A report by The Right To The City Alliance & The Center for Popular Democracy

VULTURE CAPITAL HITS HOME

HOW HUD IS HELPING WALL STREET AND HURTING OUR COMMUNITIES

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RIGHT TO THE CITY

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The financial industry has found yet another way to profit from the distress of homeowners. Investors are trading distressed residential assets – mortgages and vacant properties in severe arrears — and are building a spectrum of business plans many of which undermine neighborhood and economic stability. There is currently a hot market in severely delinquent mortgages. Banks and government entities are selling them off and investors – particularly hedge funds — are buying them.

In 2012, the U.S. Department of Housing and Urban Development's Federal Housing Administration (FHA) significantly increased its sale of pools of distressed FHA-insured mortgages through a program called the Distressed Asset Stabilization Program (DASP). The program has a dual purpose: to return and protect FHA's Mutual Mortgage Insurance (MMI) capital reserves fund to a positive position and "to encourage public/private partnership to stabilize neighborhoods and home values in critical markets."

This report focuses on the FHA's Distressed Asset Stabilization Program (DASP). The DASP has the potential to recuperate needed funds for its mortgage insurance fund, preserve homeownership, and create affordable rental housing. Instead, the FHA has designed DASP in such a way as to severely limit its effectiveness in helping hard-hit neighborhoods recover from the housing crisis. Between the start of the DASP program in 2012 and the middle of 2014, the FHA has auctioned 98,100 mortgages, for bids amounting to $8.8 billion. 97% of the auctioned loans have been won by for-profit entities, largely private equity firms. A fair amount is known about the Wall Street entities trading in "distressed assets." This report examines their business models and how their business interests are often in direct conflict with the interests of homeowners, renters and their communities.

HUD, the federal government agency with a stated mission to advance affordable housing and sustainable communities is, with the DASP, stoking Wall Street's buy-up of "distressed" real estate assets with little regard for the impact of these speculators on the struggling homeowners whose mortgages are being bought or on the impacted communities more broadly. FHA is auctioning pools of mortgages to the highest bidder, in most cases without considering the ability of their programs to achieve neighborhood stabilization goals such as homeownership preservation and affordable housing. The result is that other qualified purchasers — including nonprofits with an explicit goal and clear program to modify mortgages with principal reduction and to create affordable rental housing — are being crowded out by Wall Street speculators, most often private equity firms and hedge funds.

HUD's failure to release adequate program data leaves the public unable to know the precise impact this program is having on homeowners and communities. It hampers the public's ability to assess the completeness of HUD's information about the results of this program and whether it is or isn't meeting neighborhood stabilization goals.

In other words, shortcomings in the implementation of the program jeopardize the accomplishment of its mission.

This report focuses on three key problems with the DASP program:

1. **The current structure** of most DASP auctions hampers community stabilization by considering only the highest bid without weighting the bidders' track record of good outcomes for homeowners and communities.
2. **The current outcome requirements** and reporting structure fails to hold purchases accountable to neighborhood-stabilization goals and provides insufficient transparency and prevents community oversight.
3. **The current pre-sale certification phase** does not ensure that the FHA mortgage modification process has been followed before loans are included in DASP pools.

We propose 5 specific, actionable steps the FHA should take to strengthen the program, allow it to continue to replenish the Mutual Mortgage Insurance fund, and better stabilize communities:

1. **Credit bidders** that have stronger neighborhood stabilization plans.
2. **Strengthen outcome requirements** to preserve homeownership and create affordable rental housing.
3. **Sell more of the loans through the geographically** concentrated Neighborhood Stabilization Outcome pools.
4. **Collect and make public** detailed performance data.
5. **Improve the pre-sale process** to better protect homeowners.

Further sales of FHA insured mortgages should be halted until these reforms in the DASP are implemented. In its current form, the DASP is unnecessarily undermining the very mission of HUD. With the above improvements, HUD can make the program into one that will truly strengthen — not harm — our communities.

The financial industry has found yet another way to profit from the distress of homeowners.

As homeowners face the perils of an economy crashed by financiers, the same financiers flip mortgages, drive homeowners to foreclosure, and become distant, corporate landlords with poor track records. Investors are trading distressed residential assets – mortgages in severe arrears and vacant properties – and are building a spectrum of business plans that undermine neighborhood and economic stability. Distressed residential mortgages – and the outcomes borrowers face – disproportionately impact communities of color, which have been systematically steered toward more expensive loans.[1]

It might be expected that banks, like Bank of America, would sell off some distressed residential mortgages. In fact, Bank of America is marketing $3 billion worth of non-performing mortgages; JPMorgan Chase & Co. sold $500 million in delinquent loans in July 2014 alone; and Wells Fargo is pooling and selling $1.3 billion for regional bank clients.[2]

More surprising is the participation of government-related entities in this market. This summer, Oak Hill Advisors bought $659 billion of defaulted loans from Freddie Mac. The Federal Housing Administration (FHA), which insures mortgages on single-family and multifamily homes, has a standing program to auction distressed mortgages, generally to the highest bidder.

This report focuses on the FHA Distressed Asset Stabilization Program, which has resulted in distressed mortgage sales to date amounting to $8.8 billion over two years.The first section of the report describes the Distressed Asset Stabilization Program or DASP, the program's goals, the structure of its pools, and the composition of the winning bidders. The second section identifies shortcomings in the implementation of the program that jeopardize the accomplishment of its mission. The last section proposes FHA actions that will strengthen the program, allow it to continue to replenish the Mutual Mortgage Insurance fund and to better stabilize communities.

What is the FHA's Distressed Asset Stabilization Program?

The Federal Housing Administration is part of the US Department of Housing and Urban Development (HUD), which has a clear mission: "To create strong, sustainable, inclusive communities and quality affordable homes for all."[3] The Administration, which currently insures the mortgages on 4.8 million single-family and 13,000 multifamily homes, protects lenders from losses resulting from default on qualified and covered loans, opening home ownership to people who might not qualify for reasonable bank loans otherwise. [4]

In 2010, the FHA piloted the pooling and sale of distressed FHA-insured mortgages. Between 2010 and mid-2012, that program sold 2,100 single-family mortgages.[5]

In 2012, the FHA significantly increased its sale of pools of distressed FHA-insured mortgages through a program called the Distressed Asset Stabilization Program (DASP). The program has a dual purpose. It is part of a broader initiative to return and protect FHA's Mutual Mortgage Insurance (MMI) capital reserves fund to a positive position[6] and it aims "to encourage public/private partnership to stabilize neighborhoods and home values in critical markets" in order to help the hardest hit communities recover "as quickly as possible."[7]

HUD touts the multiple benefits of the program. While removing defaulted loans heading for foreclosure from the insurance rolls, the FHA generates capital from the auction, alleviates its costs of managing and marketing foreclosed homes as real-estate owned (REO) properties, and may provide alternatives to foreclosure for homeowners.[8] HUD promotes the idea that by removing the loans from FHA coverage, the program can also allow some borrowers to take advantage of more aggressive mortgage modification.

Mortgagees or FHA servicers may submit loans for DASP auction if they meet the following criteria:

- **The borrower is at least six months delinquent on their mortgage;**
- **The servicer has exhausted all steps in the FHA loss mitigation process.**[9]

The FHA pools the loans meeting these criteria and auctions the pool "competitively at a market-determined price generally below the outstanding principal balance."[10] After the pool is sold, the FHA processes the insurance claims for the original mortgagees and transfers the loans to the investors. Although the loans no longer have FHA insurance, the DASP requires that foreclosure be delayed for a minimum of six more months, in order to allow the new servicer to modify the loan and keep the borrower in the home, if possible.[11]

Two Kinds of Pools. DASP auctions loans in two kinds of pools: National pools and Neighborhood Stabilization Outcome (NSO) pools. National pools group mortgages from across the country and carry few restrictions after the sale, except the 6-month moratorium on foreclosure and semi-annual reports to HUD regarding the status of the sale portfolio. [12]

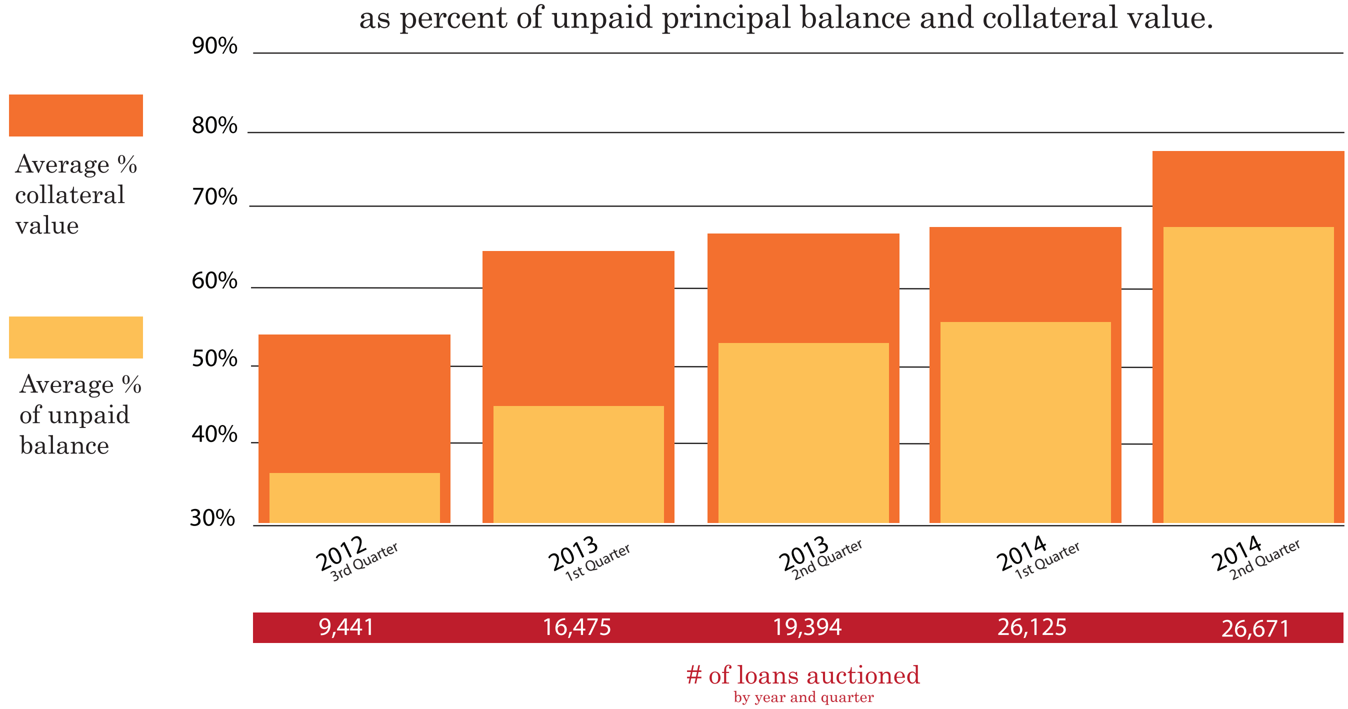
Neighborhood Stabilization Outcome pools are geographically concentrated in "areas where high numbers of seriously delinquent loans could expand an already large inventory of REO [real-estate owned] properties over the coming months." [13] Real-estate owned properties are homes that have gone through foreclosure, failed to raise enough at public auction, and become owned by the bank. The NSO pools require that no more than half of the loans within a pool can be sold as real-estate owned properties (REOs).[14] The FHA aims for these pools to create Neighborhood Stabilization Outcomes, including:

- **Loan modifications or other changes that allow homeowners to begin paying again within 6 months (known as "re-performance" in the industry);**
- **Sale of the property to an owner-occupant, including short sales;**
- **Gift to a land bank;**
- **Sale of the loan to a neighborhood stabilization grantee;**
- **Hold the property for rental for a proscribed period of time; or**
- **Total satisfaction of the loan.**[15]

The FHA requires purchasers of NSO pools to submit quarterly reports. In the absence of an NSO result, HUD may eventually appropriate the profit from the sale (though we know of no such instance).[16]

Outcomes of the Auctions. Between the start of the DASP program in 2012 and the middle of 2014, the FHA has auctioned 98,100 mortgages, for bids amounting to $8.8 billion. Of these, 21 percent have been in Neighborhood Stabilization Outcome pools, concentrated in cities in Arizona, California, Florida, Georgia, Illinois, Indiana, Maryland, Michigan, Nevada, New Jersey, North Carolina, Ohio, and Pennsylvania.[17] In the early days of DASP, bids averaged about 50 percent of the properties' value. In the June 2014 Note Sale (as the auctions are also called), the weighted average of the winning bid was 77.6 percent of the pooled property

Figure 1. Price paid for FHA DASP loan pools, by quarter, as percent of unpaid principal balance and collateral value.



Source: Aashna Desai and Sarah Edelman, Database of DASP Pools (2012-3 through 2014-2), compiled from HUD Data, Center for American Progress, forthcoming. *Note that the chart reflects only those quarters in which FHA DASP Auctions have been held.*

value.[18] As Figure 1 above shows, each quarter the winning bids represent a greater portion of the unpaid principal balance and the collateral value (or broker price opinion).

Twenty-six firms have bought pools of FHA-auctioned loans. Three nonprofit and local government funds with focused geographies have won 2.43% of the total loans, all of which have been in NSO pools. These funds – the Los Angeles Neighborhood Stabilization Program, the Mortgage Resolution Fund, and the Community Fund of New Jersey – each have explicit missions to invest in and help stabilize at-risk neighborhoods. The remaining 97% of the auctioned loans – including 88.42% of loans in NSO pools – have been purchased by for-profit entities.

Because nonperforming loans are an alternative investment class, many of the winning participants in the auctions have been for-profit entities classified as or with close ties to hedge funds and private equity firms. Alternative investment funds face much lighter regulation than other investment vehicles and are raised through targeted solicitations for high net-worth individuals, pension funds, sovereign wealth funds, university endowments, and foundations. Private equity firms, in particular, aim to extract more profit from their acquisitions than the book value. This means that they will either leverage their assets for borrowed money or break apart the assets for greater value—practices that are not necessarily aligned with achieving the goals of creating more affordable housing or stable homeownership through sustainable loan modifications.

At least 11 of the buyers, representing approximately 53% of the pools by collateral value, have securitized some or all of the HUD loans.[19] The three top winners of DASP auctions – Lone Star Funds, Bayview Asset Management, and Selene Investment Partners – are among those funds that have sold securities backed by delinquent loans.[20] As long as these practices hold, the securities enable for-profits to bid 15-20% higher on their pools. [21]

These profit-seeking players are boosting the prices for delinquent loans. Michael Nierenberg, chief executive officer of a real estate trust, seems to warn of a forming bubble: "You would think supply and slower home price growth would cause loan prices to weaken, however, the amount of capital raised for the sector has caused the pricing to increase."[22] A speculative delinquent-mortgage bubble may seriously challenge HUD's goals in the DASP by leaving little room for mortgage modifications and increasing pressure on for-profit buyers to securitize more of the loans they are buying, generating revenue for them, but encumbering the loans and increasing the barriers to modifications going forward.

Some auction participants are already submitting bids with little room for loan modifications. Twelve buyers – Altisource, Angelo Gordon, Corona, DC Residential IV Loan Acquisition Venture, DLJ Mortgage, Ellington, GFT Procurements, LSF9 Mortgage Holdings (Lone Star), LVS I, PRMF, 25 Capital Residential Mortgage Opportunities Master Fund, and Walton NPL – have won at least one pool where the broker price opinion (or estimated property value) is no less than 90 percent of the unpaid principal balance. In some cases, the pools actually had a higher property value than unpaid principal balance (that is, the loans are non-performing, but are not underwater). Angelo Gordon, Corona Asset Management, Ellington, LVS I SPE, and PRMF Acquisitions won pools that, aggregated, have estimated property values no less than 90 percent of the unpaid principal balance.

The winning bids on these pools go as high as 88 percent of the unpaid principal balance, which gives these buyers less room to modify the principal of the loans. Buyers may believe that homeowners can begin paying their loans without a significant modification. "On the other hand, the recovery value in foreclosure from these 'less underwater' borrowers would be greater, since a smaller portion of the loan would be written off upon REO sale," writes Thomas Adams, a specialist in distressed mortgages and principal of Adams Advisory Services, LLC. "This may indicate that these buyers prefer foreclosure as an outcome, compared to the other buyers."[23]

WHO PROFITS?

A look at a small selection of DASP-auction winners tell important stories about how the interests of private capital in these transactions may conflict with the stated goals of the DASP and HUD, more generally. Two of the funds are the big winners – the top two holders of DASP-auctioned loans. The third is an example of a set of funds that are buying pools that are less underwater compared to other pools.

Lone Star Funds

Lone Star Funds is a private equity firm that "seeks investment opportunities in developed markets that have suffered an economic and/or banking crisis."[24] The firm submitted winning bids for every pool offered in the June 2014 DASP auction, with a weighted average bid of 77.6 percent of the properties' value.[25] The 2014 fund that invested in the DASP loans, Lone Star Fund IX, has an investment period of 40 months.[26] In July, Lone Star bought $500 million in nonperforming residential mortgages from JPMorgan Chase & Co.[27]

Lone Star Funds owns Caliber Home Loans, a full-service mortgage company and special servicer[28] led by Joe Anderson, former Senior Managing Director at Countrywide Financial Corporation, the poster-child of the predatory, discriminatory[29] subprime mortgage boom and overheated, destructive mortgage-backed securities markets that fueled the current housing crisis.[30] Standard and Poor's Ratings Services (S&P) has ranked Caliber Homes as Above Average as a US residential special and subprime mortgage loan servicer.[31]

Bayview Asset Management

Bayview Asset Management is a mortgage investment firm with a fairly long history of securitizing distressed mortgage transactions. In 2008, the Blackstone Group took ownership of 46% of Bayview Asset Management; it remains in control the company.[32] An early report of the FHA loans described Blackstone's role in the market and in Bayview Asset Management: "Blackstone, the world's largest private-equity firm, is acquiring nonperforming loans through Coral Gables, Florida-based Bayview, which has purchased more than $22 billion in mortgages, said Peter Rose, a spokesman for New York-based Blackstone."[33]

The Blackstone Group has shown a keen interest in how to securitize single-family homes in order to extract greater revenues. It holds a rental management company, Invitation Homes, and has created securities backed by the rental income from Invitation Homes' single-family properties.[34] Right to the City's pilot research in Atlanta, Los Angeles and Riverside raise concerns of Blackstone's impact on their tenants and the surrounding communities.[35]

Earlier this year, Bayview submitted a securities offering backed by delinquent mortgages to rating agencies for rankings. Fitch Ratings said that a Standard and Poor's rating of the offering overvalued the loans backing the securities by at least 45 percent. Fitch's findings caused S&P to pull its previously released preliminary rankings mortgage-backed securities. [36]

In April 2014, Bayview entered a joint venture with Houses.com, an online marketplace for selling and renting single-family homes.[37]

LVS I SPE

A different kind of buyer, LVS I SPE has won one pool of loans whose aggregated broker price opinion (or estimated property value) exceeds the unpaid principal balance. LVS I SPE is controlled by Louis V. Schooler[38] and tied to PIMCO, a California-based investment management firm.[39]

In 2012, the SEC filed fraud charges against Schooler and one of his companies, Western Financial Planning Corporation, for defrauding real-estate investors over a 5-year period. According to the SEC, "Schooler and Western failed to tell investors that they were paying an exorbitant mark-up on the land, in some cases more than five times its fair market value. Schooler and Western also failed to tell investors that the land held by the partnerships was often encumbered by mortgages that Western used to help finance the initial purchase of the land." "The SEC also alleges that since the spring of 2011, Schooler paid 'hush money' to silence investors who discovered they had been defrauded, allowing the scheme to continue."[40] Today, Western Financial remains in receivership and SEC v. Louis Schooler is still pending.[41]

Despite this ongoing real-estate speculation-and-fraud case against Louis Schooler, HUD allowed a fund controlled by Schooler to bid on pools of loans aimed at stabilizing neighborhoods.

HUD has stated that the Distressed Asset Stabilization Program has the dual purpose of recuperating funds for the FHA Mutual Mortgage Insurance fund while also aiding in the stabilization of distressed American communities. While HUD is accomplishing its financial goal, it is doing too little to further the goal of helping hard-hit neighborhoods recover from the housing crisis.

Since the inception of the program, policy advocates – including the National Consumer Law Center, Americans for Financial Reform, Connecticut Fair Housing Center, Empire Justice Center, Legal Aid Society of Southwest Ohio, and National Fair Housing Alliance – have raised concerns about certain aspects of the program. Yet very little has changed.

The current structure of the majority of DASP auctions hampers community stabilization by considering only the highest bid without weighting the bidders' track record of good outcomes for homeowners and communities. Despite early HUD enthusiasm for the participation of community-based nonprofits in the DASP, these institutions have won only 2.43 percent of loans.[42] Community Development Financial Institutions (CDFIs) are much better suited than alternative-investment funds to further HUD's community stabilization goals. Comprising a range of structures (including banks, credit unions, loan funds, and venture capital funds), they form with the specific mission of improving the economic conditions of low-income communities.[43]

Although only two of the winning bidders in the DASP auctions have been CDFIs, others have the funds, interest, and mission match to participate in the program. CDFIs that are national in scope have formed in order to compete in the delinquent mortgage market. They are raising substantial capital to acquire mortgages, with a business model that prioritizes the preservation and creation of affordable housing through mortgage modifications with principal reduction for struggling families and the transition to affordable rental housing for properties where loan modifications are not possible. Examples include Mortgage Resolution Fund, New Jersey Community Capital, National Community Capital (a subsidiary of New Jersey Community Capital, which is an 501(c)(3) CDFI) and Hogar Hispano (formed by National Council of La Raza). These nonprofits partner with community-based mortgage counseling groups to find and work with homeowners as they enter modified mortgages or transition to other housing.

While FHA officials have talked with advocates about the importance of the involvement of nonprofits in the DASP program the FHA has failed to adjust the program so it is more conducive to the institutions most aligned with HUD's mission. As Marcos Morales, Executive Director of Hogar Hispano, Inc. recounts losing a 2012 DASP pool to a for-profit by five cents on the dollar:[44]

> [W]e identified capital with more flexibility [than a state-specific approach] in an attempt to acquire [delinquent mortgages] directly from FHA in a competitive system that is still in place. We were approved as a buyer and we deposited our funds in order to be eligible to submit our bid, which we did. Unfortunately, we discovered that no consideration was given to nonprofits and that the only interest was on pricing. Those price points did not allow us to modify as many notes as we wanted to modify, the FHA criterion for outcomes had a very low threshold which nullified our public purpose and intent. [45]

In June 2014 sales of Neighborhood Stabilization Outcome pools, National Community Capital (NCC) lost its pools to participants bidding an average of 21% more than NCC. According to a knowledgeable industry observer, "All of the winners have securitized or are likely to securitize the pool mortgages. By coincidence, the bonds issued by these entities are very similar to the average amount by which NCC lost their bids."[46]

The current auction structure hampers mortgage modifications with principal reduction and affordable housing creation. In the 2012 announcement of the DASP program, HUD suggests that the program should improve outcomes for homeowners with auctioned loans: "Because the loans are generally sold for less than what the borrower currently owes, the purchaser has the ability to reduce or modify the loan terms while still making a return on the initial investment. If no viable alternatives exist, the purchaser may be able to help the borrower sell the property through a short sale and avoid the costs of foreclosure."[47]

Structured as an auction with a sealed bidding process, the pool goes to the highest bidder. The smaller NSO pools have a few additional requirements of bidders, regarding neighborhood stabilization outcomes. Observers of the industry have noted that Wall Street speculators, like private equity and hedge funds, are heating up the distressed residential mortgage market. With a business model already driven by extracting maximum profit for the benefit of investors, the rising prices on distressed mortgages further undermine the FHA's aim to stabilize neighborhoods. In the second quarter of 2014, the average bid was 77% of the broker price opinion, or estimated collateral value, and 64% of the unpaid principal balance.[48] (The June 2014 Note Sale bids averaged even higher.)[49]

Figure 2. Average Bids Relative to Property Value and Unpaid Principal During First and Most Recent Quarter of Distressed Stabilization Program

	Average Bid as Percent of Broker Price Opinion	Average Bid as Percent of Unpaid Principal Balance
2Q 2012	53.4%	35.9%
2Q 2014	77.0%	64.4%

As prices rise, room shrinks for loan modifications and other actions to preserve homeownership where possible. A different system for selling delinquent loans that accounts for the need for mortgage write-downs and the track record and mission of bidders would better serve the purposes of the FHA.

Since 2012, large investment companies, mainly private equity firms, have raised and/or invested $20 billion to purchase as many as 200,000 single-family homes throughout the United States. This investment space opened up as a result of the foreclosure crisis, which lowered property values, tightened mortgage credit, increased rental demand, and consolidated unprecedented amounts of single-family homes under the ownership of banks and government-sponsored enterprises. The institutionalization of the single-family home market raises questions about housing access, affordability, quality and stability and the rapid entrance into this new asset class by large private equity firms and many of the same banking institutions that contributed to the financial crisis should give us pause.

— **Desiree Fields,** *Rise of the Corporate Landlord: The Institutionalization of the Single-Family Rental Market and Potential Impacts on Renters*, July 2014

The current outcome requirements and reporting structure fail to hold purchasers accountable to neighborhood-stabilization goals and provide insufficient transparency which prevents community oversight.

The FHA did not made public any reports on the neighborhood stabilization outcomes of the program as a whole, the National Pool, or the Neighborhood Stabilization Outcomes Pool until the end of August 2014 – more than two years after the creation of DASP. In its first release of data on outcomes of the DASP program, HUD claimed that the program helped stop foreclosure in 6,400 out of 91,000 loans sold through the program during the covered period. In fact, only 2,131 loans — or less than 3 percent of all loans — have so far resolved with families staying in their homes through reperformance or forbearance. In the other cases of "avoided foreclosure" homeowners lost their homes through short sales, deed-in-leiu, or third-party sales.[50]

Even after the release of these general numbers it remains the case that, as the National Consumer Law Center (NCLC) noted in 2012, no data yet provides information about any post-sale loan modifications and how affordable they are for borrowers, or the impact of sales on borrowers of color and other groups protected by civil rights law.[51] Indeed, even the financial information that is made public about auction pools and bids does not reflect the final sale. Without this data, the public is unable to learn or confirm what impact the program is having on our communities.

The current pre-sale certification phase does not ensure that the FHA mortgage modification process has been followed before loans are included in DASP pools.

Only loans that are not eligible for standard FHA loss mitigation are supposed to be included in the program. On the front lines of helping homeowners navigate their obligations, the NCLC flagged the design flaw in DASP that rewards non-compliant servicers in 2012:

> **We routinely see evidence of servicers' non-compliance with HUD's loss mitigation rules. These rules require that servicers consider homeowners for specific alternatives to foreclosure before proceeding to foreclosure sales... Right now, many thousands of FHA-insured loans have been in foreclosure for years, without completion of these basic reviews. Servicers facing delays and court scrutiny in judicial foreclosure states are contributing the overwhelming majority of loans to these sales. FHA is paying off the full insurance claim in each case.**[52]

The Government Accountability Office issued a report in 2012 demonstrating that FHA-insured loans had the worst record for unsustainable loan modifications of all private and government-guaranteed lending entities: FHA loans re-defaulted more frequently after modifications than all others. The report noted that FHA modifications seldom reduced payments significantly. It also pointed out that FHA did not effectively monitor loss-mitigation performance.[53]

During 2013 FHA substantially revised its loan modification and loss mitigation guidelines. The modification options are now much more likely than before to provide lasting alternatives to foreclosures. In this context, housing advocates say, the timing of the implementation of DASP could not have been worse. Sale of loans into DASP cut homeowners off from access to the improved FHA loan modification options just as they are becoming available. Once the loans have been sold, the investors who buy them are under no obligation to ensure access to affordable modifications.

In May 2014, a coalition of Americans for Financial Reform, Connecticut Fair Housing Center, Empire Justice Center, the Legal Aid Society of Ohio, the National Consumer Law Center, and the National Fair Housing Alliance reiterated these concerns in a letter to FHA Commissioner Carol Galante. This letter told the stories of four homeowners who were good candidates for traditional loan mitigation – in three of the cases, they were in the loan-modification process – and discovered that their mortgages had been sold through DASP without their knowledge. The sales meant that their mortgages were no longer FHA-insured and, therefore, not eligible for FHA loan modification options.[54]

MAKING DASP REALLY STABILIZE NEIGHBORHOODS

1. Credit Bidders that have Stronger Neighborhood Stabilization Plans.

The program and auction structures should better reflect both of the goals of the Distressed Asset Stabilization Program. While raising substantial capital for the Mutual Mortgage Insurance Fund, the pre-qualification process should include greater requirements around neighborhood stability and preservation. The auction process should be reformed to include a point system, or other mechanism, to weight bids based on the degree to which a bidder's program advances HUD's neighborhood stabilization goals. DASP should credit bidders with a strong plan to offer modifications with principal reduction where feasible, a property disposition plan that creates affordable rental housing, and track records that show successful implementation of such programs. With such a system, competitive bids would be the highest bids that still allow affordable loan modifications by bidders with a track record of successful loss mitigation that demonstrates an organizational commitment to community stabilization. HUD should implement a "last look" that would allow not-for-profit bidders the opportunity to match the highest bid on a pool.

2. Strengthen Outcome Requirements to Preserve Homeownership and Create Affordable Rental Housing.

All purchasers should be required to make affordable loan modifications to the maximum extent and, in cases where that is not possible, to demonstrate why they could not modify the loan. Both investors in the national pools and neighborhood stabilization buyers should be subject to stronger outcome goals and reporting. If loss mitigation is unsuccessful, homes should be sold to genuine owner occupants and/or turned into affordable rental housing (including some affordable to 30% of area median income (AMI) and below) and oversight, reporting, and penalties should be used to ensure such outcomes. Where outcomes are not achieved, penalties should be enacted to include substantial fees and/or reclaiming properties. These kinds of conditions on the outcomes of loans could reduce the attractiveness of the loans to hedge funds, which would likely be reflected in lower bids. In other words, by articulating and enforcing the mission to protect affordable housing, HUD would be better ensuring that bidders with a shared mission are able to compete for the pools of loans.

3. Sell More Loans through NSO Pools.

Another way to encourage the participation of non-profits and community-development focused purchasers in the bidding process is to place more of the delinquent mortgages into geographically concentrated Neighborhood Stabilization Outcome pools. The geographic concentration of these pools creates more opportunities for nonprofits to participate. Many Community Development Financial Institutions and other qualified non-profit entities are geographically focused. National pools in the DASP program may be too dispersed to meet their mission. The NSO pools, by contrast, are relatively focused, often around a city or set of counties. These pools align more closely with the mission of many of the nonprofits and may more effectively achieve the goals of the DASP, as well.

4. Collect and Make Public Detailed Performance Data.

Make the post-sale loan modification results of these sales publicly available, including demographic and geographic information. Purchasers of all loans – in both the National and the NSO pools – should be required to do quarterly reporting including demographic information, and details about the quality of loss mitigation implemented. The reporting should be subject to spot reviews by FHA to improve accuracy. This information should also be made public on a short time line. When purchasers of FHA pools fail to comply with reporting requirements or contract terms, HUD should assess financial penalties.

5. Improve the Pre-Sale Process to Better Protect Homeowners.

Servicers should be made to document compliance with HUD's loss mitigation requirements and FHA should develop a better screening tool to assess compliance. HUD should implement a system of notices to homeowners that accurately informs them about the sale process, the servicer obligations before and after sales, and their rights as borrowers affected by these transactions. In addition, FHA should develop a procedure for instances when homeowners disagree with a servicer's account of loss mitigation efforts.

CONCLUSION

The Distressed Asset Stabilization Program has important goals to protect the FHA's Mutual Mortgage Insurance fund and stabilize communities. However, as it is currently being implemented, it fails to meet its second goal and jeopardizes communities rather than stabilizes them. As it is currently structured, the DASP program sells mortgages into the speculative segments of the financial industry that have a track record of harming communities, when better alternatives exist.

By giving significant weight to the quality of the neighborhood stabilization program in the bidding process, strengthening outcome requirements after the sale, collecting and publishing detailed performance data, and improving the pre-sale process to protect homeowners, HUD can make the program into one that really will strengthen our communities.

NOTES

1 *Making the Mortgage Market Work for America's Families*, Center for American Progress and National Council of La Raza, June 5, 2013, http://cdn.americanprogress.org/wp-content/uploads/2013/06/AccessAffordHousing1.pdf (accessed August 22, 2014), 7.

2 Heather Perlberg and John Gittlesohn, "Hedge Funds Boost Bad-Loan Prices as U.S. Sales Increase," Bloomberg, August 11, 2014, http://www.bloomberg.com/news/2014-08-11/hedge-funds-boost-bad-loan-prices-as-u-s-sales-increase.html (accessed August 13, 2014).

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