

Date of Hearing: July 2, 2011

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

AJR 40 (Skinner) – As Introduced: May 15, 2012

SUBJECT: Mortgages

SUMMARY: Urges the Federal Housing Finance Agency (FHFA), and specifically its director, Edward DeMarco, to immediately allow the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) to offer principal reductions to homeowners who owe more than their homes are worth. Specifically, this bill:

- 1) Makes the following findings and declarations:
  - a) Since 2008, more than half a million Californians have lost their homes to foreclosure and another half million homes are currently in foreclosure or are at imminent risk of foreclosure; and
  - b) There are over 2 million California homes currently “underwater” where property owners owe more than what the home is worth and collectively the value of these homes is over \$196 billion; and
  - c) Foreclosures too often become vacant, boarded-up hazards, lower surrounding property values, increase criminal activity in neighborhoods, and discourage economic development and investment in communities; and
  - d) The wave of foreclosures that has already hit California substantially decreased tax revenue, which led to budget deficits, increased unemployment, and billions of dollars in cuts to schools, health services, and other vital services; and
  - e) Fannie Mae and Freddie Mac, the two companies that control over one-half of the home loans in the United States, and specifically over 60 percent of California mortgages; and
  - f) The director of the FHFA, Edward DeMarco, has steadfastly opposed allowing Fannie Mae or Freddie Mac to offer principal reductions to homeowners who owe more on their homes than what they are worth; and
  - g) On February 9, 2012, Attorney General Kamala Harris announced that California will join a national servicing settlement that is estimated to provide up to \$40 billion in benefits to borrowers across the country and much of these benefits include a program of principal reductions; and
  - h) Fannie Mae and Freddie Mac refused to participate in the national settlement agreement, meaning more than one-half of the home loans in the country will see no relief from this agreement; and

- i) Many economists and housing experts agree that principal reductions are the most helpful tool for limiting the number of foreclosures; and
- j) By refusing to allow principal reductions, the FHFA is ensuring that tens of millions of homeowners nationwide will continue to owe more on their home loans than what their homes are worth; and
- k) Allowing principal reductions for Fannie Mae and Freddie Mac mortgages could deter another wave of costly foreclosures nationwide.

FISCAL EFFECT: None

COMMENTS:

The Housing and Economic Recovery Act of 2008 (HERA), which created FHFA, granted the Director of FHFA discretionary authority to appoint FHFA conservator or receiver of the Fannie Mae and Freddie Mac (Enterprises) “for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity.” This response came about from substantial losses in the portfolios of the Enterprises that amounted to combined losses of \$261 billion from 2007 to the third quarter of 2011. Additionally, as of December 31, 2011, Treasury has committed over \$183 billion to support the Enterprises.

The key issue raised by AJR 40 is that the Enterprises participate in loan modifications via the Home Affordable Mortgage Program, but FHFA the conservator of the Enterprises refuses to allow them to engage in principal reduction of loans in those cases where it might prevent foreclosure.

Much of the debate regarding FHFA refusal to participate in principal reductions began in correspondence between FHFA and the United State Congress, House Committee on Oversight and Government Reform (Committee). In response to a request from the Committee, FHFA provided an analysis, on January 20, 2012, of the impact of principal reduction on the performance of loans in the Enterprises' portfolio. In summary FHFA provided:

In considering a program of principal reduction for underwater borrowers, FHFA used the net present value model developed to implement the Home Affordable Modification Program (HAMP). Using the HAMP NPV model for borrowers with mark-to-market loan-to-value (LTV) ratios greater than 115 percent, FHFA compared projected losses to Fannie Mae and Freddie Mac from borrowers receiving principal forbearance modifications to borrowers receiving principal forgiveness modifications as allowed in the HAMP program. The model, and hence the analysis, takes into account the sustainability of the modifications and assumes that principal forgiveness reduces the rates of re-default on the loans to a greater extent than would forbearance. However, in the event of a successful modification, forbearance offers greater cash flows to the investor than forgiveness. The net result of the analysis is that forbearance achieves marginally lower losses for the taxpayer than forgiveness, although both forgiveness and forbearance reduce the borrower's payment to the same affordable level.

It is important to note that it appears that the analysis conducted by FHFA examined the costs associated with principal writes of all of the Enterprises' loans, not just those where the borrower could reach a sustainable payment.

Subsequent to this correspondence, on May 1, 2012, the Committee sent a letter to FHFA detailing findings that, contrary to testimony provided by Acting Director Demarco, that Fannie Mae has examined principal reduction and that their research revealed that principal reduction would indeed reduce taxpayer losses on the Fannie Mae portfolio. The overall conclusion of the letter was that:

Contrary to your testimony, we have now obtained a wide range of internal documents demonstrating that Fannie Mae officials conducted detailed, substantive analyses and concluded years ago that principal reduction programs have enormous potential to save U.S. taxpayers significant amounts of money by reducing overall losses from foreclosures following default.

The core of the disagreement between FHFA and those in favor of principal reduction is that FHFA has hid behind a financial analysis of the impact of principal reduction on their fiscal stability, yet their own analysis implies that the decision to not do principal reduction was a result of ideological belief, not the desire to protect taxpayers.

REGISTERED SUPPORT / OPPOSITION:

Support

American Federation of State, County, and Municipal Employees (AFSCME)

Opposition

None on file.

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