door to certain risky products that have contributed to the problem of foreclosures. These lax underwriting standards spread to Fannie and Freddie and ultimately to the private sector as the role of the GSEs morphed from that of a liquidity provider to a promoter of home ownership.

23. Questions for Fannie Mae and Freddie Mac

Representatives of Fannie Mae and Freddie Mac testified before the Panel at a hearing on foreclosure mitigation held in Philadelphia on September 24, 2009. I asked the following questions for the record to Fannie Mae and Freddie Mac and await their response.

Fannie Mae.

1. Fannie Mae has so far received approximately $44.9 billion in equity injections from Treasury through the Preferred Share Purchase Agreements authorized by the Housing and Economic Recovery Act of 2008 [HERA].

   Will Fannie Mae request additional funds from Treasury through this program?

   Will Treasury's commitment to purchase preferred shares in Fannie Mae increase beyond the $200 billion limit announced in March 2009?

2. How much of the funding that Fannie Mae has received through HERA-authorized injections has been *spent* on the Administration's "Making Home Affordable" plan?

   How much has Fannie Mae *committed* from HERA-authorized funds for "Making Home Affordable" efforts?

   Specifically, how much of this funding has been and will be used by Fannie Mae for the Administration's "Home Affordable Modification Program?"

   How much of this funding has been and will be used by Fannie Mae for the Administration's "Home Affordable Refinance Program?"

3. What is the average cost of modifying a home loan under "Home Affordable Modification Program," according to Fannie Mae's most recent data?

   Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

   If you do not have these data, please explain why not.

4. What is the average cost of refinancing a home loan under “Home Affordable Refinance Program,” according to Fannie Mae’s most recent data?

   Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

   If you do not have these data, please explain why not.

5. In general, how do you expect Fannie Mae’s participation in the “Making Home Affordable” plan to affect financials for the next quarter?

   What about for the next year?

6. The Federal Reserve has already purchased about $860 billion of its $1.25 trillion commitment to buy Fannie Mae and Freddie Mac-guaranteed mortgage-backed securities.[450] To put it in context, right now, the Federal Reserve buys the lion’s share of all new issuance, which is somewhere around 80 percent.

   If the Federal Reserve stops purchasing Fannie Mae’s mortgage-backed securities then who will purchase the securities and at what price?

   Has the Federal Reserve or Fannie Mae attempted to sell these securities to private sector participants and, if so, what has been the response?

   Have any significant purchasers of U.S. Treasuries asked the Federal Reserve to cap its purchases of these securities?

Freddie Mac.

1. Freddie Mac has so far received approximately $50.7 billion in equity injections from Treasury through the Preferred Share Purchase Agreements authorized by the Housing and Economic Recovery Act of 2008 [HERA].

   Will Freddie Mac request additional funds from Treasury through this program?

   Will Treasury’s commitment to purchase preferred shares in Freddie Mac increase beyond the $200 billion limit announced in March 2009?

2. How much of the funding that Freddie Mac has received through HERA-authorized injections has been *spent* on the Administration’s “Making Home Affordable” plan?

[450] Federal Reserve, *Press Release* (Sept. 23, 2009) (online atwww.federalreserve.gov/newsevents/press/monetary/20090923a.htm).

How much has Freddie Mac *committed* from HERA-authorized funds for "Making Home Affordable" efforts?

Specifically, how much of this funding has been and will be used by Freddie Mac for the Administration's "Home Affordable Modification Program?"

How much of this funding has been and will be used by Freddie Mac for the Administration's "Home Affordable Refinance Program?"

3. What is the average cost of modifying a home loan under "Home Affordable Modification Program," according to Freddie Mac's most recent data?

   Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

   If you do not have these data, please explain why not.

4. What is the average cost of refinancing a home loan under "Home Affordable Refinance Program," according to Freddie Mac's most recent data?

   Out of this amount, how much has been financed through Treasury capital and ultimately the taxpayers?

   If you do not have these data, please explain why not.

5. In general, how do you expect Freddie Mac's participation in the "Making Home Affordable" plan to affect financials for the next quarter?

   What about for the next year?

6. The Federal Reserve has already purchased about 860 billion of its 1.25 trillion-dollar commitment to buy Fannie Mae and Freddie Mac-guaranteed mortgage-backed securities.[451] To put it in context, right now, the Federal Reserve buys the lion's share of all new issuance, which is somewhere around 80 percent.

   If the Federal Reserve stops purchasing Freddie Mac's mortgage-backed securities then, who will purchase the securities and at what price?

   Has the Federal Reserve or Freddie Mac attempted to sell these securities to private sector participants and, if so, what has been the response?

[451] Board of Governors of the Federal Reserve System, *Press Release* (Sept. 23, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20090923a.htm).

Have any significant purchasers of U.S. Treasuries asked the Federal Reserve to cap its purchases of these securities?

24. Net Present Value Analysis and the Risk of Redefault

The redefault rate is a key input cited by the Panel and used by servicers to calculate the all-in net present value of electing to pursue a loan modification versus a foreclosure. It goes without saying that the chance of waves of redefaults occurring enhances significantly the risk of the Administration's $75 billion MHA program. The self-cure rate, which refers to the ability for borrowers to catch up on loan payments without assistance, is also an important factor in NPV calculations. Understandably, under the current economic conditions where unemployment is supposed to reach at least 10 percent, self-cure rates will be likely be lower than under conventional circumstances. The Panel's report disputes the findings of a paper released by the Federal Reserve Bank of Boston, which cites self-cure rates of 25 to 30 percent, and supports a recent study showing self-cure rates of closer to between 4.3 percent and 6.6 percent. The reality is that homeowners' ability to heal themselves is largely a function of economic growth and the opportunities it affords. Another reality not mentioned is the fact that homeowners may choose not to self-cure *because* of the attractiveness of a government-sponsored loan modification plan.

The Panel also calls into question the average redefault rate of up to 50 percent cited by the Federal Reserve Bank of Boston, which, is also approximately the level of redefaults computed by the OCC and OTS one year after a loan modification has been performed.[452] It should be stressed that we simply do not have enough evidence to show that the longer-term risk of redefault on a loan modified by MHA is still *not* very high. This is true by virtue of Assistant Secretary Herb Allison's statement that only 1,800 permanent modifications – that is, those that have survived the minimum three-month threshold to become permanent – have been put in place. Only time will tell if this very costly investment will serve the number of homeowners the Administration has assured without requiring additional taxpayer funds. Since the data are ambiguous at best, it should not be affirmed by the Panel that redefault and self-cure rates are conclusively within one narrow range or another in order to make the case that government-sponsored loan modification is a more attractive option.

25. The Issue of Fairness

The Panel's report states, "Devoting attention and resources to moral sorting is at odds with the goal of maximizing the macroeconomic impact of foreclosure prevention. Trying to sort out the deserving from the undeserving on any sort of moral criteria means that foreclosure prevention efforts will be delayed and have a narrower scope. Moreover, in other cases where

[452] Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, First Quarter 2009* (online at www.occ.treas.gov/ftp/release/2009-77a.pdf) (June 2009). MHA has not been in operation for a year and it is not possible to obtain yearly re-default data.

the federal government extended assistance under TARP – such as to banks and auto manufacturers – no attempt was made to sort between entities deserving and not deserving assistance. No inquiry was made as to which investors in these entities knowingly and willingly assumed the risks of the entities' 'insolvency.'"

In fact, this distinction could be *crucial* to long-term stabilization. Programs that create moral hazard by giving no consideration to the rightful, necessary link between risk and responsibility could potentially create additional housing "bubbles" and result in greater threats to stability.

It goes without saying that moral hazard has already played out for some financial institutions that received billions in TARP funds, even if capital was initially deployed with an eye to prevent a global economic meltdown. The federal safety net was spread wide as many who exhibited irresponsible behavior were deemed "too big to fail" for systemic risk reasons, qualifying them for protected status. This is a legacy the banking system and the government will have to deal with for a long time, even if taxpayers are receiving repayments in full with interest from Capital Purchase Plan recipients. The Panel's report implies that two moral hazards make a right, and encourages an even wider number of homeowners to be bailed out from what could be their own bad decisions simply because it is the fair treatment. I question if the approximately 95 percent of taxpayers who satisfy their rental and mortgage obligation each month would consider such bailouts fair particularly if they result in higher tax rates and mortgage interests costs. The irony is that although the report concludes a moral judgment should be immaterial when doling out taxpayer money, a comparison of homeowners to Wall Street companies is in itself a moral comparison used to justify subsidization of mortgage payments.

By advocating a policy of additional bailouts the Panel has chosen to burden a substantial majority of the taxpayers with yet another subsidy-based program. It is difficult for me to appreciate the inherent fairness or appropriateness of such an approach.

26. Mortgage Fraud and Abuse

I am concerned that the Panel mentions fraud in its report only to assert how broad publication of mortgage schemes may deter homeowners from participating in MHA. SIGTARP, which has been actively monitoring fraud, waste and abuse, is currently in the process of conducting an audit on the "Making Home Affordable" program which will focus on reviewing its current status and the challenges it faces. This oversight body is sure to take cases of fraud very seriously. Widespread scams are a serious issue – the FBI estimates annual losses from mortgage fraud to be between $4 and $6 billion – and one whose significance should not be undermined in exchange for more aggressive outreach to borrowers. Homeowners must be presented with all of the facts on the serious risk of fraud as well as given the encouragement to

perform due diligence on all of the options at their disposal if they cannot meet mortgage payments.

27. Conclusions and Recommendations for an Oversight Plan and the Adoption of a COP Budget

A fair reading of the Panel's majority report and my dissent leads to one conclusion – HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure. The Administration's opaque foreclosure mitigation effort has assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.

While the Congressional Budget Office estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs, instead of focusing its attention on taxpayer protection and oversight, the Panel's majority report implies that the Administration should commit additional taxpayer funds in hopes of helping distressed homeowners – both deserving and undeserving – with a taxpayer subsidized rescue.

While there may be some positive signals in our economy, recovery remains in a precarious position. Unemployment will hit 10 percent in 2010, if not this year. This is unfortunate because the best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

Regardless of whether one believes foreclosure mitigation can truly work, taxpayers who are struggling to pay their own mortgage should not be forced to bail out their neighbors through such an inefficient and transparency-deficient program. Both the Administration and the Panel's majority appear to prioritize good intentions and wishful thinking over taxpayer protection.

To date, despite the commitment of some $27 billion,[453] only about 1,800 underwater homeowners have received a permanent modification of their mortgage. If the Administration's goal of subsidizing up to 9 million home mortgage refinancings and modifications is met, the cost to the taxpayers will almost surely exceed by a material amount the $75 billion already allocated to the Making Home Affordable program, none of it recoverable.

Taxpayers deserve a better return on their investment than what they are set to receive from AIG, Chrysler, GM and the Administration's flawed foreclosure mitigation efforts.

[453] U.S. Department of the Treasury, *Troubled Assets Relief Program Transactions Report* (Oct. 6, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_10062009.pdf). The commitment cited is as defined by the current "Total Cap" for the Home Affordable Modification Program, $27,247,320,000.

Professor Alan M. White, an expert retained by the Panel, notes in a paper attached to the Panel's report: "The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60 percent or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more."

Taxpayers – through TARP or otherwise – should not be required to subsidize mortgage holders or servicers when foreclosure mitigation efforts appear in many cases to be in their own economic best interests. The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP and HARP programs (with a reasonable expectation that additional funds may be forthcoming), has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking assistance from the government.

Any foreclosure mitigation effort must appear fair and reasonable to the American taxpayers. It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs.[454] Distinct from a moral hazard question, there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble.

In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is: "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.[455]

Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple mitigation programs that do not amplify taxpayer risk or require government mandates. Subsidized loan refinancing and modification programs may provide

[454] These "life event" affected borrowers are noteworthy because relatively few object to efforts to find achievable solutions for trying to help keep these distressed borrowers in their current residences whenever possible. Similarly, another sympathetic group of distressed borrowers involves people who were legitimate victims of blatant manipulation or outright fraud by unscrupulous lenders who pressured them into homes they could not afford. To many, those legitimate victims are certainly equally deserving of assistance. Of course, such borrowers do have the added burden proving that they were indeed victims of actual wrongdoing. However, they also have a potential remedy of pursuing legal action against fraudulent lenders, an option which is not available to others.

[455] After all, why should a person be forced to pay for their neighbor's mortgages when he or she is struggling to pay his or her own mortgages and other bills? To many people, this question is the most important aspect of the public policy debate. Given the massive direct taxpayer costs that have already been incurred through TARP and the potential costs that could be incurred through the assorted credit facilities and monetary policy actions of the Federal Reserve, I believe that it is difficult to justify asking the taxpayers to shoulder an even greater financial burden from yet another government foreclosure mitigation program that might not work.

relief for a select group of homeowners, but they work against the majority who shoulder the tax burden and make mortgage payments on time.

28. Oversight Plan

As I have stressed before, I believe the Panel continues to make the mistake of putting policy objectives above transparent and critical oversight. The October report on foreclosure issues is a strong example of this. I am again dismayed that the Panel's current release is driven by an approach that appears to favor an expansion of government-subsidized foreclosure mitigation plans over consideration of taxpayer protections and prudent supervision.

The Panel has yet to present and adopt an oversight plan. Until one is made official, reports and actions taken will not adhere to standard guidelines. I recommend the following be considered by the Panel.

The EESA statute requires COP to accomplish the following, through regular reports:

- Oversee Treasury's TARP-related actions and use of authority
- Assess the impact to stabilization of financial markets and institutions of TARP spending
- Evaluate the extent to which TARP information released adds to transparency
- Ensure effective foreclosure mitigation efforts in light of minimizing long-term taxpayer costs and maximizing taxpayer benefits.

In adherence to this mandate, the Panel should consider adopting the following standards of oversight:

- Analyzing programs proposed by Treasury to determine if they are properly designed for their intended purpose
- Determining if the investment of TARP funds in each program is permitted under EESA
- Determining if the programs are being properly implemented in a reasonable, transparent, accountable and objective manner
- Determining if taxpayers are being protected
- Determining the success or failure of the programs based upon reasonable, transparent, accountable and objective metrics
- Analyzing Treasury's exit strategy with respect to each investment of TARP funds

- Analyzing the corporate governance policies and procedures implemented by Treasury with respect to each investment of TARP funds
- Holding regular public hearings with the Secretary and other senior Treasury officials
- Holding regular public hearings with TARP recipients with special care taken to invite major recipients to testify
- Keeping a record of all invitations to testify and responses
- Determining how TARP recipients invest and deploy their TARP funds
- Reporting the results to the taxpayers in a clear and concise manner
- Avoiding public policy recommendations in the reports released by the Panel
- Conducting the Panel's oversight activities in the most reasonable, transparent, accountable and objective manner with measurable standards that hold Treasury accountable, without limitation, for the statutory mandate of EESA that taxpayer protection is an upmost priority
- Conducting the internal operations of the Panel in the most reasonable, transparent, accountable and objective manner.

29. Adoption of a Budget and Disclosure of other Matters by COP

The Panel has a taxpayer protection based statutory obligation to oversee the funds committed and spent by Treasury on all TARP programs, as well as to ensure that there is complete transparency and accountability in Treasury's reporting practices. Taxpayers should demand no less than full disclosure of how the Panel's own operations are financed. It has been one year since the Panel's inception and a budget has yet to be produced. The Panel should release a budget on continuing operations by November 1, and should make available detailed information on past uses of all funds received for Panel activities by such date. These reports should disclose in sufficient detail all operating expenses and other amounts incurred or paid by the Panel for, without limitation, rent, IT, travel, services, utilities, equipment as well as the salary and other compensation paid to all Panel employees, interns, consultants, advisors, experts and independent contractors. In order to ensure the absence of any conflict of interest, the Panel should disclose the names and affiliations of all such consultants, advisors, experts and independent contractors and the terms of the written or oral agreements through which they render advice or counsel to the Panel (even if they are not compensated for their services). The Panel should update these matters each month and disclose the results on its website.

In quarterly reports to Congress, not only does SIGTARP publish its statutory mandate and how well the organization follows EESA requirements, it also provides a detailed budget and

information on hired personnel. SIGTARP must formally request funds from Treasury for any amounts beyond the initial EESA grant. In the July report to Congress, its budget includes a specific breakdown of financing requested for staff, rent, services, transportation, advisory, etc.[456]

SIGTARP also discloses on its website the contracts that it enters into with outside vendors and other Governmental agencies to obtain goods and services,[457] a description of its senior staff,[458] and its organizational chart.[459] Although the Panel's website contains a blog,[460] it does not disclose any of the other items.

The EESA statute calls on the Panel's Chair to present a statement of expenses to the Treasury Secretary. Treasury then transfers funding for reimbursement of the Panel into separate, equal accounts in both the House of Representatives and the Senate.[461] Since the Panel runs on the fuel of taxpayer dollars, it should be held to task for creating budgets and statements of operations that are fully transparent to the public, especially as Treasury makes the decision of whether or not to extend TARP – and thus the Panel's oversight and costs – beyond December 31, 2009.

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[456] SIGTARP, *Quarterly Report to Congress*, at 161 et. seq. (July 21, 2009) (online atwww.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf).

[457] See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_procure.shtml).

[458] See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_staff.shtml).

[459] See Special Inspector General for the Troubled Asset Relief Program (SIGTARP) website (online at sigtarp.gov/about_org.shtml).

[460] See the Congressional Oversight Panel's website (online at cop.senate.gov/blog/).

[461] Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343, § 125:

FUNDING FOR EXPENSES.–

(1) AUTHORIZATION OF APPROPRIATIONS.–There is authorized to be appropriated to the Oversight Panel such sums as may be necessary for any fiscal year, half of which shall be derived from the applicable account of the House of Representatives, and half of which shall be derived from the contingent fund of the Senate.

(2) REIMBURSEMENT OF AMOUNTS.–An amount equal to the expenses of the Oversight Panel shall be promptly transferred by the Secretary, from time to time upon the presentment of a statement of such expenses by the Chairperson of the Oversight Panel, from funds made available to the Secretary under this Act to the applicable fund of the House of Representatives and the contingent fund of the Senate, as appropriate, as reimbursement for amounts.