Statement of

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Senior Associate Director for Housing and Regulatory Policy
Federal Housing Finance Agency

Before the U.S. House of Representatives Committee on Financial Services,
Subcommittee on Capital Markets and Government Sponsored Enterprises

"An Examination of the Federal Housing Finance Agency's
Real Estate Owned (REO) Pilot Program"

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Chairman Garrett and Ranking Member Waters, thank you for inviting me here today to testify on the Federal Housing Finance Agency's (FHFA) Real Estate Owned (REO) Initiative. I am Meg Burns, Senior Associate Director for the Office of Housing and Regulatory Policy at FHFA and I am responsible for managing this project.

As you know, FHFA regulates Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks, which together support over $10 trillion in mortgage assets nationwide. Since 2008, FHFA has also served as the conservator to Fannie Mae and Freddie Mac (the Enterprises), a responsibility that the agency takes very seriously. In that capacity, FHFA has focused on minimizing losses to both companies through tighter underwriting standards, more accurate pricing of risk, and aggressive loss mitigation strategies.

The full array of Enterprise loss mitigation programs are designed to keep families in their homes whenever possible, pursue alternatives to help families avoid foreclosure when a mortgage modification is not feasible, and finally, move to foreclosure expeditiously when necessary. The objective of all of these efforts is to facilitate the stabilization of communities and neighborhoods.

My remarks today will focus on the disposition of properties that are conveyed to Fannie Mae and Freddie Mac through the foreclosure process. Today, the two companies own approximately 180,000 REO properties and approximately one-half of these properties are available for sale at any point in time. Preparing properties for sale often takes several months for a variety of reasons, such as the wait period required under state redemption laws during which foreclosed borrowers may re-claim ownership rights, and time needed to repair damaged or neglected properties.

The pace of REO sales has improved substantially over the last few months, a trend that suggests that the excess supplies of these properties should decline in the future. However, the number of non-performing loans – particularly severely delinquent loans – remains large. Today, the Enterprises collectively own or guarantee approximately 1.3 million non-performing loans, the majority of which are more than a year delinquent. A priority for FHFA and both companies is to avoid foreclosure even in these protracted cases, through short sales, deeds-in-lieu, and deeds-for-lease.

Loss Mitigation and Current Approach to REO Disposition

Fannie Mae and Freddie Mac have been leaders in working to resolve problem loans and address the ongoing challenges in the market. Collectively, their efforts have made a meaningful impact on reducing foreclosures. Since conservatorship, the Enterprises have completed 1.1 million loan modifications, more loan modifications than foreclosures. These modifications plus all other foreclosure prevention activities, total to some 2.2 million foreclosure prevention actions, more than twice the number of foreclosures the Enterprises have completed during this same period.

Not every foreclosure can be prevented, however, and the REOs must be sold in a manner that is most beneficial for both the Enterprises and the neighborhoods where these properties are located. Efficiency in the process, with conscientious repair and sales preparation, diligent management, and aggressive marketing of the properties results in the best outcome for all. To date, both Fannie Mae and Freddie Mac have performed this role well. Both companies rely on retail sales strategies, where properties are sold one at a time, most often to buyers who plan to use the properties as their primary residence. In 2011, approximately 65 percent of the Enterprise REOs were sold to owner-occupants. The majority of these properties were sold within 60 days, at close to market value.

Further, both companies offer special sales opportunities for nonprofits and local governments to purchase properties before they are marketed to a broader set of investor buyers. The Enterprises' First Look programs permit properties to be used for mission-oriented community stabilization programs. During the first 15 days that a property is listed, both companies only consider offers from those seeking to purchase the home as their primary residence and public entities. Finally, for properties that do not sell within six months or so and are sufficiently concentrated in a particular geographic area, Fannie Mae and Freddie Mac engage in small bulk sales. The properties sold through these arrangements are usually lower-valued homes and are purchased by nonprofits, local governments, or regional investors.

Objectives of the REO-to-Rental Initiative

The REO-to-Rental Initiative complements these primary disposition strategies and is intended to serve as a pilot, providing an opportunity to test another model. The goals of this pilot are fairly limited, particularly relative to public perception, so it is critically important to review FHFA's objectives:

1) Gauge investor appetite for a new asset-class - scattered site single family rental housing - as measured by the price that investors are willing to pay for a traditionally high-value commodity that has been hampered by oversupply;
2) Determine whether the disposition of properties in bulk, as opposed to one-by-one, presents an opportunity for well-capitalized investors to partner with regional and local property management companies and other community-based organizations to create appropriate economies of scale, yet provides civic-minded approaches that can stabilize and improve market conditions;

3) Assess whether the model can be efficiently replicated to make it a worthwhile addition to the standard retail and small-bulk sales strategies in place at the Enterprises and other financial institutions with large inventories of properties to sell.

I'd like to also clarify some misconceptions about FHFA's intent and goals with this effort. The REO Initiative is highly targeted, focused only on markets that provide an opportunity to correct a fundamental supply-demand imbalance. This type of intervention would be highly inappropriate on a national scale and the program was never intended to be offered nationally. The pilot markets are carefully selected, based on obvious market characteristics – an oversupply of single family homes for sale and a strong demand for rental housing. Further, the pilot will not result in severely discounted sales. If the response from investors demonstrates that these properties cannot be sold at prices that are close to what Fannie Mae can get through a retail execution, the properties will not be sold. While FHFA as conservator must consider the return to the Enterprise, the agency is also concerned about the negative impact on the communities and local housing markets from any further depression of home values.

The uncertainty surrounding the outcomes of the pilot also led to the decision to involve only Fannie Mae properties in the first phase of the Initiative - for several reasons. One, Fannie Mae has more homes available, in concentration, in the selected markets. Two, given that the program is simply a pilot, FHFA was careful to consider how resources would be dedicated to infrastructure and implementation and determined that only one company should expand upon existing capabilities to test the model. And, three, given the significant legal and operational challenges associated with bundling a group of properties in any given market, the decision was made to limit the scope of properties for sale to those from one company.

Similarly, based on the uncertain outcomes, the pool of properties made available for sale in the first transaction includes a large portion of homes that are already rented. Most of the tenants living in these homes were in place when the properties were conveyed to Fannie Mae; the former investor-owners lost the properties through foreclosure. Fannie Mae and FHFA decided to assemble pools composed mainly of rental properties to ensure that large numbers of vacant properties were not held off-market for the significant period of time required to execute a sale. The sales timeline is as aggressive as it can be, but must include adequate time for the assembly of the pools, compilation and publication of property-level information, due diligence by potential buyers, evaluation of qualified investors' plans, and the ultimate bid auction itself. Furthermore, offering rental properties for bulk sale actually helps to test one of the key objectives – to determine investor appetite for this asset class.

Another fundamental misunderstanding stems from the desire to address long-standing rental housing issues with this program. In fact, the REO-to-Rental Initiative was never intended as a vehicle to increase the national supply of affordable rental housing, nor to improve the rental housing stock, through energy-efficient or "green" home improvements. Given that the properties sold under this Initiative are all unique, with various building styles and materials, any effort to engage in large-scale upgrades would be hampered by the inability to purchase building products in bulk and to standardize the construction process. Additionally, while the properties are located in general proximity to one another, the distance to travel for ongoing maintenance and management will likely be a challenge and add costs for any asset manager. The economies of scale that provide an opportunity to reduce costs in multifamily rental housing are likely not applicable to this type of housing.

I would note that the expansion of rental housing options in the affected communities could have a beneficial impact on price in the surrounding rental market. These homes also offer better alternatives for larger families than many traditional multifamily rental complexes, with more bedrooms and outdoor space for recreational activities. And the general home improvement, which may include the installation of insulation or new, more energy efficient appliances, could ultimately contribute to the overall improvement of the housing stock; it's just not the primary goal of the program.

Current Status of the REO-to-Rental Initiative

In developing the REO-to-Rental Initiative, FHFA invited several federal agencies with experience in asset disposition and REO sales to participate in an interagency working group, reviewing information received by the original request for information issued in August 2011 and evaluating alternative approaches for the pilot. The working group includes the Federal Deposit Insurance Corporation (FDIC), the Department of Housing and Urban Development, the Federal Reserve, and the Department of the Treasury, along with Fannie Mae and Freddie Mac. The interagency input has been helpful and FHFA adopted a version of the FDIC approach to asset disposition for banks as a model for this pilot.

We are well into the first transaction, announced in February, targeting areas that have been hardest hit by the housing crisis. Fannie Mae is selling approximately 2,500 properties, divided into eight sub-pools, located in Las Vegas, Nevada; Phoenix, Arizona; various communities in Florida; Chicago, Illinois; Riverside and Los Angeles, California; and Atlanta, Georgia. More detailed information on the number of properties in each location is available on FHFA's web site http://www.fhfa.gov/Default.aspx?Page=360. Immediately following the announcement, interested investors were asked to prequalify by certifying to their financial capacity, relevant market experience, and obligation to follow the transaction rules. Those who prequalified were then eligible to submit an application to participate in the auction. Evaluation of those applications is now underway.

The application process is comprehensive, rigorous, and demanding, requiring exhaustive amounts of information and documentation from the applicants and their business partners. Only those investors who have sufficient capital and operational expertise will make it past the scrutiny of the reviewers. The financial strength of the investors may depend on partnerships among several parties. Nonprofit investors may work with – and tap into the deeper financial base of – institutional investors and various types of investors can pool resources to expand capacity and create better execution. As mentioned previously, the intent of the Initiative is to test whether or not private capital can and will come into this new asset class, providing much-needed financial support to some of the hardest-hit housing markets.

Just as important, only those investors with deep operational expertise in both asset management and property management will make the cut. The application requires that the investors describe their previous experience managing these types of assets, from marketing to leasing to maintenance. How relevant, extensive, and recent that experience was will matter in the scoring.

In addition, the applicants were expected to detail their plans for operating a first-rate rental program with these particular properties. They were required to explain how they will rely on local and regional organizations to tailor their programs to meet the needs of these residents in these communities. Investors had to describe what resources they will call upon to ensure that properties are repaired, leased quickly, and well-maintained, and to guarantee that the residents receive the services they need. There is an expectation that local construction and repair companies will be engaged due to their familiarity with state and local building codes, that local property management firms will have knowledge of the potential tenant population in the area and the best means of marketing to these citizens, and that community-based nonprofits may provide supportive services to the residents. The program even requires that the new owners pay for tenants to receive credit counseling at their request from a HUD-approved housing counseling agency in order to help repair their credit and get them on more stable footing.

This rigorous application process is intended to narrow the pool of eligible bidders to those who have financial and operational expertise, but also the mission-oriented commitment to ensure that this program brings capital to markets in need in a way that stabilizes communities.

Currently the independent third party hired to review the applications is in the process of doing so and this process will be completed in next few weeks. After that, eligible bidders will be notified and the bid process will begin. FHFA's goal is to complete this first pilot transaction in the next few months.

Conclusion

To reiterate, the REO-to-Rental Initiative is a pilot, a test, to see whether another disposition strategy can complement existing sales efforts, generating private investment in single family rental housing in a way that is both efficient and effective at stabilizing local markets.

The pilot relies on Fannie Mae for execution, but frankly, the Enterprise portion of the REO market is limited, so the future benefit of the program may be more applicable to private financial institutions that choose to sell their inventory in this manner. Further, as mentioned previously, both companies will continue to rely on their existing retail sales strategies as the primary vehicle for selling homes. Retail sales move properties quickly, most often to families who plan to reside in the homes, and at prices that are close to market value. As part of the broader REO efforts underway, FHFA is working with both companies to enhance these retail sales approaches, improving and expanding specialized financing programs available for both homebuyers and small investors.

I thank you for the opportunity to testify today and look forward to your questions.