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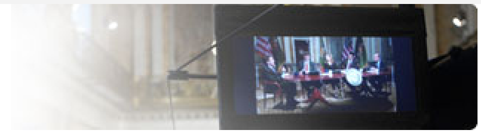

Remarks by Secretary Henry M. Paulson, Jr. U.S. Housing and Mortgage Market Update

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Before the National Association of Business Economists

Washington - Good morning. Thank you, Tom. It is a pleasure to be with you. Last week we had several significant data releases updating us on the status of the housing market correction. And just this morning, we are reviewing data released by the HOPE NOW alliance, marking the results of their efforts through January to reach and assist struggling borrowers who want to keep their homes. Industry efforts are making progress, and I will walk through these results in a moment.

Good morning. Thank you, Tom. It is a pleasure to be with you. Last week we had several significant data releases updating us on the status of the housing market correction. And just this morning, we are reviewing data released by the HOPE NOW alliance, marking the results of their efforts through January to reach and assist struggling borrowers who want to keep their homes. Industry efforts are making progress, and I will walk through these results in a moment.

I have said before that housing poses the biggest downside risk to our economy, and most forecasters expect a prolonged period of adjustment. It is an appropriate time to take a comprehensive look at the state of our housing and mortgage markets and their impact on the economy. I will do that today. My careful review has led me to three main conclusions.

Three Conclusions

First, many in Washington and many financial institutions have been floating proposals for a major government intervention in the housing market, with U.S. taxpayers assuming the costs of the riskiest mortgages. Today, 93 percent of American homeowners – 51 million households - pay their mortgages on time. Many are on tight budgets, sacrificing other things in order to make that payment. Only 2 percent are in foreclosure.

Most of the proposals I've seen would do more harm than good --- bailing out investors, lenders or speculators who, instead of getting a free-pass, should be accountable for the risks they took. Let me be clear: I oppose any bailout. I believe our efforts are best focused on helping homeowners who want to stay in their homes.

Second, this is a shared responsibility of industry, government and homeowners. We in government are working to expand options through the FHA, and we've worked with the industry to reach as many homeowners as possible to let them know that help is available. There is more that government and industry can do, and our efforts will continue to evolve. Homeowners have responsibilities as well. If borrowers won't ask about solutions, there is only so much that can be done on their behalf.

Third, the current public discussion often conflates the number of so-called "underwater" homeowners – that is, those with mortgages greater than the value of their house – with projections of foreclosures. Let's be precise: being underwater does not affect your ability to pay your mortgage, nor create a government responsibility for assistance. Homeowners who can afford their mortgage should honor their obligations --- and most do.

Obviously, being underwater is not insignificant to homeowners in that position. But negative equity does not necessarily result in foreclosure. Most people buy homes as a long-term investment, as a place to raise a family and put down roots in a community. Homeowners who can afford their payments and don't have to move, can choose to stay in their house. And let me emphasize, any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator – and one who is not honoring his obligations.

We know that speculation increased in recent years; a resulting increase in foreclosures is to be expected and does not warrant any relief. People who speculated and bought investment properties in hot markets should take their losses just like day traders who speculated and bought soaring tech stocks in 2000 .

Let me walk through my perspective on today's markets, which has led to these conclusions.

Current Housing Market Data

Recent housing data confirmed the ongoing housing correction. Existing single-family home sales fell to a 10-year low in January. At current sales rates there is now a 10.1 month supply of existing homes on the market, as compared to 4.5 months worth of inventory in a more normal market.

Similarly, new January data reported a 9.9 month supply of new homes currently on the market, more than twice the average supply during the first half of this decade. We also know that foreclosures add to inventories of unsold homes; by some estimates, more than half of properties go back on the market shortly after foreclosure.

Clearly, we have an overhang of supply. Working through the excess means that home prices will stagnate or fall, and we are seeing that now. The OFHEO index for purchased homes showed a 1.3 percent price decline in the fourth quarter of 2007 and is down 0.3 percent over the past year. The Case-Shiller composite index for the 20 largest metropolitan areas is down 9.1 percent over the past year; prices were down on an annual basis in 17 of the 20 metropolitan areas surveyed.

Of course, there is no national housing market, but instead a compilation of regional markets. The housing correction, and the run up to the correction, unfolded differently in different regions.

In recent years, many markets witnessed steep home price appreciation that was clearly unsustainable. For example, from 2002 to 2006, home prices in Bakersfield, California rose 122 percent. During that same time frame, prices rose 94 percent in Las Vegas, Nevada, and 107 percent in Miami, Florida. Not surprisingly, many areas that saw the biggest price increases are now seeing the biggest price declines.

Other markets experiencing high foreclosure rates today are those facing broader economic difficulties. Cities like Detroit, Michigan and Cleveland, Ohio didn't experience the large price appreciation, and current price declines in these markets have been triggered by weak local economic conditions.

Falling prices have impacted millions of homeowners. A recent Moody's report estimates that 8.8 million homeowners today have zero or negative equity.

While these equity considerations clearly impact homeowners' financial situation, they are not the primary concern in the effort to prevent avoidable foreclosures. And preventing avoidable foreclosures is the linchpin of our efforts to minimize the impact of the housing correction on the broader economy.

A greater determining factor in foreclosures of homeowners who want to stay in their home is the homeowner's ability to make the monthly mortgage payment, whether or not they have equity in their home. Those struggling to make their monthly payments may have had a change in life circumstance that reduces their ability to pay, or be facing a resetting adjustable rate that they cannot afford.

Essentially, these are the homeowners we are aiming to help – they want to stay in their homes, but have a mortgage product problem or an income problem.

Two-pronged Approach to Rising Foreclosures

We have a two-pronged policy approach that focuses on these two sources of rising foreclosures. First, we worked with Congress to enact a broad stimulus plan to support the economy, to maintain and create jobs so there will be fewer who suffer that income loss. The stimulus package will put $150 billion into the economy and create more than 500,000 new jobs this year. We expect to deliver stimulus payments to over 130 million households starting in May, with the bulk of those dollars distributed by the first week in July. The boost from consumer spending and business investment will add strength to our economy while the housing and credit market adjustments proceed.

Second, a private sector alliance – HOPE NOW – has adopted a broad set of tools focused on assisting struggling borrowers who want to keep their homes. This morning they released data demonstrating the results of their efforts through the month of January.

HOPE NOW Results

HOPE NOW announced that since July more than 1 million struggling homeowners received a work-out – either a loan modification or a repayment plan that helped them avoid foreclosure. Of those, 638,000 were for subprime borrowers. This data does not include refinancings, which also provide borrowers with affordable, long-term mortgages.

According to today's information, HOPE NOW's progress is accelerating. In January, there were 167,000 work-outs, up 11 percent from December. Loan modifications alone increased 19 percent from December to January. By comparison, foreclosure starts increased just 5 percent during the same period. I am encouraged that the number of borrowers receiving help is rising faster than the number entering foreclosure.

Focus on Subprime Borrowers

One of the tools of HOPE NOW is the American Securitization Forum's fast-track framework for subprime ARM borrowers that was announced in December.

Why are we focused on this small group of borrowers? Because they represent a disproportionate share of foreclosures.

Even when both the economy and the housing market are strong, many foreclosures occur. For example, between 2001 and 2005, foreclosure starts averaged more than 650,000 per year. Based on data through the third quarter of last year, we are on track for about 1.5 million foreclosure starts in 2007 and some analysts see as many as 2 million foreclosure starts in 2008.

While subprime mortgages make up only 13 percent of outstanding mortgages, about 50 percent of the foreclosure starts in the third quarter 2007 were subprime loans. And more astonishing is the fact that, while subprime ARMs are only 6.5 percent of mortgages, they represent 40 percent of third-quarter 2007 foreclosure starts.

These numbers presented a volume problem - that the time-intensive process of examining the financial situation of every subprime borrower would overwhelm the available resources, and as more borrowers called for help some who, in a normal market, would get a modification or refinance would instead go into foreclosure simply because no one could respond to them in time.

The new protocol announced in December is designed to address this volume problem by streamlining some borrowers into refinancing or modification, so that resources are available for more difficult situations.

The SEC signed off on this protocol on January 8th. Although it is complex, some servicers were able to implement it right away, while others required more time to work through the legal, operational and accounting issues. Overall, more than half of the HOPE NOW servicers had implemented the protocol by the end of January.

Those of you who know me know that I am not a patient person. I certainly would have liked to see more servicers implement the protocol faster, and I want to praise those industry leaders who acted quickly. They met their commitments, and that is welcome. I am pleased that as of today, all of the HOPE NOW members who service subprime mortgages have the protocol in place, ahead of the rising volume of resets in the coming months. Having the protocol in place industry-wide should also mean – and I will monitor this – accelerated results for subprime borrowers in the coming months.

Given the time it took to implement the ASF framework, HOPE NOW concluded it was too soon to have meaningful results specific to this fast-track plan. Instead, the results are included in the aggregate HOPE NOW reporting on subprime workouts.

In January, HOPE NOW members – through the ASF protocol and other workout programs – modified 45,000 subprime loans, up 16 percent from December. I expect those numbers to increase further, now that the ASF protocol is in place industry-wide. Transparency of the ASF protocol results is critical. I understand that tracking results is complicated – every borrower is unique and attributing particular outcomes to particular causes is difficult. Still, enough of the servicers were following the ASF framework in February that I will press HOPE NOW to break out the ASF protocol results when their February data is released, so that we can all assess its effectiveness.

It is important that everyone who agreed to this protocol follows through on their commitment. I won't look kindly on industry free riders. My measure of success will be that a borrower who has made all the payments at the initial rate, but can't afford the reset and reaches out for help, avoids going into foreclosure.

Of course, the single most significant factor that has benefited all ARM borrowers is the recent decline in short-term interest rates, which are very significantly mitigating the effects of mortgage resets. A typical subprime mortgage resetting in December might have increased from 8.5 to 10.8 percent; in today's lower interest rate environment it may reset only to 9 percent. This means on a $200,000 mortgage, the typical monthly payment will increase by about $70, instead of growing by more than $300. Market participants estimate that as many as half the borrowers who at December rates would have been fast-tracked for a modification instead did not face a significant ARM reset in January. Lower rates, rather than loan modifications, helped these borrowers avoid foreclosure.

Outreach Efforts

As we continue to urge lenders to streamline the modification and refinance process, we must also continue to urge struggling homeowners to reach out for help.

Before the creation of HOPE NOW, servicers were sending letters to delinquent borrowers and getting only a 2 to 3 percent response rate. The alliance now sends out letters on HOPE NOW letterhead, and gets closer to a 20 percent response. They've sent over 1 million letters to struggling borrowers who had previously avoided contact, and the higher response rate means almost 200,000 borrowers have reached out for help.

That's a big improvement, but it also means that more than 80 percent of at-risk homeowners aren't responding - aren't taking any responsibility. For any government or industry initiative to be effective, homeowners must actively engage with their lenders and demonstrate that they want to keep their homes. The earlier they do so, the more flexibility their lender will have. If borrowers don't ask for help, they will have to bear the consequences --- which may very well mean losing their homes when that could have been prevented.

Conclusion

As the HOPE NOW alliance continues to report results, we will evaluate progress and make adjustments. We will also continue to listen to new ideas. I believe we have the right program in place – an evolving private sector effort to reach borrowers and find affordable mortgage solutions wherever possible. We will continue to pursue FHA modernization and GSE reform in Congress, to expand access to affordable mortgages. And I will continue to focus on the broader effort to keep our economy strong as we weather this necessary housing correction.

Thank you.

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