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"The Implementation of the HOPE for Homeowners Program and a Review of Foreclosure Mitigation Efforts"

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Chairman Frank, Ranking Member Bachus, and members of the Committee, we are pleased to appear today on behalf of the Board of Directors of the HOPE for Homeowners Program (Board) to discuss the significant progress that the Board has made – and continues to make – to implement the HOPE for Homeowners Program (Program).

I am Brian Montgomery, Commissioner of the Federal Housing Administration (FHA). I was honored to be designated by Secretary Preston as his designee to the Board and to be elected Chairman of the Board by my fellow Board members who appear with me today. They are Elizabeth A. Duke, Governor of the Federal Reserve Board (Federal Reserve), Phillip L. Swagel, Assistant Secretary for Economic Policy at the U.S. Department of the Treasury (Treasury), and Thomas J. Curry, Director of the Federal Deposit Insurance Corporation (FDIC). This testimony is provided on behalf of the entire Board and is an example of the remarkable cooperation and collegiality that has been a hallmark of the Board's efforts.

First and foremost, we want to assure you that we are firmly committed to having the Program up and running by October 1, 2008, and believe this goal is achievable. We have been working diligently and cooperatively to develop and implement the Program in a manner consistent with both the terms and purposes of the HOPE for Homeowners Act (Act). The Board held a planning meeting only hours after President Bush signed the Act into law. We also are committed to issuing rules and guidance, as well as related documentation and informational materials before October 1st. These materials will comprehensively describe the Program's terms, conditions and requirements so that eligible borrowers, lenders, servicers, and investors can make informed choices as to both the benefits and costs of the Program.

We fully recognize the importance of the Program and our obligations as members of the Board. The Program was established by the Housing and Economic Recovery Act of 2008 to achieve a number of important policy objectives. These include providing eligible, distressed homeowners an opportunity to refinance into more affordable and sustainable home loans; providing lenders and servicers a new and potentially valuable tool to use in pursuing loss-mitigation strategies; and helping to stabilize communities, housing prices and mortgage markets by reducing the number of foreclosures.

In this testimony, we will provide an overview of the significant steps that both the Board and the Federal Housing Administration (FHA) have taken to date to implement the Program. In addition, we will touch on some of the key challenges that Congress faced in designing the Program and that the Board and FHA have been addressing in implementing it. As noted previously, the Board expects to approve soon final rules, guidance, documentation and informational materials for the Program. We will of course provide these materials to the Committee as soon as they are approved in final form.

Implementation Efforts and Status

We are committed to having the Program open for business on October 1, 2008. While getting a new government program operational in less than two months is no easy task, the Board and respective staff are dedicated to meeting the challenge. Since the Act became law on August 2nd, we have held 5 official Board meetings, including a half-day "roll up the sleeves" working session to discuss various aspects of the Program. We have all benefited from the tremendous collegiality, expertise and the level of intellectual discourse that has been brought to bear at these meetings to ensure that the Program is sensible and accessible.

Administration, Staffing and Funding

While perhaps mundane, we have taken steps to put in place the type of administrative infrastructure that is critical to the successful implementation and oversight of any program. For example, we have adopted by-laws, rules governing access to Board records, and procedures for financial oversight, recordkeeping, and preparation of the Board's mandated monthly reports to Congress. In addition, we have established and appointed personnel to several key officer positions for the Program to ensure that a team of professionals are charged with the day-to-day responsibility for keeping the Program on track. These officers are led by Margaret Burns, Director of FHA Single Family Program Development, who serves as Executive Director of the Program.

Each agency represented on the Board also has dedicated an experienced team of policy, research and legal staff to the Program. These staff members bring a wealth of market knowledge, program expertise, and a true commitment to the goals of the Program. Working under the direction and oversight of the Board, agency staff held numerous meetings and conference calls to develop and present to the Board options and recommendations for effectively implementing the Program in a timely manner. The Board also approved $29.5 million in initial funding for the Program's start-up costs associated with outreach, personnel, contracting, and systems upgrades. The Department of the Treasury quickly provided the funds through the issuance of HOPE Bonds, as required in the Act, and they have been transferred to HUD.

Outreach

The Board and FHA have already engaged in extensive outreach to solicit the views of potential stakeholders on Program implementation, including housing trade associations, lenders, counselors, and consumer advocacy organizations. For example, at the direction of the Board, staff of FHA and the other agencies have held numerous conference calls with servicers, investors and consumer groups. We have used these discussions to improve our understanding of obstacles to successful and sustainable loan modifications. This outreach also sought to best determine the type, characteristics and number of eligible loans that may be directed to the Program, the areas where additional guidance or actions by the Board or FHA may be necessary or useful to clarify the types of loans and borrowers that may be eligible for the Program, and the rights and responsibilities of both existing mortgage holders and the originating lender of the new HOPE for Homeowners loan.

Market Reaction

At the Board's invitation, Joseph Murin, President of the Government National Mortgage Association (GNMA), has attended meetings of the Board. Working with GNMA, the Board and FHA have conducted outreach with financial market participants to help ensure that the market is ready for securitizations backed by HOPE for Homeowner loans. Familiarity should promote liquidity, which in turn should help the product trade as close as possible to FHA Secure and other FHA-insured products. However, given the distressed nature of the borrowers likely to participate in the Program, as well as the 1.5 percent annual mortgage insurance premium mandated for HOPE for Homeowner loans, early indications are that HOPE for Homeowner loans likely will have a higher interest rate than other FHA-insured products, including *FHASecure*, because they will cost more than standard FHA loans . Recognizing this raises concerns about affordability, we will require that the new HOPE for Homeowners loan have a lower monthly payment than the mortgage or mortgages it replaces.

Program Design

Finally, and most importantly, the Board has been working diligently to finalize all aspects of the Program's design. The Program adopted by Congress recognizes that, because of the substantial economic and social costs associated with foreclosures, providing an FHA-insured refinancing product to facilitate the restructuring of distressed loans, may in certain circumstances create a better outcome for borrowers, lenders, servicers, and investors than would otherwise be attainable if the foreclosure process was allowed to run its course.

In its most basic form, the Program will allow lenders and borrowers on a voluntary basis to refinance an existing distressed loan into a new, sustainable FHA-insured 30-year fixed-rate mortgage. To do so, the existing first mortgage holder must agree to write-down its existing mortgage loan to 90 percent or less of the current appraised value of the property and pay the borrower's initial 3.0 percent FHA mortgage insurance premium. All holders of existing senior and junior mortgages must release their liens on the property and the homeowner from all indebtedness under the mortgages. The borrower will receive a new, sustainable mortgage and equity in the home, but also will be obligated to share both that initial equity and any future appreciation on the property with HUD. HUD also is directed to facilitate agreement between the existing senior lien holders and junior lien holders, which is necessary to allow the refinance to proceed, including the sharing of HUD's interest in the future appreciation in the property.

In enacting this basic Program design, Congress sought to balance several important policy objectives. These include:

- The desire to offer relief to a significant number of borrowers to help address the personal, economic and social costs associated with foreclosures and help stabilize the housing and mortgage markets;
- The need to address the real potential for the Program to induce moral hazard on the part of borrowers and adverse selection on the part of lenders and servicers;
- The need to avoid, through prudent underwriting standards and adequate cost recovery mechanisms, the origination of new, unsustainable mortgages that would unduly add to taxpayer costs; and,
- The need to offer junior mortgage holders an appropriate incentive to participate in any proposed refinancing and restructuring.

As we work towards finalizing the Program's design, we are keenly aware of the balance that Congress sought to strike in enacting the Program and the importance of reflecting that balance in our rules and guidance. For example, Congress' intent regarding the type of borrowers eligible to benefit from the Program is very clear—homeowners that desire to stay in their home but, because of the terms of their existing mortgage or declining home values, are struggling financially and have few, if any, other refinancing options available. A unique aspect of the Program is the requirement that first mortgage holders take a significant principal write-down to qualify homeowners for the Program. Because principal write-downs are costly for lenders, we can be certain that most applicants will be severely distressed homeowners. These borrowers may well have missed several payments on their mortgage or even be facing a pending foreclosure, have a high overall household debt burden and few financial assets, and have little or no equity in their homes.

The Board, however, also is charged with responsibility for establishing underwriting standards that are designed to ensure that the borrower, after any write-down in principal mandated by the statute or offered by the existing lender to further improve affordability, has a reasonable ability to repay the new FHA-insured mortgage, consistent with Federal credit policies. Developing workable underwriting standards for a population of distressed applicants is a challenge. It is likely that few, if any, of the likely applicants to this Program would be accepted under normal FHA or private lender standards.

Excessively lenient standards would result in greater borrower participation, but also raise serious concerns about Program performance and costs. We recognize that a Program with a high default and foreclosure rate is not successfully meeting the goal of putting borrowers into sustainable mortgages. We will not achieve the goals of the Program if borrowers simply are transferred from one unsustainable mortgage to another. We also are conscious that creating a Program that simply defers foreclosures, rather than preventing them, will only prolong the mortgage crisis and lead to significant costs to the Government – an outcome no one wants. At the same time we recognize that setting underwriting standards too high will result in participation volume that is significantly less than would otherwise be the case, thereby limiting the Program's effectiveness in addressing the foreclosure crises for which it was designed.

Congress also made clear that the Program is not available to borrowers who have intentionally defaulted on their existing mortgage, who knowingly or willfully provided false information to obtain their current mortgage, or who have been convicted of fraud within the prior 10 years. Likewise, the Program is not open to investor-owned properties or to homeowners that own additional properties. We expect to adopt documentation requirements that will ensure that all potential borrowers are clearly informed of these prohibitions and certify their compliance. FHA also expects to use state-of-the-art fraud detection tools, recommended by HUD's Inspector General, to proactively identify (before insurance is granted) loan applicants who have been convicted of fraud.

One of the greatest challenges to successful loan modifications is obtaining the consent of all existing lien holders, including the holders of junior mortgages. In recognition of this challenge, and of the need for junior mortgage holders to participate in the HOPE for Homeowners Program to achieve the broadest possible penetration, Congress gave the Board the authority to share a portion of the government's interest in any appreciation of the property's value, and directed HUD to take such actions as may be necessary and appropriate to facilitate coordination and agreement between the holders of the existing senior and junior mortgages on the property.

We have focused a great deal of attention on how to implement these key authorities. In evaluating this important issue, we have been greatly assisted by the modeling expertise, economic research and market knowledge of the agencies, as well as by the input we have received through our outreach efforts to lenders, servicers and other market participants. We expect the final rules and guidance will be adopted and issued soon to provide both a mechanism and a formula for a junior mortgage holder to receive limited compensation if the holder agrees to release the borrower from all indebtedness under the junior mortgage and release the lien on the property.

We also are keenly focused on the other elements of the overall Program operations that are necessary to ensure the Program's success and appropriate consumer protections. As a Board, we feel strongly that we must incorporate protections within this Program to help ensure that borrowers are placed in appropriate and sustainable mortgages and are not exploited. In this regard, the Program has several unique features, such as a relatively high mortgage insurance premium and initial equity and future appreciation sharing requirements. It is vitally important that consumers have a clear understanding of these provisions so they can adequately weigh both the benefits and costs of participating in the HOPE for Homeowners Program. To this end, the Board is developing disclosures to ensure that applicants receive clear and concise information about these unique features. In addition, the Board is creating supporting documents that will give borrowers additional details about the Program and answer anticipated questions. These documents will provide borrowers with necessary context and examples of the amount of equity and appreciation they will be required to share over time. In combination with these upfront disclosures to consumers, the FHA will conduct more stringent monitoring of participants in this Program in order to prevent predatory practices that could push unsuspecting and unprepared borrowers into another loan they cannot afford.

In addition, the Board is forming an extensive outreach and education campaign in order to educate lenders, counselors, and consumers about the HOPE for Homeowners Program and its requirements. In connection with this effort, we are designing a training curriculum that will address a lender's ability to use the Program as an option for loss mitigation and, from the borrower's perspective, help achieve sustainability going forward.

Conclusion

Thank you for the opportunity to update the Committee on our ongoing efforts to implement the HOPE for Homeowners Program and, thus, provide an opportunity for relief to eligible homeowners, lenders, servicers and communities being impacted by the current difficulties in the mortgage and housing markets. We feel confident that the Program will offer homeowners and the housing finance industry a good refinancing option that will be an important tool to help address the fallout from ongoing mortgage market difficulties in a positive way. We are committed to having the Program operational on October 1, 2008.