

THE COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF THE ATTORNEY GENERAL

ONE ASHBURTON PLACE  
BOSTON, MASSACHUSETTS 02108

MARTHA COAKLEY  
ATTORNEY GENERAL

(617) 727-2200  
[www.mass.gov/ago](http://www.mass.gov/ago)

April 11, 2012

Edward J. DeMarco  
Acting Director  
Federal Housing Finance Agency  
400 7th Street, SW  
Washington, DC 20024

**Re: Fannie Mae and Freddie Mac Must Re-evaluate  
and Utilize Principal Write-downs in Loan Modifications**

Dear Director DeMarco:

We write on behalf of the eleven states listed below to continue our dialogue concerning the Federal Housing Finance Agency's (FHFA) ability to preserve assets and prevent unnecessary foreclosures by implementing loan modifications that include principal write-downs, guided by a transparent net-present value analysis. Current data, including FHFA's most recent report, and the recent testimony on March 15, 2012 before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Housing, Transportation and Community Development, support taking these critical next steps.

More than five million people have lost their homes due to foreclosure in the past five years, with millions more on the brink of foreclosure. Effectively resolving this foreclosure crisis is a key to restoring a healthy economy for our entire country. Because Fannie Mae and Freddie Mac own a majority of the nation's home loans, they must be a leader in the arena of loan modification best practices, and not an obstruction.

FHFA's continued position that principal forgiveness conflicts with its goal of asset preservation is not supported by real data. As acknowledged in your letter to the Committee on Oversight and Government Reform dated January 20, 2012, "... under the Emergency Economic Stabilization Act of 2008 (EESA), FHFA has a statutory responsibility to maximize assistance for homeowners to minimize foreclosures. Under EESA, FHFA must consider the net present value (NPV) of any action undertaken to prevent foreclosures." While your most recent analysis in that letter acknowledges that taxpayer savings can be achieved by using principal forgiveness rather than forbearance, we believe your analysis would reflect even greater savings if based on real data and realistic assumptions.



Letter to Edward J. DeMarco  
April 11, 2012  
page two

Your modification analysis compared all NPV positive loans employing principal forbearance with all NPV positive loans employing principal forgiveness. FHFA's models need not assume one size fits all. A proper NPV analysis must be applied on a loan by loan basis.<sup>1</sup>

Further, the NPV model should consider all of a borrower's debts, not just the monthly mortgage debt, be uniform, transparent, and publicly disclosed. Your NPV test is completely model driven and FHFA's analysis cautions that the model used may not be appropriate. We encourage the FHFA to use actual results in its analyses where real data are available, including data from HAMP, and the anticipated data from the "Multistate Servicing Settlement."<sup>2</sup>

Additionally, principal forgiveness, in contrast to principal forbearance, actually improves an underwater borrower's equity position. This restores the borrower's status as a stakeholder and instills hope that she might eventually own the property outright. This psychological effect of ownership is powerful. It is not only common sense that this will incent homeowners to maintain loan payments resulting in lower re-default rates, but indeed there is research that corroborates this.<sup>3</sup>

Finally, the recent tripling of incentive payments to mortgage investors who allow principal reduction under HAMP should substantially reduce FHFA's concerns as to the impact principal reductions would have on the financial stability of the GSEs who also participate. The payouts ranged between six and 21 cents to the investors for each dollar forgiven under HAMP, but that will grow to between 18 and 63 cents.<sup>4</sup>

---

<sup>1</sup> "Traditionally, servicers have higher recoveries the greater the range of strategies asset managers and loss mitigation staff can use." FitchRatings, Global Rating Criteria for Structured Finance Servicers, August 16, 2010.

<sup>2</sup> Testimony of Laurie S. Goodman, Amherst Securities Group LP to the Committee on Banking, Housing and Urban Affairs Subcommittee on Housing, Transportation and Community Development, March 15, 2012.

<sup>3</sup> "The data indicate that the re-default rate declines with the magnitude of the reduction in the monthly payment, but also that the re-default rate declines relatively more when the payment reduction is achieved through principal forgiveness as opposed to lower interest rates." Federal Reserve Bank of New York, Staff Reports, "Second Chances: Subprime Mortgage Modification and Re-Default, August 2010.

<sup>4</sup> Supplemental Directive 12-01 February 16, 2012, Making Home Affordable Program – Principal Reduction Alternative and Second Lien Modification Program Investor Incentives Update.

Letter to Edward J. DeMarco  
April 11, 2012  
page three

There are loans in every portfolio where principal write downs are the proper business decision. We urge FHFA to reevaluate its position and utilize forgiveness as a tool in the modification of GSE owned or insured loans. With principal forgiveness FHFA can achieve its combined goal of asset preservation and foreclosure prevention. Concerns that second lien holders receive a windfall at taxpayers' expense can be addressed by requiring both first and second lien holders to adopt pro-rata principal write-downs for loan modification, as contemplated in the recent Multistate Servicing Settlement. As the largest mortgage holder in the country, the GSEs have significant leverage to require their servicing vendors to adjust practices in a manner that will increase the return to taxpayers and also prevents unnecessary foreclosures. Further taxpayer protections can be achieved by equity sharing agreements between homeowners and lenders should property values appreciate, when permitted by law.

Reluctance to principal reduction programs on the basis that internal computer systems at servicers and investors are not set up to handle principal reduction is not an excuse.<sup>5</sup> The nations' largest banks overcame similar concerns in the context of the Multistate Servicing Settlement and are now on their way toward implementing principal reduction programs. An investment in updating computer systems is well worth the cost, especially when the return to taxpayers and the housing market is so clear.

We welcome an opportunity to further discuss these issues with you and work towards solutions to the housing and economic crisis. Please contact our Consumer Protection Division Chief, Stephanie Kahn, at (617) 963-2986 or Deputy Attorney General Chris Barry-Smith at (617) 963-2539 if you are interested in working together to address our concerns.

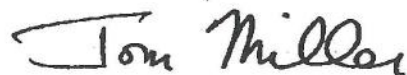
Cordially,



Martha Coakley  
Massachusetts Attorney General



Eric Schneiderman  
New York Attorney General



Tom Miller  
Iowa Attorney General

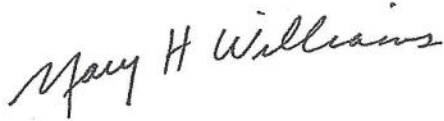


Gary King  
New Mexico Attorney General

---

<sup>5</sup> Edward J. DeMarco letter to the Committee on Oversight and Government Reform dated January 20, 2012.

Letter to Edward J. DeMarco  
April 11, 2012  
page four



Mary Williams  
Deputy Attorney General  
Oregon



Joseph R. Biden, III  
Delaware Attorney General



Lisa Madigan  
Illinois Attorney General



Douglas Gansler  
Maryland Attorney General



William H. Sorrell  
Vermont Attorney General



Lori Swanson  
Minnesota Attorney General

By: Elliot Burg  
Assistant Attorney General



Kamala D. Harris  
California Attorney General