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HEARING BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

ENTITLED

THE IMPLEMENTATION OF THE HOPE FOR HOMEOWNERS PROGRAM AND A REVIEW OF FORECLOSURE MITIGATION EFFORTS

WRITTEN TESTIMONY OF

RONALD PHIPPS

ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS®

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Introduction

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today on the current state of foreclosure mitigation efforts.

My name is Ron Phipps. I am a 3rd generation member of a 4 generation family tradition in the Rhode Island residential real estate industry. My passion is making the dream of homeownership available to all American families. As direct result of my passion, I have become very active within the NATIONAL ASSOCIATION OF REALTORS® (NAR); holding significant positions at both the state and national levels. Since 2000, I have been President of the Rhode Island Association, an NAR Regional Vice President, and a member of the NAR Executive Committee. Most recently, I was elected NAR First Vice President for 2009.

I am here to testify on behalf of more than 1.2 million REALTOR® members who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®.

NAR commends the committee for holding today's hearing on the issues impacting foreclosure and loss mitigation efforts. These are critically important issues that impact everyone involved in residential home sales (REALTORS®, lenders, servicers, investors, appraisers, mortgage insurers, and title companies). Today, we would like to focus our comments on two aspects of the larger discussion that is the subject of this hearing: the challenges facing consumers who attempt to negotiate a short sale as an alternative to foreclosure and the Hope for Homeowners Program.

Short Sales – A Valuable Foreclosure Mitigation Tool

A short sale is a sale that occurs when the sales price for a property is insufficient to pay the total of all mortgages, liens and costs of sale, and where the seller does not or cannot bring sufficient liquid assets to the closing to cure all deficiencies. A short sale can occur when an individual is in arrears on a mortgage and headed toward foreclosure. We are particularly concerned about delays in the short sale process when short sellers are in default on their mortgage loans and headed for foreclosure.

We note, too, that a short sale can also occur when an individual is current on his/her payments but the value of the house has fallen below the outstanding balance on the mortgage. Some home owners who bought at the top of the market may find that they need to sell because of divorce, job transfer or other unforeseen circumstance but find themselves upside down, owing more than the home is currently worth.

A short sale is one tool that can help both these categories of borrowers. It has particular utility as a mechanism that can be used to avoid a foreclosure. A short sale allows the borrower to sell a property that they can no longer afford. If a borrower can avoid the foreclosure process, a short sale allows the consumer to maintain some level of creditworthiness while still remitting to the lender a higher amount of the remaining loan balance than the lender would otherwise receive from the sale of a property after foreclosure.

A lender can also benefit from a short sale by avoiding the liabilities it assumes by owning the property after foreclosures. The bank's funds are not tied up while it holds the property after the foreclosure and until resale, and the bank avoids the additional costs associated with a bank-owned property such as attorneys' fees and maintenance expenses. If the bank can avoid foreclosure, then it will not need to accumulate the additional reserves it would need if the number of foreclosed properties increases in the bank's portfolio.

A 2002 study by Craig Focardi of the Tower Group estimated that the average cost of a foreclosure was $58,759 and took 18 months.[1] Thus, even though the bank will incur a loss in a short sale, the bank's overall position remains more stable than would occur if it carried out a transaction to foreclosure and ultimate resale of the property.

In addition, all the parties benefit from a quick sale and a higher short sale price. The short sale provides the added bonus of providing more support for home values in the associated neighborhood than a price derived from the sale of the foreclosed property. REALTORS® nationwide believe short sales should be used more often and more effectively because of the benefits to consumers, lenders and community tax bases.

Unfortunately, our membership is increasingly encountering road blocks that are preventing troubled homeowners from utilizing the short sale process. A main theme that is regularly mentioned by our members is that lenders are taking an extraordinary amount of time to decide if they are willing to accept a short sale purchase offer. This "waiting period" can extend 30, 60 or even more than 90 days after submission of an offer and the requested documentation.

Given these lender delays, REALTORS® indicate that it is increasingly common for exasperated potential homebuyers to walk away from their purchase offers to find another property. Too often, the original property then moves to foreclosure, and eventually the bank finds itself forced to sell it for much less than they could have if they had approved the short sale. This is disastrous for everyone involved – the homeowners, their neighborhoods and communities, and the lender.

A number of factors contributing to the problem encountered in the short sale process have been identified by our members. These include: understaffed or inexperienced loss mitigation staffs, bank appraisal values that do not reflect the distressed nature of the sale, a second mortgage that necessitates two lender/servicer approvals for the sale, and/or the approval of the entity that holds the pool of loans if the mortgage has been securitized.

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[1] Focardi, C. (2002). Servicing Default Management: An Overview of the Process & Underlying Technology. Needham, MA: Tower Group

Lender Loss Mitigation Staffing

The recurring complaints that REALTORS® hear from consumers who are interested in a short sale are that (1) it is difficult to determine who is the correct department or individual to contact with a lender or servicer, (2) no one at the lender shop answers or returns their phone call, and (3) submitted paper work is often "lost". As an example of this issue, one account comes from a REALTOR® who sat with a client, on hold for over an hour, to get an update on their short sale application. When they finally reached the customer service representative to discuss the situation, they were informed that no paperwork could be found and they would need to re-send their information before they could proceed.

Problematic Appraisals

Another issue that REALTORS® are encountering frequently is that lenders are commonly rejecting legitimate offers. In these situations, the bank's home appraisals come in much higher than the proposed short sales prices. In many cases, the bank-selected appraisers have not taken into account that the sale is a duress sale, that there may be many foreclosed homes in the neighborhood and/or that the property is often times in poor or less than optimal condition.

In early September 2008, an NAR member provided a practical example of the situation:

> *"I wrote a full price offer on May 2 for a property that had a third party involved in it. We changed the purchase agreement's closing date to August 31, 2008 as the third party made the comment that they doubted they could close it by the end of July. Two weeks before the closing, the lender rejected my buyer's offer and wanted over $10,000.00 more than the short sale price as the appraiser came in higher than what the purchase price was. This appraiser did not give any consideration to the condition of the property, or the fact that the property was a short sale. If you do the comps for this property, the listing agent was right on with the price, which we offered."*

Second Trust Holders

Finally, consumers with junior trust obligations (e.g., second mortgages or home equity lines of credit) are being hampered in their quest for a quick resolution to their financial burden because the primary lender must negotiate with the holder of the second trust to approve the short sale. In most instances, NAR is being informed that junior trust holders are unwillingly to accept the primary lender's proposed settlement to facilitate the short sale. Extended negotiations between the primary and junior trust holders increases the time required to sell the home, which often forces the potential homebuyer to search for another non-short sale property.

Actions like this are leading our members to ask:

- If I have a seller who needs to sell their home and a qualified buyer that wants to make the purchase, why does it take so long for the lender to review the information and make a decision?
- Why does the lender counter these offers only to lose the buyer and eventually have to resort to an expensive foreclosure proceeding and an even less lucrative foreclosure sale?
- Why don't the lenders who made the loans that put the borrower in this tenuous position initially want to resolve their own financial problems in a timely manner?

By thwarting the short sale, the lender sets off a negative cascade effect that hurts everyone from the borrower, who loses the property and has damaged his/her credit report; the lender, who loses money by bearing the expense of foreclosing on and then reselling the property well below the offered short sale price; the neighborhood, where home values recede due to the artificially low sales price of the foreclosed property, and the community, where the property tax base and collections also suffer.

NAR's Efforts to Address Member Concerns with Short Sales

In support of our members calls for assistance, NAR has been working on several fronts to help resolve issues encountered during the short sales process. First, in February of this year, we established a Short Sale Working Group composed of REALTORS® from across the country to examine what is occurring in the marketplace, why it is occurring, and what NAR can do to address these issues. The Working Group made a number of recommendations as to what could be done to address the problems being encountered.

First, the Working Group recognized that there was a need to educate our members about the short sale process. A nationwide residential real estate downturn is outside the experience of almost anyone born after World War II. Most of our members had never experienced even a regional soft market. As a result, NAR has a number of materials designed to help our members understand the key components of the short sale process and how to work with clients in these situations. In addition, with our input, Freddie Mac has developed an "Introduction to Short Sales" webinar for real estate professionals. We just completed testing the offering with live participants and will soon make it available to our state and local associations, as well as the general membership via the Internet along with the materials already posted.

As a direct result of this working group, NAR also began working with the Government-Sponsored Enterprises (GSEs) to create a MLS-GSE information sharing pilot that is just getting underway. Under the pilot, the GSEs are working with multiple listing services (MLSs) in high foreclosure areas to share real-time information about housing markets so the GSEs can expedite short sale decisions.

Finally, NAR is reaching out to our partners in the real estate industry to further develop and implement the other recommendations made by the Working Group:

- Make contact information for lender/servicer loss mitigation personnel easily available to borrowers: Troubled borrowers need to be able to easily locate online the correct department and the individual who will be responsible for processing the short sale application.

- Develop a single industry-wide short sale application (Uniform Short Sale Application) and list of supporting documents that all lenders and servicers would agree to accept.

- Garner commitments by all lenders and their servicers to keep the listing agent and seller regularly informed of the status of the short sale application throughout the process and respond to reasonable requests for information, and

- Obtain a commitment by all lenders and their servicers to deliver a clear answer, in writing (yes or no), within a reasonable time frame (i.e. 30 days).

A Bright Spot for Short Sales

Over the course of the past 25 years, regional real estate markets have occasionally experienced downturns related to problems in their local economies. Before 2007, if borrowers and lenders in these distressed local markets agreed to a short sale, a heavy tax burden fell on the borrower. A short sale triggered a taxable event. If a lender forgave some portion of a mortgage obligation, the tax laws required that the borrower recognize income in the same amount as the forgiven debt. Thus, even though a house was sold and the seller/borrower received absolutely no cash from the transaction, the borrower was assumed to have received income in the amount of the forgiven debt and was required to pay tax on that phantom income at ordinary rates. As early as 1995, NAR sought legislation to overturn this result. It seemed unreasonable that at a tax burden would be applied at the time of an individual’s biggest economic setback.

The residential real estate market prospered during the late 1990’s and boomed as the new century began. When the housing and subprime crisis began in late 2006 or early 2007, individuals who lost their homes in both short sales and foreclosures were alarmed to find that their financial problems were compounded with this tax burden. In early September 2007, President Bush and Ways and Means Chairman Rangel both concluded that it was essential to remove the tax burden associated with forgiven debt. Chairman Rangel introduced H.R. 3648, the Mortgage Forgiveness Debt Relief Act.

In December 2007, President Bush signed H.R. 3648. It provided tax relief for mortgage debt forgiven on a principal residence. Tax relief is provided for loan forgiveness of up to $2 million ($1 million on a married filing separate return). The relief is available for sales or exchanges in 2007, 2008 and 2009. NAR had sought permanent relief, but was nonetheless pleased that this important measure is now enacted and that it will ease some burdens. NAR deeply appreciates the care and attention given to this important provision.

The Hope for Homeowners Program

The Hope for Homeowners (H4H) program, created in the recent Housing and Economic Recovery Act (HERA), was designed to help homeowners who are facing foreclosure refinance with a safe, affordable mortgage. This program could prevent hundreds of thousands of families from losing their homes and more. However, timely and careful implementation will be necessary to make it work.

NAR strongly supports the goals of the Hope for Homeowners program. Allowing qualified homebuyers to refinance their mortgage into a safe, affordable 30-year fixed FHA loan will help many families avoid foreclosure. At the same time the program protects the investment of the government and taxpayers by sharing in equity and appreciation with the homeowner. However, the programs must be carefully implemented to ensure lender participation, while continuing to safeguard the FHA fund.

We applaud HUD for reaching out to government agencies, lenders and other interested parties immediately after the bill was signed to discuss how this program will be implemented. HUD has sought input from many stakeholders in the FHA and refinancing process. NAR has participated in several conference calls. Moreover, we believe HUD's efforts to engage the lenders in the design and implementation process is critical to their participation in the program. We encourage lenders to provide their input now, so the final program is one they can willingly embrace. Widespread lender participation and well-informed REALTORS® can help many families to keep their piece of the American dream.

Conclusion

Our nation faces a significant challenge in dealing with the economic turmoil in today's housing market. In order to overcome this threat, we must assist those families threatened with the loss of their home through the use of all of the tools that we have at our disposal. The short sale is a tool that offers families who cannot avoid the loss of their home a viable method to repay a portion of their debt obligation, while maintaining a level of dignity during this trying period. Moreover, this foreclosure mitigation tool will reduce the amount of write-offs lenders face due to the disposition of property after foreclosure and will lessen a foreclosure's negative impact on communities. For those families that have the ability to stay in their homes if their problematic mortgages are responsibly restructured, we remain hopeful that the Hope For Homeownership Program will allow them to keep their piece of the American Dream.

I thank you for this opportunity to share our thoughts. The National Association of REALTORS® stands ready to work with Congress and our industry partners to improve upon current short sale practices and make loan modification programs effective tools to help struggling homeowners and communities.