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Introduction

Thank you, Chairman Hensarling, Ranking Member Waters, and Members of this Committee, for the opportunity to testify about HUD's Distressed Asset Stabilization Program (DASP). I appreciate your interest in this program, as it serves important functions: offering homeowners a chance to keep their homes, and supporting our Mutual Mortgage Insurance Fund (MMI Fund).

DASP Background

DASP is a component of HUD's 601 Notes Sales Program. This program auctions severely delinquent single family mortgages insured by FHA. The 601 Note Sale Program was first established in 2010 to provide an alternative to HUD's traditional foreclosure and conveyance process. In 2012, HUD introduced the Neighborhood Stabilization Outcome (NSO) component of the program and at the same time coined the Distressed Asset Stabilization Program for loans sold through the 601 program and meeting certain criteria outlined below.

Under DASP, loans are segregated into two types of sales: National sales and Neighborhood Stabilization Outcome (NSO) sales. National sales represent the bulk of the sales. National sales have less restrictive servicing requirements and tend to include more vacant properties. NSO sales involve pools of loans secured by properties in a defined geographic area, have fewer vacant properties, and have servicing requirements that encourage outcomes aimed at helping to stabilize neighborhoods. Specifically, purchasers of NSO pools must achieve certain outcomes for at least 50 percent of their loans. The acceptable outcomes include: re-performance; rental to a borrower; sale to an owner occupant; gift to a land bank; and sale to a Neighborhood Stabilization Program Grantee (NSP) or to a non-profit organization or a loan payoff.

DASP represents the first time HUD decided to sell a significant volume of assets in an auction format. As part of the new DASP program, HUD began stepping up the volume and frequency of loan sales in 2012 in part to address the impact of the Great Recession. As you know, the recession left many lending institutions with a large volume of defaulted assets.

At HUD, we see the DASP as an innovative method of leveraging a public/private approach to deal with a particularly difficult problem: managing the pipeline of defaulted assets resulting from the crisis. Many FHA lenders had backlogs of assets. This was unprecedented for the lending industry and for the country. In fact, there was a lot of concern about how we could avoid a situation in which a glut of foreclosed properties would be dumped into our communities and neighborhoods. Using an auction to sell large volumes of loans—a standard for the private sector—was a relatively new approach for HUD. But it made sense. When compared to the Real Estate Own (REO) process, an auction provides a number of benefits. With REO, the lender must foreclose and convey the property to HUD. This can be a lengthy, expensive procedure. Under the DASP, lenders sell mortgage notes and file a claim without going through foreclosure. Therefore, through DASP, the assets can be sold for more than would be recovered through the traditional REO conveyance process. Also, the auctions allow us to more effectively manage defaulted loans by expediting the process—all while providing additional protections for the homeowners including giving them second chance to keep their home.

Impact on the MMI Fund

With regards to protecting tax payer investments, there is no question the DASP program has been a successful way of managing defaulted assets. Since its inception, the program has contributed to the financial health of the MMI Fund with our best estimate being that DASP added about $2.2 billion in economic value. DASP recoveries were 16 percent higher than recoveries on assets conveyed through the traditional REO process in FY 2015. We have also significantly reduced our pipeline of defaulted assets. In 2012, total HUD REO inventory contained more than 100,000 properties; now there are about 30,000 properties in our inventory. The decline is due in part to the fact that other disposition methods such as the DASP are employed. Thus, a much smaller number of properties end up in our REO pipeline. Additionally, the seriously delinquent rate for the FHA portfolio has declined from 9.58 to 5.86 percent—also due in part to the DASP program. Further, when identifying options for changes to the DASP, we ensured that the new enhancements would continue to benefit taxpayers and the MMI Fund.

The DASP Results in Positive Outcomes for Homeowners and Communities

In addition to improving recoveries, the DASP results in positive outcomes for homeowners. The goal of the DASP has always been twofold: support recoveries to the fund while preserving homeownership and help stabilize neighborhoods. The program is designed so that only loans headed to foreclosure after all FHA prescribed loss mitigation efforts have been exhausted are eligible. Thus, DASP loans are on average 27 months delinquent at the time they are sold. Despite the severe delinquency, DASP transactions have resulted in positive outcomes for a number of borrowers.

Overall, HUD has sold approximately 105,500 loans and 57,400 have been resolved; 43.3 percent of the resolved loans did not end up in foreclosure; instead:

- Nearly 10,000 borrowers whose loans were sold through the program remain in their homes due to their loans becoming re-performing after sale, primarily as a result of loan modifications; and
- Another 14,000 borrowers were successfully offered graceful exit alternatives like Short Sales (over 8,000 borrowers) and Deed-in-Lieu of Foreclosure transactions (almost 6,000 borrowers) which allowed them to avoid the costly and often traumatic effects of foreclosure.

DASP Continuous Improvement

From its inception, HUD has taken a continuous improvement approach toward the DASP. Initially, the DASP represented a novel approach, a new idea, and it was clear that improvements would be necessary to make sure the program was always operating in an optimal manner. As with many of our recent efforts to improve the way HUD does business, we closely track outcomes and make adjustments to improve program delivery. We are committed to constantly evaluating the DASP to improve its effectiveness. To that end changes to the program have been made in advance of every sale. After announcing the DASP in 2012, HUD conducted its first direct sale to non-profits partnered with local governments, and in 2013 HUD began increasing its efforts by hosting webinars and conferences to encourage greater participation—especially from non-profits— in the program. In 2015 we made a series of changes including:

- Extending the time period from six months to 12 months in which purchasers cannot foreclose on properties that are owner-occupied;
- Requiring purchasers to evaluate borrowers for the Home Affordable Modification Program (HAMP), or for a proprietary modification with substantially similar terms;
- Offering pools of loans where only nonprofit groups and units of local governments are eligible to participate;
- Strengthening reporting requirements for DASP sale purchasers; and
- Offering non-profits a first look at vacant properties included in NSO sales.

We have continued this approach of constant innovation with the series of changes announced last month. The most recent changes affect three key areas: protecting communities, encouraging non-profit participation, and improving data transparency. The key changes that support borrowers and neighborhoods include making principal forgiveness the first option purchasers must consider when evaluating borrowers for modifications; limiting interest rate increases to no more than one percent per year after a five-year fixed-rate period; and prohibiting purchasers from walking away from vacant properties. Compliance with these requirements is enforced through the loan sale agreement.

The key changes affecting non-profits include establishing a streamlined bidding option for non-profit buyers; setting a participation target of 10 percent for non-profits and government entities; and strengthening the requirements investors must meet to obtain Neighborhood Stabilization Outcome (NSO) credit when selling to non-profit organizations. Additionally, we are planning to release better data on the outcomes our investors achieve with each loan, as well as some demographic information.

We believe these changes further enhance the DASP. Encouraging principal reduction will help keep more borrowers in their homes, which is in the interest of the broader community, avoiding foreclosure helps neighborhoods. Everyone knows that occupied, well-maintained homes support property values. Limiting interest rate changes improve the likelihood that the borrowers will receive sustainable modifications; this is consistent with Home Affordable Modification Program (HAMP) and like prohibiting 'walk-aways' contributes to neighborhood stabilization. Greater non-profit participation can expand the pool of potential bidders and better data allows everyone to evaluate the program.

All of the changes—made continuously since the program was first introduced—have led to a successful program. The Chairman's July 6 letter asked what deficiencies HUD sought to remedy with this most recent round of changes. Our changes were not aimed at remedying deficiencies, rather they reflect our commitment to continuously improving this program.

First, many of the improvements announced by FHA aligned with the changes announced earlier in the year by FHFA; creating market standardization with the intention of generating greater investor interest. Our changes go further and are aimed at increasing the number and variety of potential investors, *e.g.*, trying to structure pools that will attract both for-profit and non-profit bidders. For a variety of practical reasons, loans are never auctioned one loan at a time. So, it is important to find a way to structure pools to attract a wide variety of investors. And that is exactly what the non-profit pilot is designed to do—provide an efficient way for non-profits to participate by allowing them to select a few loans (up to 5 percent of the pool) that meet their needs as long as the bids meet a fair price for the loans.

This bidding process is structured in a way that is unlikely to diminish the interest of the for-profits in bidding on the larger pool. In fact, we anticipate that the changes will expand the number of people who bid in these auctions. This can have many benefits: the most important of which is increased competition and therefore maximizing recoveries for the Federal government. The changes will also help us promote home-retention and neighborhood stabilization—all of which is good for the homeowners, neighborhoods, and taxpayers.

With respect to the Chairman's question regarding the timeline for working on changes, after each sale there are discussions with participants and interested parties on the sale and suggestions for improvement. As soon as our last sale held on November 2015 was completed, we began thinking about how to improve the program for the next sale.

Our stakeholders regularly make suggestions about methods for improving the DASP. Community organizations, think tanks, and Members of Congress have also shared their views on this program. It is impossible to craft good policy without considering the views of a wide variety of stakeholders and interested parties. Thus, it is a standard practice for us to talk with potential investors and stakeholders about how the program could be improved. Additionally, from time to time, we have conversations with FHFA as they run a similar program for the GSEs.

We believe that gathering views and input from a wide variety of stakeholders is an important part of the process. It helps us arrive at the right kind of changes. For example, a January 6th Urban Institute report states, “We support HUD’s efforts to continue to carve out smaller, geographically targeted pools for nonprofits, since only by entering the space can nonprofits build capacity over time to undertake larger projects.” That said, we take our responsibility to be objective in our deliberations and decisions seriously. Thus, we considered many different views, and we believe the wide range of suggestions and advice received from the large variety of stakeholders was a crucial element of developing enhancements that make the program even more effective.

I also wish to address your question regarding changes we considered but did not adopt. There were many suggested changes due to the strong interest in the program from a wide range of stakeholders. External stakeholders have suggested changes such as offering non-profits a discount that is below the aggregate reserve prices. It was also suggested that bidders receive preferred pricing if they have a history of positive neighborhood stabilization outcomes. At least one media outlet urged us to place an indefinite moratorium on the program. These suggested changes were not adopted. The changes we did adopt were carefully designed to improve the program, increase participation, and protect borrowers and communities, as well as maximize returns to the Federal government.

Regarding the impact of the changes on the MMI Fund, as you know, I share the Committee’s concern that the FHA MMI Fund remain fiscally sound. Reaching the two percent capital reserve ratio last year was an important achievement and evidence that the agency has recovered from the Great Recession. We are committed to continuing our progress in building a strong Fund and our decisions about the DASP program were made with that commitment in mind. We do not anticipate that these changes will adversely impact the MMI Fund; instead, they represent common sense protections that help promote home retention and neighborhood stability, yet are not burdensome on the investor.

Finally, the letter asks about supporting metrics, economic analyses and studies we used to evaluate the economic impact and any additional information HUD used when formulating the changes. There is an abundance of literature on auctions, modifications, and the effect of defaults on neighborhood stability. This literature and considerable practical experience are the basis of the expert judgment of many of the participants in the process. We are planning to work with outside experts to study the effectiveness of DASP. Most importantly, we will monitor the effects of these changes and make adjustments as necessary as part of our continuous efforts to improve DASP.

In conclusion, I am quite proud of the improvements the HUD team made to this program. HUD has shown itself a leader in adopting a novel way to resolve one of the most pressing issues that resulted from the crisis. The GSEs followed FHA in hosting sales of defaulted assets. We have worked hard with lenders, advocacy groups, and investors to design an effective program. Over all, we have sold more than 100,000 loans, helping thousands avoid foreclosure and keeping thousands in their homes. That is a remarkable track record of supporting our mission of preserving homeownership and helping communities. We have done all of that and still contributed over two billion dollars to the MMI Fund. I believe DASP is a great example of how a successful public-private partnership can work.

Thank you for the opportunity to testify today.