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HFA ________________________

Entry Name ____________________

Communications	Homeownership	Rental Housing	Special Needs Housing
☐ Annual Report ☐ Promotional Materials and Newsletters ☐ Creative Media	☐ Empowering New Buyers ☐ Home Improvement and Rehabilitation ☐ Encouraging New Production	☐ Multifamily Management ☐ Preservation and Rehabilitation ☐ Encouraging New Production	☐ Combating Homelessness ☐ Housing for Persons with Special Needs
Legislative Advocacy	**Management Innovation**	**Special Achievement**	**Are you providing visual aids?**
☐ State Advocacy ☐ Federal Advocacy	☐ Financial ☐ Human Resources ☐ Operations ☐ Technology	☐ Special Achievement	☐ YES ☐ NO

Legislative Advocacy – State Advocacy
MassHousing – Special Housing Commission

It seems there isn't a person in this country who isn't familiar with talk of the "mortgage crisis" over the last several years. Homeowners who had grown accustomed to the idea that real estate prices could only go up have been faced with a hard reality since 2008; after a period of unprecedented growth that many analysts referred to as the "housing bubble", there was a universal shift in both the economy and the housing market that affected hundreds of thousands of homeowners.

The "back story" is well known. Beginning in the late 1990s and continuing well into the early 2000s, there was a widespread acceptance of the idea that increasing homeownership in the United States was an important goal both for the individual and for the country. This policy direction translated into specific and targeted efforts to increase national homeownership levels. All of this demand for mortgage financing in turn fueled the evolution of mortgage-backed securities (MBSs) and the packaging of mortgage loans to be sold on Wall Street. It was this widening availability of funds that many have argued fed the ever-increasing housing boom. This ready availability of funds also contributed to the rise in home prices that, over time, proved unsustainable. Then, when home prices began to fall, there grew an increasing number of homeowners who found that the amount that they owed on their home mortgages now exceeded the value of the home itself – a situation that is often referred to by the term "underwater."

While there have been many programs that have grown out of the federal government's efforts to address mortgage modifications – the challenge of homeowners who are current on their payments but have mortgages that are "underwater" has persisted. This in turn, has been a common issue raised in Massachusetts by some elected officials who believe that this issue must be addressed by government intervention.

In an effort to offer relief to "underwater" borrowers in the Commonwealth, a freshman state representative filed a new bill during the 2011/2012 Massachusetts Legislative Session that would create an immediate moratorium on foreclosures of any mortgages that were registered at Mortgage Electronic Registry Services and that also would require MassHousing to develop a loan program to provide mortgage refinancing assistance to non-delinquent homeowners without regard to their loan-to-value ratios. The bill – *H.1183, An Act Providing for Homeownership Consolidation and Relief* – was referred to the Joint Committee on Financial Services. MassHousing's Executive Director and Director of Government Affairs reached out to and met with the legislator and his staffer to discuss the Agency's concerns about the legislation. They also met with the Chairman of the House Committee on Financial Services to present these concerns. Ultimately, MassHousing testified against this legislation before the Joint Committee, raising serious concerns about the financial feasibility of the bill, and also about the unintended consequences of the bill that the Agency believed could actually exacerbate a homeowner's indebtedness.

Some background on the Massachusetts legislature is important to put this issue into perspective. Massachusetts has a two year legislative cycle. During the 2011/2012 Legislative Session, a total of 7,258 bills were filed of which 674 were signed by the Governor. Of those 674 bills, 440 related to legislation specific to a Massachusetts city or town, 122 related to the creation of sick leave banks for state employees, and 84 were state appropriation related. The vetting process for new legislation in Massachusetts is significant and the likelihood of H.1183 becoming law in its first filing was slim. However, issues facing troubled homeowners in the Commonwealth was a common concern among members of the Massachusetts Legislature – which gave the issue more attention and "juice" than a new bill might otherwise have.

And so it was that during budget deliberations for Fiscal Year 2012, the freshman author of H.1183 successfully offered an amendment to the state budget creating a special commission to consider the feasibility of a mortgage refinancing program that could benefit non-delinquent underwater borrowers. Similar language was not included in the Senate version of the FY12 budget, but during Conference, the

House language remained and the *Special Commission to Study the Feasibility of Providing Home Mortgage Financing Assistance to Non-Delinquent Homeowners* was created – Section 175 of Chapter 68 of the Acts of 2011.

Different from H.1183 which would have ***required MassHousing to create a state-appropriated program*** to refinance non-delinquent borrowers, the language in the outside section created a Special Commission ***to study the feasibility of creating*** such a program. The Special Commission was made up of four state legislators (including the freshman State Representative who authored the bill and amendment), the State Treasurer and Receiver General, the State Banking Commissioner, two Gubernatorial Appointees (one representing the Massachusetts Bankers Association and the other representing the Massachusetts Credit Union League), and MassHousing's Executive Director who was established by the statutory language as Chair of the Commission. MassHousing was required to serve as staff for the Commission and to manage all of the issues relating to calling meetings (and posting them as required by state law) and writing minutes for each meeting and then writing the Commission's report and assembling all of the related attachments. (In the end, the report totaled 378 pages in all.)

At the Commission's first meeting Tom Gleason, as Commission Chair, worked to establish a tight and well-defined Charter for the Commission's work. The Commission's charter, derived directly from the amendment language, made clear that its consideration of mortgage refinancing issues would be limited in scope to challenges facing non-delinquent homeowners – and specifically those who find themselves in a negative equity position (that is – holding a mortgage that has a value greater than the current appraised value of the property).

Although MassHousing was sympathetic to the issues confronting homeowners who were upside in their loans, the goal seemed questionable. If homeowners were not delinquent in making their mortgage payments, they had an ability to pay. As a practical matter, being "underwater" on one's mortgage does not, in and of itself, make a mortgage unaffordable in terms of a borrower's monthly mortgage payment but it does affect a borrower's ability to sell or refinance his or her home.

The Special Commission to Study the Feasibility of Providing Home Mortgage Financing Assistance to Non-Delinquent Homeowners met from March of 2012 through January of 2013. During these many months, outside experts were invited to make presentations before the Commission and to advise the Commission members on various aspects of economic theory, mortgage and real estate finance, risk guarantee issues and the secondary mortgage market. Each invited guest speaker was carefully selected in succession by MassHousing's Executive Director to chart the pathway for consideration of this issue by the members of the Commission.

The Commission's research started with a review of the existing programs that have been established at the federal level to assist homeowners who find that their homes are now worth less than the original purchase price and therefore less than the value of their existing mortgages. Overall, while there are many programs that have been created (including HAMP, HARP, etc.), these programs generally only benefit borrowers whose mortgages are held by Fannie Mae, Freddie Mac or the FHA. While this captures a large number of homeowners in the United States, it certainly does not encompass all outstanding mortgages – and borrowers who are outside of this circle are still experiencing difficulty refinancing their homes at this time. The Commission needed to determine the number of Massachusetts borrowers outside this circle.

This led the Commission to engage the work of an actuarial consulting company known as Milliman, Inc. to determine the scope of the problem that existed in the Commonwealth of Massachusetts with a further analysis of the costs associated with providing assistance to these borrowers. Specifically, Milliman sought to identify how many loans with negative equity existed in Massachusetts. It then went on to consider how many of these loans would be ineligible for existing financing programs; and finally considered how many of these borrowers would likely be eligible for a program that would be established based on a set of criteria that matched the Commission's charter and legislative mandate. Milliman's analysis showed that just over 2,400

single-family homeowners might be eligible for a potential new program and that the cost to provide a refinancing benefit to this group of borrowers, through a loan guarantee fund, would total $100 million.

The Commission felt it was also important to consider the economic factors that are at play in any consideration of mortgage modifications and refinancing discussions and invited Paul Willen, a Senior Economist and Policy Advisor in the Research Department at the Federal Reserve Bank of Boston, to address the Commission. Mr. Willen's analysis of market factors indicated that the fact that a borrower has negative equity in his or her home does not mean that the borrower will default. Further, it was Mr. Willen's assertion that while some may argue that increasing a borrower's monthly cash flow by reducing his or her mortgage payment will have a positive net effect on the economy because these borrowers will then spend more money on consumer goods and services – this is not necessarily the case. Mr. Willen explained, in fact, that the money would simply be transferred to one group (the borrower), from another group, (the investor who receives a return on his or her investment in the form of the interest rate of a mortgage backed security). In this way, it could actually have a net negative effect on the economy at worst or a "breaking even" at best.

As the Commission's work progressed, it became clear that an important factor to consider was the role of the secondary mortgage market in any potential mortgage refinancing proposal undertaken by the Commonwealth. Whereas the Milliman report provided the Commission with an idea of the potential funding needed for the establishment of a loan guarantee fund – additional analysis was needed to determine if there would be any potential investors in the current mortgage market that would be interested in the purchase of the loans that would be made as part of a mortgage refinancing program. This consideration was important because if such a market did exist, it could provide a viable source of funds to support these new mortgages.

Further research was sought from State Street Global Advisors (SSgA), a well-known financial firm that has worked extensively in the federal New Issue Bond Program (NIBP) and also managed assets for the Treasury as part of its efforts to manage over $220 billion in mortgage backed securities. To aid the Commission, SSgA completed a detailed analysis of a series of recent market Mortgage Revenue Bond (MRB) funding transactions in order to determine the likely outcome if a program were created in the Commonwealth based on the mandate of the Special Commission – and to consider how such a program might be funded.

SSgA determined that it would require approximately $260 million in upfront capital to make up the gap between the current mortgage value of these loans and what they could expect to be sold for as a part of a new mortgage securitization, as outlined by the legislative mandate in the Special Commission's work. In all – the implied risk inherent in the characteristics of the loans that would potentially be affected by a new mortgage refinancing program – was shown to present too great a challenge for investors to purchase at a cost which would make a program financially viable.

The Special Commission submitted its final report in December of 2013. The Special Commission's conclusion, through its careful analysis, was that providing home mortgage refinancing assistance to non-delinquent homeowners in the Commonwealth through a state-funded program was not feasible. The Special Commission's conclusion was informed based on myriad issues but chief among them was the extraordinarily high cost of providing such a program to certain non-delinquent homeowners in the Commonwealth and the lack of any market to purchase these loans.

MassHousing had believed that this would be the likely outcome of the Commission's work – but despite the Agency's best efforts to communicate that position through its testimony in opposition to the original bill – the message couldn't be heard at that time. The Special Commission proved to be the necessary vehicle for this – and it was fortuitous that the Executive Director of MassHousing was named as the Chair. The legislative mandate that created the Special Commission was a principled idea, but it was not a practical idea. In this way, MassHousing sought to educate the members of the Commission carefully over time through the presentations made to help them to understand the issues and arrive at the conclusion they did.

COMMISSION TO STUDY THE FEASIBILITY OF PROVIDING HOME MORTGAGE FINANCING ASSISTANCE TO NON-DELINQUENT HOMEOWNERS

Members

Thomas R. Gleason (Chair)
Executive Director
MassHousing

Craig Stepno
Designee
State Treasurer and Receiver General

Senator Anthony W. Petruccelli
Senate Chair
Jt. Committee on Financial Services

Representative Michael A. Costello
House Chair
Jt. Committee on Financial Services

Representative Geoffrey G. Diehl
House Minority Leader Appointee

The Honorable Robert L. Hedlund, Jr.
Senate Minority Leader Appointee

Sandra Clarke
Designee
Commissioner, Division of Banks

Mark S. Cochran
Jeanne D'Arc Credit Union
Gubernatorial Appointee
Massachusetts Credit Union League

David Brennan
Cape Cod Five
Gubernatorial Appointee
Massachusetts Bankers Association

December 18, 2013

To:
His Excellency Deval Patrick
The Honorable Anthony W. Petruccelli
The Honorable Michael A. Costello
Members of the Joint Committee on Financial Services
Steven T. James, House Clerk
William F. Welch, Senate Clerk

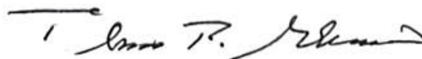
On behalf of the Commission to Study the Feasibility of Providing Home Mortgage Financing Assistance to Non-Delinquent Homeowners, the following report is respectfully submitted by the Commission as authorized by Section 175 of Chapter 68 of the Acts of 2001. On December 21, 2012, the Commission filed an Interim Report. Please accept the attached document as the official report of the Commission.

As a result of careful analysis, the Commission has determined that providing home mortgage refinancing assistance to non-delinquent homeowners in the Commonwealth through a state-funded program is not feasible.

The attached report contains detailed information on the work of the Commission and provides a great deal of data on home mortgage financing and refinancing as well as the secondary mortgage market.

I hope you find the report informative. Please feel free to contact me or Nancy McDonald, MassHousing's Government Affairs Manager at 617.854.1852 if you have any questions.

Sincerely,



Thomas R. Gleason
Chairman

REPORT

of the

SPECIAL COMMISSION TO STUDY THE FEASIBILITY OF PROVIDING HOME MORTGAGE FINANCING ASSISTANCE TO NON-DELINQUENT HOMEOWNERS

SECTION 175 OF CHAPTER 68 OF THE ACTS OF 2011

DECEMBER 2013

EXECUTIVE SUMMARY

The Special Commission to Study the Feasibility of Providing Home Mortgage Financing Assistance to Non-Delinquent Homeowners met from March of 2012 through November of 2012. Outside experts were invited to make presentations before the Commission and to advise the Commission members on various aspects of economic theory, mortgage and real estate finance, risk guarantee issues and the secondary mortgage market. These experts provided detailed and researched presentations which are included as part of the permanent record of the work of the Special Commission.

The Commission began by carefully establishing the parameters that would define its work. This led to the creation of a Charter, drawn directly from the text of the legislative language which established the Commission. The Commission's charter made clear that its consideration of mortgage refinancing issues would be limited in scope to challenges facing **non-delinquent** homeowners – and specifically those who find themselves in a negative equity position (that is – holding a mortgage that has a value greater than the current appraised value of the property). While the Commission acknowledges the enormous challenges facing borrowers who are at-risk of foreclosure, this group of borrowers was not the focus of the Commission's research or deliberations.

The Commission's research started with a review of the existing programs that have been established at the federal level to assist homeowners who find that their homes are now worth less than the original purchase price and therefore less than the value of their existing mortgages. These mortgages are often referred to as being "underwater". Overall, while there are many programs that have been created (including HAMP, HARP, etc), these programs generally only benefit borrowers whose mortgages are held by Fannie Mae, Freddie Mac or the FHA. While this captures a

large number of homeowners in the United States, it certainly does not encompass all outstanding mortgages – and borrowers who are outside of this circle are still experiencing difficulty refinancing their homes at this time.

This led the Commission to engage the work of an actuarial consulting company known as Milliman, Inc. to determine the scope of the problem that exists at present in the Commonwealth of Massachusetts with a further analysis of the costs associated with providing assistance to these borrowers. Specifically, Milliman sought to identify how many loans with negative equity exist in Massachusetts. It then went on to consider how many of these loans would be ineligible for existing financing programs; and finally considered how many of these borrowers would likely be eligible for a program that would be established based on a set of criteria that matched the Commission's charter and legislative mandate. Milliman's analysis showed that just over 2,400 single-family homeowners might be eligible for a potential new program and that the cost to provide a refinancing benefit to this group of borrowers, through a loan guarantee fund, would total $100 million.

The Commission felt it was also important to consider the economic factors that are at play in any consideration of mortgage modifications and refinancing discussions and invited Paul Willen, a Senior Economist and Policy Advisor in the Research Department at the Federal Reserve Bank of Boston, to address the Commission. Mr. Willen's analysis of market factors indicates that the fact that a borrower has negative equity in his or her home does not in and of itself mean that the borrower will default. Further, it was Mr. Willen's assertion that while some may argue that increasing a borrower's monthly cash flow by reducing his or her mortgage payment will have a positive net effect on the economy because these borrowers will then spend more money on consumer goods and services – this is not necessarily the case. Mr. Willen explained, in fact, that the money would simply be transferred to one group (the borrower), from another group, (the investor who receives a return on his or her investment in the

form of the interest rate of a mortgage backed security). In this way, it could actually have a net negative effect on the economy at worst or a "breaking even" at best.

As the Commission's work progressed, it became clear that an important factor to consider is the role of the secondary mortgage market in any potential mortgage refinancing proposal undertaken by the Commonwealth. Whereas the Milliman report provided the Commission with an idea of the potential funding needed for the establishment of a loan guarantee fund – additional analysis was needed to determine if there would be any potential investors in the current mortgage market that would be interested in the purchase of the loans that would be made as part of a mortgage refinancing program. This consideration is important because if such a market did exist, it could provide a viable source of funds to support these new mortgages.

Further research was sought from State Street Global Advisors (SSgA), a well known financial firm that has worked extensively in the federal New Issue Bond Program (NIBP) and also managed assets for the Treasury as part of its efforts to manage over $220 billion in mortgage backed securities. To aid the Commission, SSgA completed a detailed analysis of a series of recent market Mortgage Revenue Bond (MRB) funding transactions in order to determine the likely outcome if a program were created in the Commonwealth based on the mandate of the Special Commission – and to consider how such a program might be funded.

SSgA determined that it would require approximately $260 million in upfront capital to make up the gap between the current mortgage value of these loans and what they could expect to be sold for as a part of a new mortgage securitization, as outlined by the legislative mandate in the Special Commission's work. There are many factors that influence this finding – and those specifics are detailed in the Commission's report that follows. In all – the implied risk inherent in the characteristics of the loans that would potentially be affected by a new mortgage refinancing program – was shown to

present too great a challenge for investors to purchase at a cost which would make a program financially viable.

The Special Commission has determined, through its careful analysis, that providing home mortgage refinancing assistance to non-delinquent homeowners in the Commonwealth through a state-funded program is not feasible. The Special Commission's conclusion was informed based on the extraordinarily high cost of providing such a program to certain non-delinquent homeowners in the Commonwealth and the lack of any market to purchase these loans. Through the Commission's work, it was determined that these factors – among others – make this proposal infeasible.

BACKGROUND

The Commonwealth of Massachusetts, and indeed the nation, finds itself in a housing crisis born of a decline in the real estate market that one could argue is the most significant devaluation of home prices in the last 50 years. Homeowners who had grown accustomed to the idea that real estate prices could only go up have been faced with a hard reality since 2008; after a period of unprecedented growth that many analysts refer to as the "housing bubble", there was a universal shift in both the economy and the housing market that affected hundreds of thousands of homeowners.

Beginning in the late 1990s and continuing well into the early 2000s, there was a widespread acceptance of the idea that increasing homeownership in the United States was an important goal both for the individual and for the country. Homeownership does provide many important benefits both to families and the communities in which those families buy a home. Homeownership helps families build equity over time and manage their financial futures. At the same time, it strengthens communities by giving people a real stake in the neighborhoods in which they live and the schools to which they send their children. This policy direction translated into specific and targeted efforts to increase national homeownership levels.

Unfortunately, in some cases, this increase came from changes in the way that many lending institutions viewed the criteria for a potential borrower's ability to qualify for mortgage financing. This included lower down payment requirements and less documentation – in some ill-fated cases – even no documentation requirements. In addition to low-interest rate loans and adjustable rate loans, there was the advent of interest-only loans. What's more – all of these mortgage vehicles became more widespread and more socially acceptable. Borrowers who thought they might never

own a home suddenly had reason to believe that there might be a way for them to buy into what was an explosively active housing market.

All of this demand for mortgage financing in turn fueled the evolution of mortgage-backed securities (MBSs) and the packaging of mortgage loans to be sold on Wall Street. It was this widening availability of funds that many have argued fed the ever-increasing housing boom. This ready availability of funds also contributed to the rise in home prices that, over time, proved unsustainable. Then, when home prices began to fall, there grew an increasing number of homeowners who found that the amount that they owed on their home mortgages now exceeded the value of the home itself – a situation that is often referred to by the term “underwater”. As a practical matter, being “underwater” on one’s mortgage does not, in and of itself, make a mortgage unaffordable in terms of a borrower’s monthly mortgage payment but it does affect a borrower’s ability to sell or refinance his or her home.

Broadly, there are two different categories of borrowers who face challenges with their mortgages – both of whom could have mortgages that have negative equity – or are “underwater”. First are the victims of what are generally referred to as “predatory” lenders. These are borrowers who did not have an adequate level of income to be able to afford a home and sustain a mortgage over the long term and were often qualified for loans with little underwriting. Specifics of the impact of these so-called predatory lenders have been well-documented in the media over the last several years and considered by policy makers at both the state and the national level. While these borrowers may hold mortgages that would be deemed “underwater”, there are likely other issues that may be affecting their inability to refinance their mortgages including a poor payment history – and who – given this delinquency were not the subjects of the Commission’s study.

There is another distinct group of borrowers who are **not** delinquent on their mortgages but who would benefit from the reduced payment that could possibly be achieved if they were able to refinance to a lower interest rate – but find they are unable to refinance because of their negative equity or "underwater" position. There have been programs created at the national level through Fannie Mae and Freddie Mac to provide mortgage modifications for borrowers who are at risk of foreclosure. However, to date, there have not been any programs to assist borrowers who are able to pay their monthly mortgages, but would like to be able to achieve monthly savings with a reduction in their interest rate (despite their negative equity position) unless their loan is held by one of the Government Sponsored Enterprises (GSEs) or is an FHA loan.

It is borrowers in this group who were largely the subject of language included as an outside section in the Massachusetts budget for FY 2012, which created the Commission, to consider the feasibility of creating a mortgage refinancing program that could benefit these borrowers.

CHARTER OF THE COMMISSION

The Commission first met in March of 2012 and began by establishing a charter to guide the Commission's work. The Charter stated that the Commission would "consider through review and evaluation, the feasibility of providing refinancing assistance for non-delinquent homeowners in the Commonwealth, who are unable to refinance at a lower market interest rate because of any of the following:

- a loss of income
- a depreciation in the value of their home
- current secondary market guidelines."

As a further part of its review, by its Charter, the Commission established the goal to "consider the feasibility of establishing a fund encumbered by the Commonwealth to be pledged to the Massachusetts Housing Finance Agency as a mortgage refinance guarantee." All of this tracked closely with the legislative language that had been passed to create the Commission.

It was acknowledged in the first meeting that whatever the Commission's findings, it would be impossible to have any impact on what Fannie Mae and Freddie Mac would allow in terms of refinancing within the portfolio of loans that the GSEs own.

It was also discussed and accepted as a threshold understanding by the Commission members that the Commission's work was specifically to research the *"feasibility"* of establishing a fund for a mortgage refinance guarantee. A key point too was the focus on non-delinquent borrowers – as stated by the legislation that established the Commission. The Commission acknowledged that while there has been an overwhelming increase in foreclosures over the last few years and that while many homeowners remain at risk for a variety of reasons – this group of borrowers does not represent the focus of the Commission's research and deliberations. The Commission acknowledges the significant work that has been undertaken by Attorney General Martha Coakley's office in Massachusetts to address issues related to predatory lending practices and borrowers at-risk of foreclosure.

For the purposes of the Commission's work, inquiries were made with both the National Council of State Legislatures (NCSL) and the Council of State Governments (CSG) to determine if there were any statewide programs being undertaken anywhere in the country that addressed the issues that the Commission was charged with analyzing. Based on this survey, it was determined that there were no programs identified in any other states.

In an effort then to more clearly define the scope of the problem, the Commission sought to bring in policy area experts over time to present background on particular aspects of mortgage finance and the current mortgage market. Background materials from the U.S. Treasury were identified, gathered and distributed to Commission Members for their review and consideration. This included information on:

- President Obama's Plan to Help Responsible Homeowners and Heal the Housing Market
- Home Affordable Modification Program (HAMP)
- Principal Reduction Alternative (PRA)
- Second Lien Modification Program (2MP)
- FHA Home Modification Program (FHA-HAMP)
- USDA's Special Loan Servicing
- VA-HAMP
- Home Affordable Foreclosure Alternatives Program
- Treasury/FHA Second Lien Program
- Home Affordable Refinance Program (HARP)
- FHA Refinance for Borrowers with Negative Equity (FHA Short Refinance)
- Home Affordable Unemployment Program (UP) *(Appendix I.)*

A review of these materials, which were detailed and lengthy, identified the numerous government sponsored programs that have been created in an effort to assist borrowers who are either at-risk of foreclosure or who may simply wish to refinance their mortgages but find they are unable to do this. This includes everything from HAMP and HARP to President Obama's plan announced in February of 2012 to "provide borrowers who are current on their payments with an opportunity to refinance and take advantage of historically low interest rates". Many of the programs that were identified would potentially target borrowers who owe more on their homes than their homes are now worth – the underwater borrower.

MARKET HISTORY AND PRESENT REALITIES

A presentation was provided for the Commission by Kevin Mello, the Manager of MassHousing's Mortgage Servicing Department. Mr. Mello has worked in mortgage finance for over twenty-eight years, has been employed by MassHousing for nearly two decades and is experienced in mortgage modification and foreclosure prevention efforts. MassHousing services over 16,000 loans worth over $2 billion and for many years has been involved in mortgage modifications – even before there was a nation-wide program.

Mr. Mello explained that over the last thirty years there have been two major economic downturns affecting the real estate market. The first began in the late 1980s and spanned into the early 1990s and was largely precipitated by Savings and Loan (S&L) defaults and more locally, condominium overdevelopment. The mortgage problems experienced during this time period were nowhere near as widespread as the current crisis.

In contrast, the current crisis is more national in scope with very few areas left unscathed. In fact, many have argued that the ongoing "great recession" was precipitated by the mortgage crisis which was itself caused by exotic mortgage products and predatory lending practices in the mortgage banking industry.

It is interesting to note that the current crisis represents a departure from past practice in terms of borrowers' response to hardship. Previously, borrowers would seek to negotiate with other consumer creditors (such as credit cards or auto loans) first, before approaching their mortgage lender for a modification. In this particular crisis, this is no longer the case, as borrowers seek to negotiate first with their mortgage lender, while staying current on consumer debt.

Mr. Mello explained that there has been a great deal of attention paid in the media to the substance of the current mortgage crisis. In turn, targeted outreach strategies have been developed, largely by the federal government and then filtered down through the GSEs and other institutional investors.

Mr. Mello went on to explain that at the beginning of the crisis, the focus was on "victims", or people who were perceived to be "victims" of predatory and fraudulent lending. The next group was sub-prime borrowers who received mortgage loans with terms that they did not understand or could not afford. Beyond that, the focus of attention expanded to prime borrowers experiencing financial hardship due to job loss. Over time, the focus has expanded to include "underwater" borrowers not experiencing financial hardship, but unable to refinance due to lack of equity.

Mr. Mello said that the challenges for government programs and lenders with this group include: the moral hazard of identifying who deserves relief and how much; a process for establishing whether or not there is a hardship and whether that hardship is a pre-requisite to providing modification relief; whether to provide help to so-called "non-victims" who bet wrong by taking on more debt than they could safely afford to repay on homeownership or investment properties or with consumer credit; and then determining who will pay the bill for the relief and restructuring that takes place.

The efforts of the federal government to address this crisis have been significant – but at times they have been unsuccessful. This is largely explained by the complexity of the challenge and the difficulty in finding one solution to what is, in fact, many layers of a problem. For example, with the initial iteration of the HAMP program – the federal government's "Making Home Affordable Modification Program" – the programmatic requirements allowed servicers to enter into trial plans based simply on stated incomes on the part of the borrower. This ultimately proved unadvisable and

the government eventually reversed its position to require underwriting of all income, assets and liabilities association with a modification application.

Eventually, however, more prescriptive guidelines were established for the review of a mortgage relief application and for consideration of the type of relief that should be provided to consumers. For example, underwriting has generally been standardized to a 31% housing ratio. This ratio was established by the federal government and then adopted by the rest of the industry as an affordability threshold for borrowers.

Beyond the standardization of the housing ratio, a number of other measures have been utilized, which include:

- a stepped-rate program through HAMP, where a loan is modified to a floor of 2% and then stepped-up in increments of 1%, back to the current market interest rate at the time of modification;
- term extensions, where servicers are able to extend the remaining term of mortgage loans up to a maximum of 40 years from the date that the loan has been modified;
- additional principal bifurcation and even principal forgiveness in certain circumstances; and
- a net present value (NPV) analysis requirement for modification decision-making.

There are many options for borrowers who have an FHA loan or a GSE loan (such as Fannie Mae or Freddie Mac). There are, in fact, programs in HARP 1 and HARP 2 that follow the charge of this Commission – in that they provide refinancing opportunities to borrowers who are "underwater", but are not otherwise experiencing a financial hardship. However, HARP 2 is limited only to GSE borrowers at this point. Mr. Mello reported to the Commission that at the time of his report (in March of 2012) it was his

understanding that the Obama Administration was seeking Congressional approval to expand eligibility for HARP 2 to non-GSE borrowers, but it had not come about as of that time. The concept in that case was said to have been structured in order that the FHA would provide the insurance for these loans. *(During the course of the Commission's work, no further information was released on this concept, however at the time of this report's publication, President Obama had resurrected this idea in his "State of the Union" speech in January 2013.)*

While the challenges of dealing with this issue at the national level may seem to be confined to the implementation of the federal government's programs – the challenges that the federal government faces may in fact be the same challenges that would be faced by a state program. This may also explain why no other states to the Commission's knowledge, have undertaken mortgage relief programs outside the parameters of those programs offered through the federal government.

In attempting to determine the potential scope of the problem in Massachusetts, the Commission used information gathered through Corelogic – a financial, property and consumer information, analytics and services company. This national organization is widely recognized within the industry as a reliable source of information for loans, properties, property values, delinquencies, foreclosures and real-estate owned properties (REOs).

The Commission first examined data gathered by Corelogic and presented as "Market Trends Data: Market Trends Equity of State-County (Massachusetts) from December 2011." *(Appendix II.)* This analysis highlighted residential housing stock with a calculation of first mortgages and other mortgages including equity lines of credit, second mortgages and down payment assistance loans in Massachusetts. For the purposes of this analysis by Corelogic, negative equity loans were defined as the total

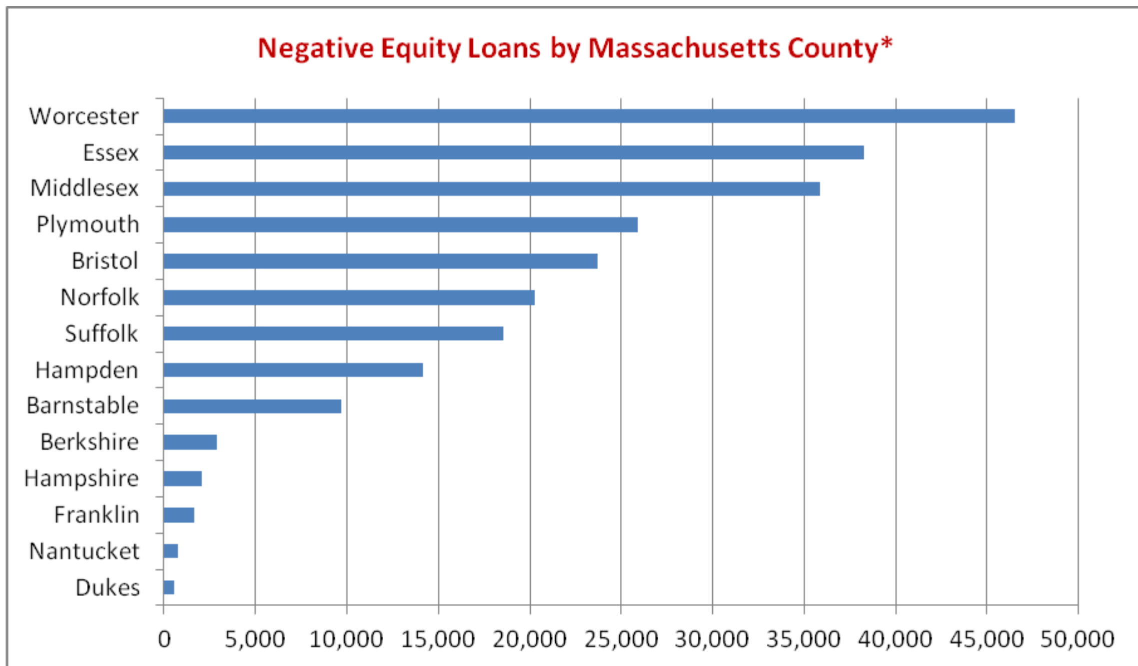
number of both first and second mortgages with negative equity. Negative equity is defined as a loan value that is higher than the appraised value of the collateral.

The data provided as "Corelogic Market Trends Equity by State-County" was a further refined outline that calculated negative equity by county in Massachusetts. Corelogic uses known data and trends to extrapolate data about housing. For example, for the data that is presented in the spreadsheet in Appendix II, Corelogic used the information that is "known" and available. This includes:

- the date of a home's purchase;
- the purchase price of the home; and
- the value of the mortgage that was recorded at the time of the sale.

Corelogic then considers the index of property values in a certain geographic area over a period of time. Because of the database of information that they use – they are often able to get down to a "granular" level which could be as specific as census track to establish variances. Next, Corelogic analyzes this change in property values and establishes the "curve" of values either up or down. This allows them to establish a likely property value for homes at a certain point in time. Assuming a normal amortization schedule, Corelogic is then able to estimate the outstanding loan amount on an existing property. This number is then compared to the estimated value of the home to determine if there is negative equity.

The chart below shows Corelogic's analysis of the number of negative equity loans in December of 2011 as the Commission began its work. This illustrates that there were 240,887 loans estimated to be in a negative equity position, with the counties of Worcester and Essex as the top two.



* Data Period: December 2011

With a trend of moderately increasing real estate values, based on Warren Group data released in February 2013, it is likely that the number of loans in a negative equity position, as reported above, has not increased.

After considering the broad implications of the data generated by Corelogic, the Commission felt it was important to delve deeper into the specifics of these kinds of numbers to establish a more refined view of the information. This led the Commission to the services of an actuarial firm known as Milliman, Inc. This type of firm was selected to present information to the Commission because the principals would be able to produce a specific and detailed analysis of the current situation in Massachusetts with regard to borrowers in a negative equity position and provide an estimate of what kind of financing vehicle would be needed to refinance these loans. An actuarial firm such as Milliman is also skilled in determining what kind of risk would arise from a loan program for borrowers who are current on their mortgages but have negative equity; including the associated risk that would exist in terms of the incidence and severity of losses in that kind of loan portfolio.

The Commission's goal in engaging Milliman, then, was to request an analysis that examined how many of these loans would likely go into default based on the loan characteristics, what the severity might be based on the loan-to-value and future forecasts of property value behavior (which would be different by county and community and neighborhood) and also what reserves would need to be set up in order to properly fund all of the anticipated losses from that insurance pool, over a particular term. The expectation was that the actuary would be able to provide estimates for the amount of up-front capital that would be needed for a potential loan program.

MILLIMAN – AN ACTURIAL ANALYSIS (*Appendix III.*)

An analysis specific to the work of the Commission was prepared by Milliman under the direction of Principal and Financial Consultant, Kenneth Bjurstrom. Mr. Bjurstrom manages a practice dedicated to analyzing the financial risks associated with issuing and servicing mortgages, mortgage guaranty insurance, and credit enhancement structures.

In order to address the issue named in its forming – that is – the feasibility of providing homeownership refinancing assistance to non-delinquent homeowners – one of the fundamental charges of the Commission was a consideration of how loan guarantees are structured and how they work in the mortgage market to help facilitate the financing or refinancing of mortgages. In keeping with this mandate, Mr. Bjurstrom produced an actuarial analysis of a refinancing program for non-delinquent homeowners in Massachusetts.

In considering the background of the mortgage crisis in Massachusetts – Milliman's analysis notes that from 2000 – 2006, housing prices nearly doubled. As such, for a borrower who bought a home in the first quarter of 2000, the decline in the value of

his or her home has likely not been as steep. Generally, even though borrowers who purchased in the beginning of 2000 will have seen a decline in real estate values, the value on their home at present is most likely still up at least 50%.

This retained value diminishes for origination dates after 2000. For example, it is estimated that a borrower who purchased his or her home at the end of 2003 is essentially "breaking even" on this home now in terms of value.

The market analysis provided by Milliman sought to determine:

- how many loans with negative equity exist at present?
- of these loans how many are ineligible for an existing refinancing program? and,
- how many of these borrowers are likely to be eligible for a program that would be contemplated by the Commission's mandate?

The Milliman analysis used information derived from the database at Corelogic. This database contains monthly payment information collected from about 80% of all lenders. Utilizing Corelogic data provides the best source of in-depth information on the loans in Massachusetts including relevant investor information and loan characteristics. Specifically, the analysis considered the universe of borrowers in Massachusetts, their loan amounts, their lenders, and the investors on the loans.

This type of analysis is important because loans that were owned by Fannie Mae or Freddie Mac would not be included for the purposes of this analysis because these loans would be covered by another program, (specifically HAMP or HARP). FHA loans are also removed from consideration because modification loans are available to those borrowers as well. In this way, the loans remaining are generally the balance sheet lending by community banks, as well as loans that are done through other investors (as

an example, this could include loans for an agency like MassHousing). These remaining loans represent the eligible Massachusetts homeowners who do not have the potential for another solution to refinance their homes given their negative equity.

Given this breakdown, the first Milliman analysis considered a universe of 34,000 active loans in Massachusetts. In this analysis, only single family residences were included. Homes that are not owner occupied, which might be investor properties or second homes, were filtered out, as were loans with FICO scores less than or equal to 660 (because a potential refinancing program would likely only be designed to serve borrowers who live in the home and have a credit score above 660). (The author of the analysis explained that a program could be designed that allowed a lower FICO score, but the risk increases exponentially as FICO scores go down.) Loans with an interest rate of less than 5% were also filtered out because it likely wouldn't change a borrower's payment significantly enough to make a real difference for that borrower. Using a criterion that is present in most federal government programs – this analysis also assumed that the borrower has been current on his or her loan for 12 months.

Given these filters, Milliman determined that the number of underwater borrowers who are not eligible to participate in another program – and who would be eligible for a new potential program – drops from 34,000 to 2,415. The number would be greater if two-family homes were included in this calculation.

Additional details produced by the Milliman analysis *(Appendix III. - page 15)* showed that this pool of mortgages had:

- an average original mortgage amount of $243,000, which on average has amortized down to a loan balance of $223,000;
- an average original interest rate of 6.1%;

- a 4% interest rate was used as the "new" interest rate for a newly created mortgage refinancing program (because this was generally the market interest rate at the time of the study);
- a 12% average market decline was used to determine the average amount that a given loan would be underwater; this translated into an average of 4.3%, making the loan-to-value 104%; therefore,
- a reduction in interest rate to 4% on this estimated loan amount would reduce a borrower's mortgage payment from $1,481 to $1,066 for a $415 per month savings.

Another important component of Milliman's analysis involved a best estimate of average savings per borrower that would be experienced from a loan refinancing program. This was determined by estimating how long, on average, after refinancing, borrowers will have the loan. From an insurance perspective, consideration is given to duration, cost and savings. Given this formula – if the average monthly benefit is $415 – this translates into an annual value of $4,950 ($415 x 12 months). This annual value is then multiplied by 4.8 years (the average time period that a borrower generally holds a mortgage) $4,950 x 4.8 = $23,904. Therefore, the average benefit per borrower is nearly $24,000.

Overall, the Milliman analysis contemplated a $100 million program. Using this dollar amount – it is estimated that 2,500 – 3,000 people could be helped. The financial benefit to each borrower is $24,000 and the cost to the lender is $24,000. The cost to the Commonwealth per borrower is calculated as $100 million divided by 2,500 borrowers (this is without expenses). If less money were put up for the program then in turn fewer borrowers would be helped. Therefore, it is posited that it would cost $40,000 per person to provide $24,000 in benefit. This $40,000 figure – while not necessarily the number that would be lost – is still very important in a consideration of a potential program. While the $40,000 may not be spent, the Commonwealth would

need to be prepared to lose it and would have to fund any guaranty program accordingly.

The next factor considered in the Milliman analysis was one of risk – and this includes both possible risk and likely risk. In terms of the "risk continuum", there is a model that is used by actuaries to assign risk at the loan level. For the purposes of the Commission's analysis, the 2,400 borrowers are considered. The modeling shows that if there were foreclosures on all 2,400 loans and the value of these properties went to zero – then the amount of exposure would be calculated at $539 million. Of course the modeling also takes into account the reality that not every loan will go into foreclosure. The estimate used by actuaries for these purposes is that 10% of the borrowers will lose their homes. (The reasons for these losses could be change in marital status, unemployment, or even strategic default – but it is determined that over the 4.8 average life span of these loans, 10% will default on their mortgages.)

By way of background, it is important to understand that in a traditional mortgage program there must be a level of insurance protection that is between 25% - 30% of the loan amount (assuming the borrower hasn't made a down payment of at least that much). Milliman's analysis utilized a figure of 50% coverage for loans that would be made under a hypothetical program. This higher level of coverage is necessary given the high LTV (over 100%) for many of the loans that would be made. With a high end LTV loan that has values that go beyond 125% – a more traditional 25% - 30% depth of coverage would likely not be sufficient to encourage investors to participate in the program.

Using 50% coverage then, the average loss in the program is estimated to be $25 million. (This assumes a $100 million program – and the $25 million in anticipated losses would be on 2,500 loans insured.) A simple guideline in determining a risk-to-capital requirement is four-to-one coverage. For the purposes of this hypothetical

program then, the risk capital requirement needed would be $25 million times four or $100 million.

The concept of “4x” with regard to risk is a generally accepted risk parameter in the market and would likely be the minimum amount of coverage considered. This kind of risk guidance takes into account the reality that not every future probability can be perfectly known. As such, the cost of designing a volatile line of business like mortgages in this market is done by taking an analyst’s best estimate and multiplying it by four to be 99% confident that under all scenarios there would be no need to ask for any additional funds from the state to support the program. This is important in terms of making the most prudent funding decisions. This is also important because the analysis that was done assumed that such a fund, if established, would not have any other recourse to the Commonwealth’s resources in the event of widespread loan failure.

Another factor that must be considered is the loss of income to lenders if a loan is refinanced and taken off a bank’s balance sheet. For example, the $24,000 that represents a savings to the borrower over 4.8 years is a loss of income to the bank over that time. While the issue of bank losses is not the specific focus of the Commission’s review, it is included here because it is an important consideration, although certainly not a roadblock. Additionally, the Commission is aware that community banks are working on their own modification programs and do recognize the value of customer relationships in their decision-making with regard to modifications.

The other important issue to be considered, as part of this kind of analysis, is the availability of new mortgage capital to make a first mortgage loan and the applicability of a loan guarantee fund. There began to be concern among the members about the availability of new mortgage capital and an assumption, based on a general working

knowledge of market conditions, that there would not be anyone to make these new first mortgages.

The Commission also believed it was important to have Milliman produce an additional analysis that would now include two- to four-family properties – rather than simply single-family properties. This additional analysis was completed by Milliman and is included in the Commission's report. (*Appendix IV.)*

As the work of the Commission progressed through the late Spring 2012 – there was also more conversation at the federal program level about "HARP 3.0" and the idea that there may be some movement at the federal level in the direction that the Commission has been charged with considering – and that is non-delinquent borrowers who simply want to refinance.

Throughout the Commission's meetings and deliberations – there were also questions and speculation involving the economic value that may be derived from the kind of program that the Commission is to consider. Therefore, it was determined that it would be important for the Commission members to hear from an economist – who would consider the impact that this program might have on the economy.

PAUL WILLEN – AN ECONOMIST'S PERSPECTIVE (*Appendix V.*)

Paul Willen, a Senior Economist and Policy Advisor in the Research Department at the Federal Reserve Bank of Boston made a presentation to Commission members in July.
Mr. Willen provided an overview for Commission members on issues related to the mortgage market generally and some particulars of home mortgages. The issue of negative equity and its impact on foreclosure was considered – and explained that the mere fact that a borrower has negative equity (defined as a borrower who owes more

than the value of their house) does not mean that the borrower *should* default on his or her loan nor does it mean that he or she *will* default on his or her loan.

Mr. Willen explained his belief that the reason that policy solutions to the foreclosure crisis over the last six years have failed is because they are based on the premise that "somehow millions of foreclosures can be prevented and the economy improved in all kinds of different ways without spending any money." It is Mr. Willen's assertion that policies that can help borrowers cost money – and that this money must come from lenders, investors or taxpayers.

The principals of economics might allow one to think of a mortgage as an "option" – that is – the right to buy something or sell something for a pre-agreed price. A mortgage is a contract. A borrower sells the house to the lender and gets an option to buy the house back by paying off the outstanding balance on the mortgage.

Mr. Willen explained a policy paper that he had written in 2008, whose findings are supported by the Commission. The paper examined individuals in Massachusetts in 1991 who owned houses where their mortgages were 120% or more of the value of the home. He found 53,823 borrowers in Massachusetts who fit that description and followed them over the next two years. What he found was that only 5% of those people lost their homes. The unemployment rate at that time was 9.5%. For borrowers who had LTVs of over 120% in 1994, it was found that two-thirds of them would have had less than 80% LTVs six years later. This showed the value of those borrowers keeping their mortgages.

Mr. Willen had also examined data that was more current. In looking at borrowers who had an LTV of greater than 120% in the fourth quarter of 2007, what was seen again is that most people did not lose their homes. He argues that most borrowers with negative equity "stick it out" to avoid a "buy high, sell low" strategy.

Generally, under normal circumstances, the way that a fixed rate mortgage works is that the borrower is protected from increases in the interest rate and has an option to refinance when interest rates go down. This is the deal that borrowers believe they have when they receive a fixed rate mortgage.

What borrowers did not take into account when they took these mortgages out in 2005 and 2006, Mr. Willen explained, was that house prices would fall so much that it would become impossible to refinance the mortgage; and when interest rates went down, borrowers were unable to take advantage of those low rates.

The HARP program has made it possible for people to refinance from high interest loans to low interest rate loans even though they have negative equity.

As an example, there might be a borrower with an interest rate going from 6% down to 4% - so the borrower is in fact paying less. (The 6% number is used for illustrative purposes only, but it is interesting to note that in the Milliman Report (Appendix III. Page 16), the interest rate used in the analysis titled, *Massachusetts Loan Data, Original Loan Situation,* is 6.1%.) The issue, Mr. Willen explains, is that the money has to come from somewhere. This money comes from investors. For example, there are investors who own portfolios of loans on which they are receiving a 6% rate of return. What happens is that the loan is going to be paid off in full and the investor will no longer receive 6% every month. They can go out and buy a new pool of loans, perhaps, but the new pool of loans will be paying 4%.

In this way – the money is transferred from investors to borrowers. This is significant in terms of economic theory – because while one might argue that investors generally consume a smaller fraction of their incomes than borrowers – therefore creating a positive net effect – this is not the reality. Actually – the investor is anticipating that

he or she is going to get a high return from the loan. The investor is anticipating that he or she will receive the 6% coupon not just now – but for the foreseeable future. Therefore – this represents a capital loss to the investors, which is far larger than the cash flow increase to the borrowers.

The example Mr. Willen used *(Appendix V. - page 25)* was one of a $200,000 mortgage where a borrower refinances from 6% to 4%. In this example, the borrower has a $4,000 increase in cash flow, but the lender/investor has a $20,000 reduction in wealth. While it is true – in considering the effect of consumption of this change – that the borrowers (especially credit constrained borrowers) will probably spend a large fraction of that $4,000 – and that investors (because they generally consume a smaller fraction of their income than the average borrower) are generally going to spend a much smaller fraction of their change in wealth – the key point is that the change in wealth for the investor is much bigger than the increase in cash flow to the borrower.

This means that if it were just the case that there was a $4,000 reduction in cash flow to investors, then it would be reasonable to say that the investors would probably lower their spending by 5% or 10%. However, if the lenders and investors have a $20,000 reduction in wealth, there will be a much bigger reduction in spending by the investors, which will wipe out a substantial portion of the spending by borrowers.

These explanations of economic theory were helpful in the Commission's work because an argument that many may make with regard to the value of a mortgage refinancing program is that the money that borrowers save with a reduction in interest rate is money that will then be spent in the economy – which could provide an economic boost. Unfortunately, Mr. Willen's examination of this issue provided an alternative view – explaining that because the money saved is simply a transfer from one group to another – it would likely not have a positive net effect – and in fact could be a net negative effect at worst and a breaking even at best.

In an effort to follow into the next point on the issues to be considered by the Commission, it was determined that an analysis and presentation would be important to determine if there is any money in the mortgage market to handle a refinancing program that could be contemplated by the Commission. This led the Commission to invite experts familiar with the workings of the secondary mortgage market. The guest presenters for this topic are employed with State Street Global Advisors (SSgA). SSgA is one of two or three top asset managers in the world, with over $2 trillion in assets.

STATE STREET GLOBAL ADVISORS (SSgA) – A SECONDARY MARKET ANALYSIS (*Appendix VI.*)

MassHousing had experience working on a team with SSgA for a national program where Fannie Mae and Freddie Mac were buying tax exempt mortgage bonds under the New Issue Bond Program (NIBP). SSgA was the firm behind that effort – buying mortgages and putting these types of deals together on behalf of the U.S. Treasury Department – and beyond this they have a strong understanding of the mortgage backed securitization market.

Specifically, SSgA was given the full and complete assignment to manage the assets for the Treasury and ultimately worked to dispose of about $220 billion of mortgage backed securities.

With regard to the work of the Special Commission, SSgA conducted its study by reviewing the Milliman Report that had been prepared for the Commission. Whereas Milliman did an analysis from an insurance industry perspective and sought to determine how much funding would be necessary to guarantee the fund (which as a reminder was determined by Milliman to be $100 million to guarantee the funds at

50% coverage), SSgA explored the question of whether these types of loans could be sold into the market and if so – at what cost?

As background, it is important to understand that there are two types of mortgage securities – Agency MBSs and Private Label Securities (or Non-Agency). Agency MBSs are Ginnie Mae, Fannie Mae and Freddie Mac. There is no credit risk with these. Ginnie Mae has full government backing; and Fannie Mae and Freddie Mac have implicit government backing. Payments are backed by the government so there is never a question of *whether* an investor will be paid. The only question comes with regard to *when* an investor will be paid – so there is only cash flow timing risk.

Private Label Securities – or Non-Agency Securities include a wide range of issuers and present credit risk and cash flow timing risk because there is no government backing. There are questions of both *whether* and *when* an investor will be paid back. Loans can sometimes be sold as "whole loans" but they are typically structured with an additional credit enhancement in order to be saleable.

These are important distinctions because the kinds of loans that would likely be considered in the Commission's mandate would be Private Label Securities or Non-Agency Securities rather than Agency MBSs. There are assumptions that are made in SSgA's analysis with regard to borrower characteristics – and this trends generally with those made by Milliman in their analysis. They are:

- a pool which would include borrowers with lower FICO scores than those regularly seen currently;
- a range of property types (townhomes, condos, 2-4 family homes);
- high LTV over 95%; and
- borrowers who would not qualify for government refinance programs.

Given the subset of loans defined by Milliman as eligible for this program, SSgA in turn determined that an analysis of feasibility based on an "Alt-A" pool of loans would be the best market proxy vehicle. The reason that these loans would be considered Alt-A – and therefore below prime "A" loans – is generally driven by inclusion of borrowers in the program with lower FICO scores. The loan-to-value ratios which would be included are also problematic – as well as the fact that these loans were already Non-Agency loans and likely included other risk factors that prevented them from being sold to the GSEs in the first place.

SSgA completed a detailed analysis of a series of recent market funding transactions in order to determine the likely outcome if a program were created in the Commonwealth based on the mandate of the Special Commission – and to consider how such a program might be funded.

As importantly, is the issue of the market – or pool of investors – that would potentially purchase these loans. Given the loan characteristics – which can be understood to present some risk – the investors would likely need to be paid a higher rate of return in order to be willing to take this investment risk. Again – this poses a problem – because at its most basic level – the number at which an investor would be willing to purchase the loan is likely not lower than the percentage rate that the borrower is paying currently – and in fact could actually be higher.

SSgA, in their analysis, noted that the loans that would likely be considered in this program are seasoned and performing – which is an advantage in terms of trying to sell them. However, they are high LTV and could have low FICO scores – and this erases the potential benefit – and defines the risk.

Beyond this – SSgA explained that because of the crisis in the mortgage market, rating agencies are reluctant to rate proposals that are not backed by prime collateral. Given

this factor, it is a big assumption that a program like the one that is contemplated by the legislation could be rated. Even with a potential enhancement, a rating for this type of program would be difficult to obtain – and as a practical matter – if a pool of loans is not rated it likely cannot be sold in today's market at a reasonable cost.

SSgA provided the Commission with a very detailed analysis of historical trends in the market most recently – which were used to inform a discussion of pricing for a product such as the one contemplated by the Special Commission. Specifically, SSgA took the Milliman study and developed an analysis based on the world as it existed in November 2012 – with the same type of mortgages that Milliman had considered – and then provided an analysis of where it might price today. As part of this analysis, SSgA had to assume that these loans would need to be sold back into the market to recoup the capital that would be required to purchase them out of the banks where they are currently held. Overall – SSgA arrived at an assumption that only 70 cents on the dollar would come back – on average from the purchase and re-sale of these loans. Additionally, SSgA's estimate is that it would require approximately $260 million in upfront capital to purchase the pool of loans that has been estimated to exist in the categories as outlined by the legislative mandate for the Special Commission's work. It is also estimated that even if a smaller subset of loans – those with a higher FICO score for example – are created, there would still be a substantial potential loss.

The analysis provided by SSgA, while drawn from the assumptions used in the Milliman report, utilizes a different strategy. Whereas the Milliman strategy would involve purchasing these loans from the institutions where they currently reside and then holding them – SSgA considers the possibility of buying these mortgages from existing lenders/investors, aggregating them and then selling them back into the marketplace. Unfortunately, their analysis proved that this strategy is also very expensive – as is Milliman's strategy – albeit for different reasons.

In the case of buying these mortgages, aggregating them and selling them back, the SSgA analysis shows that approximately 30 cents on the dollar will be lost. The Milliman analysis determined that there would be a requirement of at least $100 million in upfront capital required. In the SSgA analysis, it was determined that there would be a need for approximately $260 million in upfront capital. There was some discussion among Commission members about whether there might be a way to recoup some of this loss by asking the homeowner to provide reimbursement, at the end of the loan, for this improvement in interest rate. This reimbursement would come either through equity or at the sale of the home.

Unfortunately, while this concept had been discussed at some length on the national level under the HAMP program – it has never been implemented and no one seems to have a successful model under which this kind of plan would work. Also, the problem is that while a plan like this might recoup some of the losses – it could not possibly eliminate them.

One other idea discussed among Commission members with SSgA, although not analyzed in any great depth, was the idea of compensation to banks for keeping a loan on their books – but reducing the interest rate. Unfortunately, this makes it an institution by institution discussion as to whether a bank would accept a lower rate – or allow a loan to be prepaid in its entirety at some lower rate of return (for example 90 cents on the dollar) in order to reduce future risk. This would also raise a problem, however, because of the need for creating a program at scale. It also becomes more challenging if there are a series of "one-off" conversations with dozens of lenders. This is further complicated when it comes to nation-wide lenders who would be asked to do something different for mortgages in Massachusetts than they are doing elsewhere.

Another idea which was discussed was the possibility of pulling out higher credit quality loans and trying to do those on their own. However, even going up to 720 or 740 on a FICO score did not mean that it would be a no-investment proposition – just a smaller one. Unfortunately, the reality is that there will still be a cost – and the cost may be too great to justify the benefit that would be provided.

FINDINGS AND RECOMMENDATIONS

The Commission finds that providing Massachusetts state government sponsored home mortgage refinancing assistance to non-delinquent homeowners is infeasible at any reasonable cost in the current mortgage market. As directed, the Commission considered the idea of providing refinancing assistance for residents of the Commonwealth, who, due in part to a loss of income, a depreciation in the value of their real estate, or the current refinancing exposure criteria as established by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, are unable to refinance at a lower market interest rate. The Commission finds that it would be infeasible to establish a fund encumbered by the Commonwealth to be pledged to the Massachusetts Housing Finance Agency as a mortgage refinance guarantee – given the prohibitively high cost of such a program.

Given the breadth and scope of the Commission's research and examination of the mandate by the Legislature there is no dispute that unfortunately, there are a number of borrowers in the Commonwealth at this time who cannot refinance their mortgages because of the factors identified. The Commission finds further that these borrowers likely cannot refinance if they have experienced one of the factors named (i.e. loss of income, depreciation of home price, and current refinancing exposure criteria) or if their mortgage is not held by Fannie Mae, Freddie Mae or the FHA.

Consider, for example, two hypothetical borrowers who live side by side in a hypothetical city or town in Massachusetts. Both hypothetical borrowers are current on their mortgages, both borrowers have an interest rate of 6% and both borrowers have homes that are “underwater” – which is to say that they owe substantially more on their homes than the current appraised value of the homes.

In this hypothetical scenario – if Borrower A had a loan from a local or national bank that had been sold into the secondary mortgage market at the time of purchase (i.e. Fannie Mae, Freddie Mac) or it was an FHA loan and Borrower B had a loan from a local or national bank that had been held in the financial institution’s portfolio, Borrower A could have several options available to him or her with regard to refinancing whereas Borrower B would not.

It has been argued by some that this circumstance is inherently unfair. It is certainly a reality that has been brought into sharp focus as part of the Commission’s analysis – but the corollary reality is also as pointed. This is the reality that it would be very difficult – and extraordinarily expensive – for the Commonwealth to fund any kind of mortgage refinance guarantee to benefit this subset of borrowers.

The Commission would encourage community banks and other state-wide lenders who hold mortgages in this state to continue to work with borrowers to whatever extent possible to refinance these homes. However, the Commission also acknowledges that, in many instances, these lenders cannot simply reduce interest rates without having a funding structure in place that would make up the difference of the interest rate reduction.

The Commission’s analysis shows generally that there may be approximately 2,500 borrowers who could potentially benefit from a refinance program in the Commonwealth such as the one considered by the Commission. However, the derived

benefit – of approximately $24,000 per borrower would likely carry a price tag – in terms of public benefit expended of anywhere between $24,000 and $40,000 per borrower. **The Commission believes that in spite of this potential benefit, the cost of such a program – (estimated at $100 - $260 million) – cannot be justified.**

Another serious challenge that was considered by the Commission was the process of selling these potentially refinanced mortgages into the secondary mortgage market. On this point, the analysis received as part of the Commission's work determined that the potential for this sale was not guaranteed. In fact, there exists a distinct possibility that the loans could not be packaged or sold – or that if they were – the cost would be such that the interest rate to borrowers may not be desirable – or the potential loss to the Commonwealth would prove too great. The broad estimate in terms of potential loss on this investment would be $300 million.

It is also important to note that mortgage refinance programs that are state-centric are difficult to implement – although this was not a determining factor. It is simply acknowledged by the Commission that it may be challenging for lenders who have a presence in more than one state to participate in a program that offers benefits in one state that are not available in another.

This finding leads to an important recommendation of this Commission:

- ❖ To encourage the federal government to develop a program which could serve to dovetail with the existing HAMP and HARP programs that might serve non-delinquent borrowers who mortgages loans are not held by the FHA or one of the GSEs.

One such step has already been taken in Massachusetts with the Division of Banks recent Guidance issued on December 27, 2013. The Commission would like to

acknowledge the recent clarification by the Division of Banks, *Guidance Relative to Residential Mortgage Loan Modifications for Non-Delinquent Borrowers and Troubled Debt Restructuring (TDR),* of December 27, 2012. (Appendix IX.)

In this guidance, the Division has clarified that, "in cases where both the borrower and his or her current lender wish to modify the terms of a mortgage loan that is current and performing (i.e. non-delinquent) and the only concern is that the collateral value has fallen below the outstanding loan amount (typically referred to as being "underwater"), that credit may not necessarily have to be classified as a TDR."

The Commission believes that this guidance provides great value to lenders in helping them to be responsive to the needs of their borrowers and to make carefully considered decisions regarding mortgage modifications for customers who would benefit from such a modification. This new guidance from the Division of Banks, which helps lenders to better understand whether or not its mortgage modifications in certain instances will trigger accounting requirements, is an important issue that has been addressed in a favorable way for Massachusetts banks – and by extension – their consumers. The Commission is hopeful that this guidance may help – in certain instances – some of the very borrowers whose circumstances have been the subject of the Commission's work.

Specifically, the new guidance states that, "If a residential mortgage borrower and his or her lender wish to modify the terms of a mortgage, the singular fact that the loan is underwater does not necessarily constitute a TDR provided that the borrower is:

(a.) performing satisfactorily under his or her mortgage loan, and
(b.) not experiencing financial difficulties."

The guidance goes on to state that, "A lender may choose to modify a residential loan under the revision in mortgage terms statute (Massachusetts General Laws Chapter 183, Section 63A). As with any loan modification program, lenders should have policies and procedures in place to address and document all modification requests in a consistent manner."

Additionally, as reported in the "*Housing Affairs Letter*" in his recent State of the Union Speech, President Obama, "pressed Congress to expand help for troubled homeowners in order to keep the momentum of the housing market on course. (President) Obama wants to allow responsible homeowners to refinance their loans at existing low interest rates, and says doing so will boost housing and the broader economic recovery." President Obama wants to give "homeowners without government-backed loans an opportunity to refinance." This would likely prove a benefit to many of the borrowers whose current challenges in the area of mortgage refinancing were considered by the Commission.

CONCLUSION

The Commission is grateful for the participation of the various government officials, government agencies, quasi-public agencies and private companies. The detailed analyses that were provided to the Commission in its consideration of these important issues were crucial in determining the cost of a potential program and its potential scope. While the Commission does not recommend that the Commonwealth create a new mortgage refinancing program, it does recommend continued attention to this concept and in particular continued attention by the federal government to meet the needs of unserved borrowers.

RESPECTFULLY SUBMITTED,

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