Remarks by Under Secretary Robert K. Steel to the NYC Subprime Lending and Foreclosure Summit

12/12/2007

New York, NY--Thank you, Scott, for your kind introduction. And let me also thank the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Bank of New York, and the City of New York for hosting this important summit.

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Today's event has brought together some of the best minds in housing, finance, government, regulatory and academic research institutions to discuss the importance of housing, here in New York City and throughout the nation. I am optimistic that we will all agree on the significance of these issues and learn from each other about ways to address current challenges.

The Success of America's Housing System

The housing system in the United States is respected around the world. And our housing finance structure is a marvel in its size, scope, and efficiency. The strong American tradition of private ownership did not happen by accident; instead it has been fostered over many many years. As a society, we in this country have long felt that homeownership has many underlying benefits. For example, the late Edward Gramlich points out in his book that homeowners tend to save more, invest more in their children, and build more wealth than their neighbors in rental housing.

At the center of America's success in housing is our modern day housing finance system, which has produced high quality homes for millions of Americans and over time increased the homeownership rate to its current level of 68 percent.

One of the many recent benefits of our housing finance system has been the extension of credit to borrowers without a long credit history or perfect credit scores. Today, families with lower scores on the FICO scale – the most commonly used method of determining credit scores - can access mortgage credit at interest rates a few percentage points higher than the prime interest rate. The market for these borrowers has risen dramatically in recent years. In 1994, subprime mortgage originations were only $35 billion. Today, the subprime mortgage market is about $1 trillion.

Although today the term subprime evokes some uncomfortable feelings, we should pause for a moment and recognize that the increased use of subprime products over the last thirteen years resulted in millions of new mortgages. For example, one industry source estimates that there are currently about 6 million total subprime mortgages. In 2000, there were less than a million.

As a result of this financial innovation, together with the overall strength of the U.S. economy, the homeownership rate reached historic levels during the past thirteen year period. And the homeownership rate among minorities increased to new highs. For instance, the homeownership rate for African Americans rose from 42 percent to 49 percent, and the rate for Hispanic Americans rose from 45 to 50 percent.

Also during this period, the percentage of successful homeowners reached extremely high levels. Just two years ago, the foreclosure rate stood at less than 1 percent (0.97 percent) and the delinquency rate was only 4.44 percent – that is, almost 95 percent of American homeowners were successfully staying in their homes and paying their mortgage on time. It is worth pointing out however, that even during periods of historically strong housing markets, not all homeowners were successful. Even in strong housing years, some borrowers who over-extend themselves or experience a change in life circumstance find they can no longer afford their home. In fact, between 2001 and 2005 the rate of foreclosures started averaged approximately 1.7 percent a year, meaning more than 650,000 homeowners began the foreclosure process each year.

Current Challenges

Foreclosures – like unemployment – are an unfortunate reality given the dynamism of our economy today. Recently, lax underwriting standards and resetting adjustable rate mortgages combined with falling house prices are causing the foreclosure rate to rise above its longer-term average. When foreclosures rise, and are concentrated in particular neighborhoods, they begin to have an even greater negative impact. Concentrated foreclosures drive down property values and undermine the financial stability of families, communities and ultimately our economy.

An estimated 1.8 million owner-occupied subprime mortgages are scheduled to reset in 2008 and 2009. Not all will end in foreclosure. Some homeowners will be able to afford their new payments without trouble and many others will qualify for a refinanced, fixed-rate mortgage. Other homeowners, however, have stretched beyond their means or have made speculative bets on the housing market, buying up multiple houses or condos expecting to make a profit. Unfortunately, for many of these borrowers, foreclosure is inevitable.

A third group of homeowners facing resets fall somewhere in the middle. Our ambition is to identify the group of homeowners who, with a bit of assistance and flexibility, can find affordable solutions and stay in their homes.

Our Approach

Whenever facing a challenging public policy issue, the first step is full understanding. Throughout the spring and summer months, as we watched challenges in the housing and mortgages markets unfold, we embarked on a comprehensive campaign of understanding and evaluation. We spoke with leading experts, counselors and markets participants to learn as much as we could about the size and scale of the problem and the scope of potential policy responses. We are, of course, continuing to learn and always seeking new perspectives but this period of initial conversation helped shaped our early conclusions.

On August 31st, President Bush announced an aggressive, comprehensive plan to prevent avoidable foreclosures and help as many homeowners as possible stay in their primary residences. The Departments of Housing and Urban Development and Treasury have been working closely with leading servicers, mortgage counselors, lenders, and investors to help people stay in their homes.

In October, a large group of servicers, counselors, lenders and investors came together and announced the formation of an alliance called Hope Now. To date, the Hope Now Alliance consists of four counseling organizations, 21 mortgage servicers and lenders (comprising 65 percent of the U.S. market for mortgage servicing and almost 85 percent of the subprime servicing market), three investor groups (including the American Securitization Forum, which represents over 370 members), and 10 trade associations.

The initial task was to set up a method of identifying and reaching struggling borrowers. This infrastructure was established through outreach letters, an expanded toll-free hotline and counselors who are on call to help struggling homeowners.

The next phase, announced just last week by the President, includes a complementary private sector agreement to streamline the process for modifying and refinancing subprime mortgages for eligible homeowners. These new industry guidelines, issued by the American Securitization Forum, will create an efficient process for identifying borrowers who qualify for a loan modification or refinancing. This, in turn, will free up resources and allow mortgage servicers to focus on those borrowers who require more in-depth analysis. It will also expedite the evaluation process, a critical necessity given the approaching wave of resets in the coming 18 months.

Going Forward: Implementation and Measurement

Under this new agreement, the servicers estimate that up to 1.2 million subprime, adjustable rate mortgage holders may be eligible for a fast-track refinance or loan modification.

We are committed to tracking and measuring the success of this program as it is implemented. Today, the industry does not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance, evaluate counselors' effectiveness, or determine the precise number of modifications and refinancings being made. The Hope Now Alliance is developing standard measures which will allow us to identify categories of borrowers who can be helped, determine successful treatments, and measure the rate of successful outcomes.

This agreement has developed over time and will likely continue to evolve in the future. Implementation will not be easy but we will closely monitor it and as Secretary Paulson has said "do our best to address issues as they arise."

Conclusion

The efforts announced last week are part of a larger initiative to help distressed homeowners. We have also asked Congress to do their part. In August, President Bush requested that Congress temporarily eliminate taxes on mortgage debt forgiven on a primary residence, pass Federal Housing Administration (FHA) modernization to make affordable FHA loans more widely available, enact comprehensive reform of government sponsored enterprises, and move appropriations bills to the President's desk that include additional funding for mortgage counselors.

There are significant social and economic implications of addressing the challenges we are facing in the mortgage markets. Although there is no perfect solution, we believe our efforts will help encourage stability in household wealth and home prices, as well as the broader financial markets and the U.S. economy.

Thank you. I will now be pleased to take questions.