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Melvin L. Watt, Director
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Washington, D.C. 20024

Dear Director Watt:

Since its creation in 2008, the Federal Housing Finance Agency (FHFA) has played a critical role in guiding the recovery of our nation's housing market. During that same period, our office, along with Attorneys General from across the country, has worked to address the underlying causes of the foreclosure crisis, and to stabilize and rebuild the hardest-hit communities. As FHFA enters a new chapter, and as Congress considers the future of the Government-Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, now is an opportune time to raise several issues that we believe are critical to ensuring a robust recovery from the foreclosure crisis.

Specifically, we believe that buyback programs implemented by credible not-for-profit institutions, and loan modification programs that permit principal reductions for distressed borrowers, are key to helping homeowners recover from this foreclosure crisis and restoring a healthy economy. At the outset, I note that while we had several exchanges with your predecessor on these and other related issues, we were ultimately unable to achieve meaningful progress. However, since assuming FHFA's directorship earlier this year, we have had very productive exchanges with your staff. Accordingly, it is my hope that we can work together to ensure that FHFA promptly adjusts its policies in these and related areas.

Non-Profit Buyback Programs. Massachusetts has had tremendous success with so-called "buyback" programs, such as Boston Community Capital's (BCC) Stabilizing Urban Neighborhoods (SUN) Initiative. Through the SUN Initiative, BCC purchases a home (which is generally owned by the lending bank) at its current market value and finances its immediate resale to the former homeowner. SUN adheres to strict and conservative underwriting standards and provides only 30 year fixed-rate mortgages; indeed, the rate of default on their mortgages is below the national average. As a result, financing is extended only to those homeowners who can truly afford to stay in their homes, thus preventing displacement, avoiding the blight of abandoned homes, and stabilizing neighborhoods all in one thoughtful program. Through this initiative, nearly 500 families in Massachusetts have been able to remain in their homes and have



seen their monthly mortgage payments cut to a level that reflects the property's true market value.

A related statute, Massachusetts G.L. c. 244, § 35C(h), prohibits a creditor that sells a property to a 501(c)(3) tax-exempt organization from conditioning such sale on a requirement that the property not be resold or rented to the former homeowner. To date, the GSEs have not complied with this provision, which has unfortunately impeded the ability of buyback programs to maximize the number of borrowers they can assist – which in turn has hindered the broader goals of neighborhood stabilization and revitalization.

For example, Freddie Mac currently refuses to participate in a BCC-sponsored buyback transaction in Boston's Upham's Corner neighborhood. Freddie Mac's recalcitrance in this regard both hurts the homeowner that had previously fallen victim to subprime lending practices, and undermines broader community stabilization efforts in this hard-hit neighborhood.

We raised this issue in recent conversations with your staff, and are hopeful that FHFA will expeditiously amend its policies to allow the GSEs to participate in these community-based buyback programs. We hope that these changes are promptly adopted, and my staff is available to work with you to this end (including exploring policy mechanisms that will ensure fairness).

However, our office also is considering all available legal avenues – including litigation – to ensure compliance with Massachusetts law, should FHFA fail to promptly amend its policies to allow the GSEs to participate in credible buyback programs.

Principal Reduction. As previously raised with FHFA in both formal and informal communications, we believe that loss mitigation programs that employ principal reduction as one of many available options are most effective in achieving affordable and sustainable loan modifications. Moreover, a loan that is modified such that the borrower can afford to stay in the home and continue paying is generally far more financially advantageous for lenders and investors when compared to foreclosure. As such, modifications utilizing principal reduction can help preserve and conserve the GSEs' assets, a FHFA mandate, while also stabilizing families and neighborhoods (a second FHFA mandate). Data from HAMP and the national mortgage settlement clearly demonstrate that principal reduction is an effective method of addressing negative home equity. Numerous studies (including from the Congressional Budget Office and the Federal Reserve), and our experience through the Massachusetts HomeCorps program, demonstrate that principal reduction guided by a net-present value (NPV) analysis can generate affordable and sustainable loan modifications.

While we recognize FHFA's concerns surrounding principal reduction – based on predictions of moral hazard and strategic default – we ultimately believe them to be overstated and largely unsubstantiated. In other words, the abstract fear of waves of strategic defaulters is insufficient to justify a wholesale rejection of principal reduction as an available tool. To the degree that these concerns are legitimate, we believe that they can be addressed through thoughtful policy mechanisms, such as clear modification underwriting standards, a showing of hardship by the borrower, and shared home value appreciation. Additionally, some policy options – such as

incremental principal reduction that is phased in if the borrower remains current – have been employed successfully here in Massachusetts.

At this juncture we urge FHFA to promptly reevaluate the GSEs' principal reduction policies. Every day, families and communities continue to suffer the harmful consequences of unnecessary foreclosures because of FHFA's refusal to authorize principal reduction as a loan modification tool. As we are all well aware, the housing recovery has been notably uneven, with the hardest hit areas still struggling to recover. We believe that principal reduction, when considered among an arsenal of other loss mitigation options, will substantially accelerate recovery from the foreclosure crisis, particularly in those communities most deeply affected by the market meltdown. At the same time, we recognize that adopting a fair and effective principal reduction policy would mark a major shift for the GSEs. Accordingly, my office is prepared to work with you and your staff to craft a reasonable and fair principal reduction policy that guards against any potential abuse. As noted earlier, my office has firsthand experience with the types of programs and policies that have both utilized principal reduction and effectively precluded strategic defaults, and we would be happy to share our experiences with you.

Additional Issues. Finally, we would also like to discuss the GSEs' interpretation of our state laws governing foreclosures, G.L. c. 244, § 35B. We understand Fannie Mae's interpretation of this law unnecessarily precludes a whole class of borrowers from review for certain types of loan modifications. Such a result is contrary to the goals of this statute, which is intended to provide additional protections for those borrowers whose loans have predatory characteristics. Again, my staff can discuss this at greater length with you and your staff at your convenience.

Thank you for your attention to these matters. I look forward to continuing to work with you on these and other important issues.

Cordially,



Martha Coakley
Attorney General

cc: Senator Elizabeth Warren
Senator Edward Markey
Secretary Shaun Donovan, U.S. Department of Housing & Urban Development
Director Richard Cordray, Consumer Finance Protection Bureau