

U.S. DEPARTMENT OF THE TREASURY

Press Center



Under Secretary for Domestic Finance Robert K. Steel Testimony before the Senate Committee on Banking, Housing and Urban Affairs

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Washington - Chairman Dodd, Ranking Member Shelby, Members of the Committee, good morning, I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on "Foreclosure Prevention and Neighborhood Preservation." These are important and challenging issues; addressing them will require collaborative work on all our parts, and I look forward to hearing your perspectives and working together.

Chairman Dodd, Ranking Member Shelby, Members of the Committee, good morning, I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on "Foreclosure Prevention and Neighborhood Preservation." These are important and challenging issues; addressing them will require collaborative work on all our parts, and I look forward to hearing your perspectives and working together.

Let me begin by broadly examining the characteristics of foreclosure, in both good times and bad, then describe how our approach to this issue has developed, and finally provide an update on the progress we are making to address current challenges.

Characteristics of Foreclosure

We are experiencing a period of adjustment in the housing sector of our economy. Fortunately, our economy is resilient and diverse, and our long-term economic fundamentals remain strong. Nevertheless, the Administration recognizes the importance of housing to our economy, and as Secretary Paulson has said many times, the housing decline is the most significant current risk to our economy.

In addition to the housing decline exacting a penalty on economic growth, many individual families will experience firsthand strain due to resetting mortgage rates and home price depreciation. Too many American homeowners face the frightening prospect of losing their home in foreclosure – and a significant number of other families already have. Foreclosures also pose negative externalities, placing hardships on neighboring homes and undermining the financial stability of broader communities and the families who live there. Many homeowners who are paying their mortgages on time face lower property values due to foreclosures in their neighborhood.

The latest available data (from the third quarter of last year) indicate that 2007 was on track for a foreclosure starts rate of 2.7 percent. To put that number into perspective we should recognize that many homes end up in foreclosure every year, even when housing markets are strong. Between 2001 and 2005, for example, the U.S. annual rate of foreclosure starts averaged approximately 1.7 percent, meaning more than 650,000 homeowners began the foreclosure process each year. This baseline rate of foreclosure can result from events such as job loss, credit problems, changes in family circumstances, or other sources of economic instability.

Over the course of the next two years, we expect the foreclosure rate to remain elevated above its historic level. A rising foreclosure rate during a period of housing price depreciation is not surprising. Yet, largely because of relaxed underwriting standards in recent years – particularly in the subprime market – and resetting mortgages, the number of homeowners facing hardship will be higher than during other recent housing downturns.

In total, approximately 1.8 million subprime mortgages are expected to reset over the next two years, but not all will end in foreclosure. Many homeowners will be able to afford their new payments without trouble or may be able to qualify for refinanced, fixed-rate mortgages on their own. In fact, of the 2/28 subprime ARMs originated in 2005, 88 percent had not defaulted as of late last year. Others, however, have stretched far beyond their means, and unfortunately, foreclosure may be unavoidable. In fact, many loans enter into foreclosure before ever reaching the reset date. A third group of homeowners facing resets falls somewhere in the middle. The challenge is to identify the homeowners in this middle group, who with a focused and timely response can stay in their homes.

Treasury's Response

The Administration's goal is to prevent foreclosures for homeowners. It is not about assisting lenders or bailing out investors.

Our response is based upon a three point plan: (1) to better identify, reach and connect with counselors those at-risk homeowners who can be helped, (2) to assist in developing additional products for homeowners, and (3) to increase the speed and efficiency of moving these at-risk borrowers into affordable solutions.

Whenever facing a challenging public policy issue, such as this one, the first step is full understanding. While we are continuing to learn, our response to date represents months of listening Congress to leading academics, servicers, mortgage counselors, lenders, homeowners, and investors to understand the causes of foreclosures and the best ways to help people keep their homes.

Last March, in a meeting hosted by Chairman Bair at the Federal Deposit Insurance Corporation (FDIC), we heard from several housing experts to help us understand the scope and scale of these challenges. In April and May, the Treasury Department hosted two large meetings, inviting all the relevant regulators to help us gain a greater understanding of the problem and map out potential policy responses. Over the course of the summer months, we sought the sound counsel of outside experts. We spoke with dozens of individuals, including leading counselors, mortgage servicers, academics, housing and consumer advocates, and other experts, such as the late Ned Gramlich, a former Federal Reserve Governor and prescient housing scholar who predicted the significance of these challenges before anyone else.

On August 31, President Bush announced an aggressive, comprehensive plan to help at-risk homeowners stay in their primary residences. The President charged Secretary Jackson and Secretary Paulson to lead this effort.

As the Treasury Department and the Department of Housing and Urban Development (HUD) met with a variety of mortgage market participants and non-profit credit counselors in the late summer and early fall of 2007, it became clear that while many market participants were working diligently on their own trying to reach and help homeowners, but it was inadequate given the scale and pace of pending resets.

On October 10, HOPE NOW was formed as an alliance among counselors, servicers, investors, and other mortgage market participants to maximize outreach efforts to at-risk homeowners and help them stay in their homes. The Alliance grew and today servicers participating in HOPE NOW comprise over 94 percent of the subprime mortgage loan market.

HOPE NOW adopted a centralized hotline for telephonic foreclosure prevention counseling (888-995-HOPE, operated by the Homeownership Preservation Foundation). Expanding and sustaining the capacity of the HOPE hotline was essential as outreach efforts increased. Servicers and investors now reimburse HOPE hotline counselors \$100 for every counseling session completed. This is an important step toward maintaining a sustainable funding model for counseling, as government and foundation funding have traditionally been the sole source of counselor support.

Additionally, HOPE NOW servicers are contacting all adjustable-rate mortgage borrowers at a minimum of 120 days prior to their mortgage reset. This will allow servicers' early identification of borrowers who will have challenges – greatly increasing their options for help. While some servicers were already doing this, we believe it was an important step to standardize this practice for all HOPE NOW servicers.

Furthermore, through coordinated outreach efforts, HOPE NOW members are reaching out to all at-risk borrowers and offering help through both mortgage servicers and non-profit credit counselors. A direct mail campaign began in November to contact all borrowers who are 60 days or more delinquent on their loans with no prior servicer contact. This letter informs them that help is available.

Secretary Paulson has also encouraged HOPE NOW members to expand and expedite mortgage solutions for at-risk borrowers. On December 6, President Bush announced a new private-sector framework to streamline the process for modifying and refinancing subprime mortgages for eligible homeowners. These new industry guidelines, issued by the American Securitization Forum (ASF), created an efficient process for identifying borrowers who qualify for refinancing or loan modifications. This, in turn, will free up resources and allow mortgage servicers to focus on those borrowers who require more in-depth analysis.

Lastly, HOPE NOW servicers and counselors have finalized best practices that will increase efficiency in communication among servicers, counselors and homeowners. Through these best practices, including the continued development of cross-industry technology, more homeowners will be helped as counselors are more effectively able to connect with servicers.

Early Progress

As Secretary Paulson has said, we are committed to measuring the success of this program as it is implemented. Before the establishment of HOPE NOW the industry did not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance or to evaluate counselors' effectiveness. Today, the Alliance is standardizing a variety of measures which policymakers, homeowners and investors need in order to monitor performance. These performance measurements include data such as the number of loans in default, outcomes for these loans, and success rates for modifications and refinances. These metrics will allow us to identify categories of borrowers who can be helped, determine successful treatments, and measure the rate of successful outcomes.

Early sets of numbers have already been reported, and these demonstrate that material progress is being made.

For instance, early data indicate that Alliance members are identifying and connecting with more at-risk borrowers than just a few months ago.

- Since its launch, HOPE NOW has worked to increase significantly the awareness and capacity of the HOPE hotline – in August the hotline was receiving an average of 625 phone calls a day; the HOPE hotline is now receiving 4,000 new phone calls a day. That is a 540 percent increase.
- Moreover, in the first two months of a new monthly mailing campaign, HOPE NOW and its members have mailed 483,000 letters to delinquent homeowners who had previously avoided contact, with a response rate to date of over 16 percent. That is an estimated 77,000 borrowers who called for help after receiving a letter.

In addition to outreach, new affordable mortgage solutions are being developed to help homeowners.

- On August 31, the Administration announced FHASecure to offer homeowners foreclosure alternatives; since then, over 75,000 Federal Housing Administration (FHA) insured loans have been closed putting over \$10 billion to work. In addition, it is estimated that about 100,000 more applications are in the pipeline.
- Just last month, Congress passed a temporary mortgage debt tax relief act that will provide homeowners relief from taxes that would have otherwise been due from principal forgiveness. This tax relief will help homeowners avoid nearly \$200 million in taxes a year for the next three years.
- The Administration has advocated temporarily raising the cap on tax-exempt bonds for state housing authorities to help borrowers refinance. This proposal would increase the total annual cap on existing programs by \$15 billion over three years, with this extra cap targeted at refinancing existing loans of subprime borrowers. This is important because real estate markets are regional and states are well-positioned to tailor programs that meet the specific needs of their communities.

We also have made a great deal of progress in increasing the speed and efficiency of moving borrowers into affordable solutions. The ASF program announced last month is helping fast-track eligible borrowers into a refinancing or loan modification, and it is freeing up resources, allowing servicers and counselors to focus on borrowers who need detailed case-by-case help. The ASF streamlined plan is only one part of our effort, but we expect the results to show a meaningful increase in the number of modifications and refinances as reporting begins.

The Mortgage Bankers Association and HOPE NOW have both made good progress in helping us evaluate performance to date. Although a more in-depth analysis of recent activity, including the beginning progress of the fast-track plan, will be available in the coming weeks and months, HOPE NOW reported that:

- The industry helped 370,000 homeowners with subprime loans in the second half of 2007 through modifications or new repayment plans, and 120,000 of those homeowners received modifications.
- Moreover, the rate of modifications of subprime loans tripled from the third quarter to the fourth quarter of calendar year 2007, and even more are expected as we move forward in 2008 and the ASF framework begins to take effect.

The Administration also has requested that the Congress do its part and we are appreciative that significant progress has been made. As you know, the Congress appropriated an additional \$180 million to NeighborWorks to fund counselor networks. We also applaud the swift action taken by Congress to pass the President's tax relief proposal, which was signed into law in December.

FHA modernization is moving through the Congress, and we are hopeful that it will reach the President's desk soon. Additionally, government sponsored enterprise (GSE) reform has cleared the House of Representatives, and we look forward to working with this Committee as Members consider legislation on the subject. The Treasury Department also looks forward to working with the Congress on the Administration's proposal to allow state housing authorities to issue tax-exempt bonds to help refinance borrowers into affordable mortgage products.

Conclusion

Mr. Chairman, in conclusion, let me thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. We have made substantial progress since August and there is much more work to do. We will continue to learn as we move forward and look for additional measures to help avoid preventable foreclosures.

Thank you and I look forward to your questions.