Congress of the United States
Washington, DC 20515

November 22, 2011

Acting Director Edward DeMarco
Federal Housing Finance Agency
1700 G Street, NW
Washington, D.C. 20552

Dear Mr. DeMarco:

We understand that the Federal Housing Finance Agency's objective in the conservatorship of Fannie Mae and Freddie Mac ("the enterprises") must be to minimize taxpayer costs. We do not urge that the enterprises reduce principal on mortgages as a kindness to homeowners, as sympathetic as the circumstances of many homeowners are. We strongly believe, however, that the continued refusal to reduce principal in any circumstances is greatly increasing taxpayer losses.

We urge that FHFA disregard short-term accounting treatment of principal reductions and consider only the long term consequences for taxpayers. In a letter dated March 24, 2011, you wrote that the "costs of principal reduction include the immediate losses to be realized on otherwise performing loans…" Whether losses are recognized for accounting purposes sooner or later is of no consequence to taxpayers' costs. It should not matter at all that a mortgage can be valued at par for accounting purposes so long as the homeowner makes payments on time. Underwater mortgages are obviously at great risk of eventual default, and the costs of foreclosure are brutal. First Quarter Credit Supplements from Freddie Mac reported that, based on unpaid principal balance, 19 percent of its single-family loan guarantee portfolio was underwater; Fannie Mae reported that 17.7 percent was underwater. In short, principal reductions of underwater mortgages could reduce the risk of default for almost 20 percent of the enterprises' portfolios.

Even if the enterprises are recapitalized before such default, investors will undoubtedly look beyond the accounting treatment of performing but underwater mortgages in valuing the enterprises' portfolios.

We are enclosing a study entitled "The Case for Principal Reductions" by Laurie Goodman at Amherst Securities Group, and a study the staff of the Federal Reserve Bank of New York entitled "Second Chances: Subprime Mortgage Modification and Re-Default." Both studies conclude that principal reductions result in much more successful modifications. The Goodman study examines the "moral hazard" argument that you frequently offer to justify the refusal to reduce principal, and concludes that the argument is simply unsupported by the evidence.

The performance of the enterprises' mortgage modifications leaves much to be desired for homeowners, for the housing market, and for taxpayers. According to Freddie Mac's Third Quarter Financial Results Supplement, 44 percent of loans modified two years ago are now more than three months past due.

In the face of such strong evidence of the advantages of principal modification, the enterprises' continued payment of generous bonuses raises more questions about the motivation for such short-term accounting treatment of underwater mortgages. Does the short-term accounting treatment of principal modifications affect the calculation of those bonuses?

Again, we strongly urge that you reconsider your refusal to allow principal reductions to achieve better performing modifications and avoid the extreme losses of unnecessary foreclosures, and that FHFA consider only the eventual costs to taxpayers of the conservatorship, not the illusory accounting treatment that now appears to guide FHFA's modifications.

Sincerely,

Rep. Brad Miller

Rep. John Conyers

Rep. Maxine Waters

Rep. Elijah E. Cummings

Rep. Keith Ellison

Rep. Al Green

Rep. Dennis Cardoza

Rep. Pete Stark

Rep. Mike Honda

Rep. Jan Schakowsky

Rep. Jackie Speier

Rep. Mike Thompson

Rep. Luis Gutierrez

Rep. George Miller

Rep. Raul Grijalva

Rep. Barbara Lee

Rep. Shelley Berkley

Rep. Sander Levin

Rep. John Tierney

Rep. Susan Davis

Rep. Bob Filner