Congress of the United States
Washington, DC 20515

February 27, 2012

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Dear Mr. DeMarco:

We write to you now as part of an ongoing effort to help the millions of our constituents who are struggling with negative home equity, as well as those who may lose their homes through foreclosure. On January 20th, you wrote to many Members of Congress, explaining your refusal "to allow Fannie Mae and Freddie Mac to engage in principal forgiveness at this time." For the reasons set forth below, we ask that you revisit this decision immediately.

For several years, economists and experts on the housing and securities markets have called for targeted write-downs in the balances of mortgage principal owed by some underwater homeowners. On January 6th, William Dudley, President of the Federal Reserve Bank of New York, called on Fannie Mae and Freddie Mac to implement several different types of principal reductions. On February 9th, Mark Zandi, Chief Economist at Moody's Analytics, told the Senate Banking Committee that encouraging more principal reductions offers "the best odds of ending the housing crash more quickly and definitively." Many other leading authorities have made similar statements, including Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve, Martin Feldstein, Chairman of the Council of Economic Advisers under President Reagan, and Alan Blinder, former Vice Chairman of the Federal Reserve.

Despite this weight of expert opinion, you have refused to permit Fannie Mae and Freddie Mac to write down the principal balances of any underwater mortgages, even in cases where it can be demonstrated that doing so would yield the greatest long-term savings for taxpayers. The Government-Sponsored Enterprises (GSEs) under your conservatorship own or guarantee approximately sixty percent of the outstanding residential mortgages in the United States, including nearly three million underwater loans. Your unilateral decision to block all forms of principal write-down has prevented the housing market from recovering more quickly.

You have promised that the Federal Housing Finance Agency (FHFA) would "reconsider its conclusions if other funds become available" for principal write-downs. That has now happened. On January 27, the Treasury Department announced that it would triple the incentives for investors offering principal reductions to underwater borrowers, through the Home Affordable Modification Program (HAMP). Under this new policy, the Department will pay 18 to 63 cents for each dollar of principal that is written down, and will also make these incentives available to Fannie Mae and Freddie Mac. These new incentives will be paid out of pre-existing funds available for foreclosure relief. Your previous analysis found, at most, "slightly" more taxpayer savings for offering principal forbearance instead of principal write-downs. Given the size of the new HAMP incentives, an updated analysis may well reach a different conclusion.

Even aside from the new incentives provided by the Treasury Department, there are other compelling reasons for you to reconsider your decision against principal reductions. Unlike FHFA, private banks have no legal obligation to maximize assistance to homeowners at risk of foreclosure—they are guided solely by a desire to maximize profits and minimize losses in distressed loans. Yet many banks have written down the principal balances of a significant number of underwater mortgages held in their own portfolios. According to the Office of the Comptroller of the Currency, in the third quarter of 2011, 18.4% of all modifications and 33.4% of HAMP modifications for loans held in the portfolios of federally chartered banks included some form of principal reduction. Furthermore, private banks are better at issuing sustainable loan modifications than Fannie Mae and Freddie Mac. In 2011, the six-month re-default rate for modified loans was 13.6% for Fannie Mae and 11% for Freddie Mac, compared to 8.6% for loans held in bank portfolios. This data strongly suggests that your blanket rejection of principal reductions is misguided.

The reasoning behind your decision appears flawed and incomplete in other ways. Among other things, it appears that you have not considered how principal reductions might be structured in a more targeted fashion, to maximize taxpayer savings. As Representatives Elijah Cummings and John Tierney have noted, "even based on your own questionable assumptions and data, your most up-to-date analysis demonstrates that principal reduction programs would serve taxpayer interests more effectively than any other alternative." Your letter of January 20th made no mention of this, even though the supporting documentation showed that principal reductions would save taxpayers more money than principal forbearance, if modifications are limited through the use of a net present value test. You also seem to have ignored other innovative ways to implement principal reductions, such as a program that would allow lenders and investors to share in the future appreciation of home values.

Our country faces a national foreclosure crisis. The American people expect government officials, whether elected or part of the civil service, to solve the complex problems that our nation confronts. We therefore urge you to harness your agency's powers, resources, and financial expertise to prevent more foreclosures and reduce negative equity.

We hope that, with the new incentives provided by the Treasury Department, you will thoroughly revisit FHFA's analysis of principal reductions. In particular, we ask that you determine how they can be structured to minimize both taxpayer losses and foreclosures, to the greatest extent possible. Please also provide us with a detailed explanation of the data you use to arrive at your decision.

Sincerely,

Zoe Lofgren

Anna G. Eshoo