Statement of
Sheila C. Bair Chairman
Federal Deposit Insurance Corporation
On
A Review of Foreclosure Mitigation Efforts
before the
Financial Services Committee
U.S. House of Representatives
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2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) concerning strategies to avoid unnecessary foreclosures, including implementation of the HOPE for Homeowners Act of 2008 and the FDIC's recent loan modification efforts at IndyMac Federal Bank.

My testimony will provide a brief discussion of the problems created for communities and individuals by unnecessary foreclosures and the importance of converting distressed loans into long-term, sustainable loans through programs such as the HOPE for Homeowners. In addition, I will provide an update of the FDIC's recently launched loan modification program for customers of IndyMac Federal Bank.

The Housing Markets and the Impact of Unnecessary Foreclosures

In testimony before this committee in April, I discussed various proposals to address the turmoil in the mortgage markets and stem unnecessary foreclosures. This turmoil was caused by a complex set of interrelated causes, including weakened lending standards, inadequate consumer protections, regulatory arbitrage and speculative activity. Steep home price declines are an important dynamic that drives up foreclosure rates. Falling home prices reduce homeowner equity, which then makes it more difficult to refinance or sell a home, leading to lower sales and higher delinquencies.

Following a period of sustained growth in home sales, new home construction and average home prices in the first half of this decade, U.S. housing markets are now experiencing their most serious downturn of the past 60 years. Severe housing market downturns have occurred in California, Nevada, Arizona, Florida and other boom markets where rapid increases in home prices proved unsustainable. Dozens of cities have now experienced average home price declines of more than 10 percent, and the Case-Shiller index of 20 large U.S. cities has declined by almost 19 percent from its July 2006 peak.

Through the second quarter of 2008, U.S. residential construction activity has fallen for 10 consecutive quarters, subtracting an average of almost 1 percentage point from annualized GDP growth over that period. Yet even as construction activity has declined,

inventories of unsold homes have steadily risen. The Census Bureau reports that the inventory of unsold new homes in July stood at a level equal to 10.1 months of current sales--r twice the level at the end of 2005.

Declining home prices and an excess supply of unsold homes are closely linked to the historic levels of credit distress that have recently been recorded in nonprime mortgage portfolios. As of June, seriously delinquent loans amounted to some 4.5 percent of all U.S. mortgage loans outstanding and almost 27 percent of subprime adjustable-rate mortgages.1 An estimated 1.5 million mortgages entered foreclosure during 2007, followed by almost 1.2 million additional loans in the first half of 2008. Distressed sales continue to place downward pressure on home prices in the most troubled markets. An estimated 45 percent of all California home sales in July 2008 were foreclosure resales, up from 7.6 percent one year ago.2

The rising trend of foreclosures imposes costs not only on borrowers and lenders, but also on entire communities. Foreclosures may result in vacant homes that may invite crime and create an appearance of market distress, diminishing the market value of other nearby properties. In addition, the direct costs of foreclosure include legal fees, brokers' fees, property management fees, and other holding costs that are avoided in workout scenarios. These costs can total up to 40 percent or more of the market value of the property.3

Minimizing foreclosures is important to the broader effort to stabilize global financial markets and the U.S. economy. Foreclosure is often a very lengthy, costly and destructive process that puts downward pressure on the price of nearby homes, as noted above. While some level of home price decline is necessary to restore U.S. housing markets to equilibrium, unnecessary foreclosures perpetuate the cycle of financial distress and risk aversion, raising the possibility that home prices could overcorrect on the downside.

Over the past year and a half, the FDIC has worked with mortgage lenders, the securitization industry, servicers, consumer groups, other regulators and Congress to identify and correct barriers to solving current market problems while establishing controls to guard against their reappearance in the future.

The HOPE for Homeowners Act

As I stated in April, no single solution or "silver bullet" can address the adverse effects of the deficiencies that have contributed to the current market turmoil. Rather, a number of approaches emphasizing different solutions for the different segments of the market are required. One of these approaches, for which Congress should receive significant credit, is the HOPE for Homeowners Act. The HOPE for Homeowners Program (Program), which the Act established, will make a positive difference for many homeowners facing foreclosure.

I am pleased the FDIC is able to lend our assistance as a member of the Board of Directors of the Program (Oversight Board), which oversees implementation of the HOPE for Homeowners Act. The Oversight Board consists of the secretaries of Housing and Urban Development (HUD) and Treasury and the chairpersons of the Board of Governors of the Federal Reserve System (FRB) and the Board of Directors of the FDIC, or their designees. General duties of the Oversight Board include establishing requirements and standards for the Program that are not otherwise specified in the legislation, and prescribing necessary regulations and guidance to implement those requirements and standards.

The FDIC and fellow Oversight Board members are committed to full implementation of the Program by the October 1, 2008 deadline. Our respective agencies have worked cooperatively together to address the many issues necessary to achieve full implementation by the statutory deadline. These efforts also have included outreach, projecting the volume of potential loan activity in the Program, forecasting loss rates for new loans, and estimating credit subsidies. Representatives of various groups that will be affected by the new program, including lending, loan servicing, and consumer groups, have participated in what has been an intense and collaborative effort by the agencies to get the Program up and running quickly.

The statutory approach for the Program made effective use of existing governmental and market structures. By modeling the proposal on existing FHA programs, the time and expense of implementing the Act have been significantly reduced. The new program incorporates many of the principles the FDIC considers necessary to be effective. It converts current problematic mortgages into loans that should be sustainable over the long-term and convertible into securities. It also requires that lenders and investors accept significant discounts and prevents borrowers from being unjustly enriched if home prices appreciate.

As part of the planning for the HOPE for Homeowners launch on October 1, the Board will be authorizing a series of efforts across the country to quickly inform the public about the availability of the Program. The FDIC's Community Affairs program staff is working with HUD on an outreach strategy and will provide whatever support and expertise we can to assist in the effort.

IndyMac Federal Bank Loan Modifications

As the Committee knows, the former IndyMac Bank, F.S.B., Pasadena, California, was closed July 11. The FDIC is conservator for a new institution, IndyMac Federal Bank, F.S.B. (IndyMac Federal), to which the accounts and assets of the former IndyMac Ban, F.S.B. were transferred. As a result of this arrangement, the FDIC has inherited responsibility for servicing a pool of approximately 742,000 mortgage loans, including more than 60,000 mortgage loans that are more than 60 days past due or in foreclosure. As conservator for IndyMac Federal, the FDIC has the responsibility to maximize the value of the loans owned or serviced by IndyMac Federal. Like any other servicer, IndyMac Federal must comply with its contractual duties in servicing loans

owned by investors. Consistent with these duties, we hope to convert as many of these distressed loans as possible into performing loans that are affordable and sustainable over the long term. We are now actively evaluating distressed mortgages for refinancing through FHA programs, including FHA Secure. Once it is implemented, we certainly plan to utilize the Hope for Homeowners Program as well.

An additional option that I have long advocated is streamlined loan modifications. This is particularly necessary as delinquencies have continued to increase. IndyMac certainly has experienced significant delinquencies. As a result, on August 20, the FDIC announced a loan modification program to systematically modify troubled residential loans for borrowers with mortgages owned or serviced by IndyMac Federal. Of the more than 60,000 delinquent mortgages serviced by IndyMac Federal, approximately 40,000 are now eligible for our loan modification program because they are either owned by IndyMac Federal or serviced under securitization agreements providing sufficient flexibility. We are working with the owners of the remaining mortgages to gain approval to apply the new modification program to those loans as well.

As we have done in some past failures, the FDIC as conservator for IndyMac Federal has suspended most foreclosure actions for loans owned by IndyMac Federal in order to evaluate the portfolio and identify the best ways to maximize the value of the institution. As mentioned above, the FDIC also has begun a program of loan modifications for delinquent and at-risk borrowers. The FDIC as conservator for IndyMac Federal is systematically identifying loans in the portfolio that are currently delinquent or in default, or where borrowers are unable to make their payments due to interest rate resets or other reasons. Where it will improve the value of the loan, IndyMac Federal is offering loan modifications to eligible borrowers.

By achieving mortgage payments for borrowers that will be both affordable and sustainable, these distressed mortgages will be rehabilitated into performing loans and avoid unnecessary and costly foreclosures. We expect that by taking this approach, future defaults will be reduced, the value of the mortgages will improve, and servicing costs will be cut. The streamlined modification program will achieve the greatest recovery possible on loans in default or danger of default, in keeping with our statutory mandate to minimize impact on the insurance fund and improve the return to uninsured depositors and creditors of the failed institution. At the same time, we can help troubled borrowers remain in their homes. Under the program, modifications are only being offered where doing so will result in an improved value for IndyMac Federal or for investors in securitized or whole loans, and where consistent with relevant servicing agreements.

Applying workout procedures for troubled loans in a failed bank scenario is something the FDIC has been doing since the 1980s. Our experience has been that turning troubled loans into performing loans enhances overall value. In recent years, we have seen troubled loan portfolios yield about 32 percent of book value compared to our sales of performing loans, which have yielded over 87 percent.

In implementing the loss-mitigation program, IndyMac Federal's first priority is maximizing the value of the mortgages by assisting borrowers who are seriously delinquent or in default on their mortgages. However, where its servicing agreements permit, IndyMac Federal also is working with borrowers who face upcoming resets or other changes in their ability to repay.

Only mortgages on the borrower's primary residence are eligible for the streamlined approach, and borrowers have to demonstrate ability to repay the modified loan by documenting income. Under the loan modification program, IndyMac Federal determines whether the modified mortgage payments will be affordable to the individual borrower based on the borrower's income information. The modifications are designed to be sustainable based on achieving a 38 percent first mortgage debt-to-income ratio of principal, interest, taxes and insurance.

A combination of interest rate reductions, extended amortization and forbearance are all tools being used to reach a payment affordable for the borrower. The modified mortgages are capped permanently at the current Freddie Mac survey rate for conforming mortgages -- currently about 5.93 percent. To achieve a sustainable mortgage payment equal to a 38 percent DTI, IndyMac Federal can reduce the rate to as low as 3 percent for five years. After five years, the interest rate would gradually increase by 1 percentage point per year until it reached the Freddie Mac survey rate applicable when the mortgage was initially modified. The interest rate would be fixed at this rate for the balance of the mortgage term. If necessary to achieve a payment at a 38 percent DTI, IndyMac Federal also can extend the amortization term of the mortgage or defer payments on a portion of the principal of the loan. Application of these options always must be evaluated to ensure IndyMac is maximizing the value of the mortgage that can perform as compared to foreclosure. No fees are being charged for these loan modifications, and unpaid late charges are being waived.

If a borrower's income information reveals that the borrower is not qualified for the proposed modification, IndyMac Federal will work with the borrower to discuss alternatives to allow the borrower to remain in the home, including options such as the HOPE for Homeowners Program.

By the end of August, more than 4,000 modification proposals had been mailed to IndyMac borrowers. Through today, IndyMac has mailed more than 7,400 modification proposals to borrowers and has called many thousands more in continuing efforts to help avoid unnecessary foreclosures. While it is still early in our implementation of the program, over 1,200 borrowers have accepted the offers and many more are being processed. I am pleased to report that these efforts have prevented many foreclosures that would have been costly to the FDIC and to investors. This has been done while providing long-term sustainable mortgage payments to borrowers who were seriously delinquent. On average, the modifications have cut each borrower's monthly payment by more than $430.

Our hope is that the program we announced at IndyMac Federal will serve as a catalyst to promote more loan modifications for troubled borrowers across the country.

Conclusion

The FDIC strongly supports programs that result in mortgage loans that are sustainable over the long term and avoid unnecessary foreclosures that harm individual borrowers and the economy. Prudent workout arrangements are in the long-term best interest of both the financial institution and the borrower. As a member of the Oversight Board for the HOPE for Homeowners Program, the FDIC is committed to successful implementation by the October 1 deadline. In addition, the FDIC will continue the systematic program now in place at IndyMac Federal to convert troubled loans into performing loans and enhance the value of these assets.

I commend the Committee on its leadership in passing the HOPE for Homeowners Act and look forward to working with Congress on this and other programs to return our housing markets to stability and improve our economy.

1 Source: Mortgage Bankers Association, National Delinquency Survey, Second Quarter 2008. Seriously delinquent loans are defined as loans 90 days or more past due or in foreclosure.

2 Source: DataQuick press release at: http://www.dqnews.com/News/California/RRCA080820.aspx.

3 Capone, Jr. C. A., Providing Alternatives to Mortgage Foreclosure: A Report to Congress, Washington, D.C.: United States Department of Housing and Urban Development, 1996.

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