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Re: No. 2012-N-1

To Whom It May Concern:

I am a professor at CUNY School of Law teaching bankruptcy, contracts, commercial and consumer protection law. I have written extensively about the subprime mortgage market, the foreclosure crisis and mortgage servicing, including some empirical research regarding the effect of state laws on mortgage origination and default rates.[1] I am currently serving as co-reporter for the Uniform Law Commission committee on residential mortgage foreclosure process and protections, and have in that connection engaged in extensive study of existing state foreclosure laws and mediation processes. Professors Adam Levitin of Harvard Law School and Elizabeth Renuart of Albany Law School join me in this comment. Professor Levitin has written a separate comment letter, to which I am also a signatory.

FHFA has proposed to increase the guarantee fee, i.e. the wholesale price of mortgage loans, in five states it characterizes as having "exceptionally high costs", as a result of "state laws and practices," namely Connecticut, Florida, Illinois, New Jersey, and New York. The FHFA proposal to price discriminate in the purchase of residential mortgages based on a single state-law environment variable is completely lacking in a factual, cost-related basis. Pricing based on credit risk should be based solely on actual and projected risk-related costs, rather than political ideology. This pricing proposal does not even attempt to properly associate the proposed variable (state foreclosure processes) with enterprise costs, or to isolate the variable's effect on credit costs from the effects of other variables. It is thus based on a demonstrably inadequate model and on false factual assumptions.

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[1] *The Impact of Federal Pre-emption of State Anti-Predatory Lending Laws on the Foreclosure Crisis,* 31 Journal of Policy Analysis and Management 367 (2012) (with Lei Ding, Carolina Reid and Roberto Quercia); *The Impact of State Anti-Predatory Lending Laws on the Foreclosure Crisis,* 21 Cornell Journal of Law & Public Policy 247 (2011) (with Lei Ding, Carolina Reid and Roberto Quercia); *State Anti-Predatory Lending Laws and Neighborhood Foreclosure Rates*, 33 Journal of Urban Affairs 451 (2011) (with Lei Ding, Carolina Reid and Roberto Quercia).

My comments are limited to the faulty factual and modeling assumptions underlying the pricing proposal. There are independent policy-based objections to this novel attempt to use GSE mortgage pricing to influence state legislatures, based on considerations of constitutional federalism and the role the GSEs should play in smoothing out mortgage credit availability, that I will not address.

Credit losses on mortgages are the product of the expected default rate and the loss rate given default, i.e. loss severity. The loss rate given default, in turn, depends on the rate of three competing outcomes after a loan goes into default: cure, prepayment and foreclosure sale, as well as the loss severity experienced for each of these three competing outcomes. The FHFA proposal does not even attempt to measure the impact of state foreclosure laws (leaving aside all other state laws that may impact losses) on default rates, cure rates, or prepayment rates, but instead considers only the impact of the state laws on loss severity for foreclosed properties. Even with respect to loss severities, the proposal considers only two aspects of that cost factor, the foreclosure timeline and carrying costs, omitting the subsequent REO carrying costs and loss on resale. Moreover, the proposal fails to adequately determine the causal effect that state laws have on foreclosure loss severities by ignoring other known causal factors, such as servicer and attorney practices and exogenous variables impacting home price movements. In the comments below, I will consider each of the gaps in the FHFA analysis in turn.

The gaps in the model can be summarized as follows:

1) default rates are not uniform across the country, but vary from state to state,

2) The variation in default rates is in a different direction than the variation in foreclosure timelines, i.e. states with longer foreclosure timelines have a lower default rate (or higher cure rates),

3) Other state law variations, including laws that govern both mortgage servicing and origination, likely have an impact on default and loss rates, so that if FHFA wishes to "punish" states for foreclosure delays it ought to "reward" them for other laws that reduce defaults and increase cures, and

4) Loss severity and foreclosure timeline delays are not caused solely or primarily by provisions of state law, but are also a function of servicer and attorney behavior that pricing incentives are unlikely to alter, and that FHFA could alter more directly through contract enforcement,

5) Loss severities variations among states are also a product of non-legal environmental variables such as home prices, and

6) The model completely ignores the external costs that accelerated foreclosure proceedings impose on local housing markets, which in turn significantly affect GSE losses.

The proposal begins by saying: "Recent experience has shown a wide variation among states in the costs that the Enterprises incur from mortgage defaults." However, the proposal does not actually give any data on the bottom line aggregate default loss costs experienced by the enterprises state by state, in relation to loan volume. That would require providing data on default rates, cure rates, prepayment rates, and loss severities, by state, which the proposal does not do. Thus, for example, if state A has a 900-day foreclosure timeline, but a default rate of only 5% and a 50% cure rate, and state B has a 300-day foreclosure timeline with a 20% default rate and a 10% cure rate, losses will likely be higher in state B, the state with the shorter foreclosure timeline.

The methodology set forth in the proposal relies on three metrics that do not in themselves demonstrate a direct cost effect of state foreclosure laws. Instead, these metrics are just some of the components of loss severity, which is itself just one component of actual credit losses. The three metrics are 1) "the expected number of days that it takes an Enterprise to foreclose and obtain marketable title to the collateral backing a mortgage in a particular state", 2) average per-day carrying cost that the Enterprises incur in that state, and 3) "the expected national average default rate on single- family mortgages acquired by the Enterprises. To estimate the magnitude of the state-level differences in average total carrying cost, the estimation assumes that loans originated in each state will default at the national average default rate."

This third element includes a vital, and demonstrably false, assumption, i.e. that all states have the same mortgage default rates. Mortgage default rates vary considerably from state to state, as an examination of the Mortgage Bankers Association's quarterly National Delinquency Survey will show. More importantly, it ignores the equally important fact that the variable at issue, namely state foreclosure laws, may have an important effect on default and cure rates. FHFA assumes that variations in default rates (and presumably cure rates, although they are not mentioned) are entirely driven by loan quality at origination, a demonstrably false assumption. For example, there is evidence that judicial foreclosure states have higher rates of default cures than nonjudicial foreclosure states.[2] Thus, the precise vector FHFA proposes to use as a reason to increase prices (lengthier state foreclosure processes) might actually decrease credit loss costs. Moreover, FHFA has access to actual data from the GSEs that it could use to develop a more complete model of loss variation among states. It would not be difficult to measure state-to-state variations in default rates, cure rates and prepayment rates, rather than creating a cost model that ignores these data and relies on a key false assumption.

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[2] Collins, J. Michael, Herbert, Christopher E. and Lam, Ken, State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default (October 2010),http://ssrn.com/abstract=1475505; Capozza, D., & Thomson, T, Subprime transitions: Lingering or malingering in default? 33 Journal of Real Estate Finance and Economics 241-258 (2006); Cutts, A. C., & Merrill, W, Interventions in mortgage defaults: Problems and practices to prevent home loss and lower costs. In N. P. Retsinas & E. S. Belsky (Eds.), Borrowing to live: Consumer and mortgage credit revisited 203-254 (2008). Washington, DC: Brookings Institution Press.

There are other important variations among states as to laws that regulate the risk of mortgage loans at origination, and as to laws designed to mitigate losses in mortgage servicing. Anti-predatory lending laws, for example, have had a demonstrable impact on reducing default rates by reducing the origination of poorly underwritten mortgages.[3] State laws calling for homeowner counseling and foreclosure mediation have also clearly reduced defaults.[4] Apart from laws regulating origination and servicing behavior, states have funded programs to reduce foreclosures and increase default cures, including the Pennsylvania HEMAP loan program, New York's funding of homeowner counseling and legal assistance, and similar programs. Thus, if it is appropriate for FHFA and the GSEs to price discriminate among states based on the effect of state laws on credit losses, FHFA needs to consider the effect of all state laws, regulations and programs, not just the foreclosure timelines.

Cure rates for defaulted loans are higher than the national average in four of the five states singled out by FHFA for surcharges. My own computations from the publicly available Wells Fargo CTS loan-level data for subprime and alt-A mortgages found that nationally, 28.6% of mortgages defaulting between 2007 and 2011 cured or prepaid, while 49% were foreclosed and 22% remained delinquent. The cure/prepaid totals for New York, Connecticut, New Jersey, and Illinois were 38.7%, 37.2%, 34.1%, 29.3%, respectively. Only Florida, at 21.6% cured or prepaid, did worse than the national average. Arizona, one of the states with the shortest foreclosure timelines, had one of the lowest cure/prepaid rates of 22.2%. A complete table of these computations is provided in the appendix to this comment. States with higher cure rates should have lower loan losses, other things being equal.

FHFA's proposal also assumes that "state laws and practices" are the cause of the foreclosure timeline variations. The proposal is a transparent effort to influence the legislatures who make those state laws. After all, if the variations were a result, for example, of poor default management by GSE contractors in certain states, charging homebuyers in those states a premium would make little sense.

The foreclosure timeliness published by FHFA are clearly not just the sum of the notice and other legally-mandated periods that must expire in the various states. In New York, for example, the timeline used by the GSEs of 820 days is almost quadruple the time that would be required for a servicer to follow the legally required steps to foreclose, from notice of default to a completed sale. In other words, the timelines established by the GSEs reflect not only state legal requirements but also the delays caused by the relative volume of foreclosures, and the competence and diligence of law firms and of the servicers. In New York, a single law firm that handled 40% of all foreclosures in the state, Stephen J. Baum and Associates, was forced to close in the wake of the robo-signing

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[3] Carolina Reid et. al., The Impact of State Anti-Predatory Lending Laws on the Foreclosure Crisis, 21 Cornell Journal of Law & Public Policy 247 (2012)

[4] Collins, J. Michael, Herbert, Christopher E. and Lam, Ken, State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default (October 2010) http://ssrn.com/abstract=1475505.

scandal, and resulting delays have greatly extended foreclosure timelines in that state. New York's court policy requiring attorneys to certify the accuracy of mortgage servicer foreclosure complaints has led to foreclosure firms in the state refusing to proceed, and to a lawsuit by homeowners demanding that the firms file the necessary paperwork to move cases forward. New York foreclosure delays, in other words, are attributable to a considerable degree to the practices of servicers and foreclosure attorneys, who are contractors and agents of the GSEs.

Other states have experienced extended foreclosure timelines simply because they have experienced particularly high volumes of defaults. Florida is perhaps the most obvious example of this. Thus, the interstate variation in default rates is not independent of foreclosure timelines, and price discrimination based on those timelines is partly just double-counting default risk.

There is also likely to be significant variation in foreclosure timelines from one year to the next, and even one quarter to the next, and it is difficult to see how pricing surcharges based on these timelines can avoid arbitrariness. The risk-based pricing pretext advanced by FHFA presupposes that the foreclosure timelines it would use are predictive of the timeliness that will govern future foreclosures of newly originated mortgages, a dubious assumption.

Another factor that affects GSE losses not mentioned in the FHFA proposal is the time to market REO and the ultimate resale price. Other things equal, a state with faster foreclosures will likely have a larger REO inventory (with fewer loans in process, cured, prepaid, sold at short sale, or otherwise diverted from REO). That larger inventory, in turn, will increase the supply of houses for sale, extending disposition timelines and reducing resale prices. More broadly, the state laws and processes that in part are delaying foreclosures in order to increase loss mitigation outcomes have positive externalities for the local housing market, in preventing vacancies and REO inventory, that will reduce GSE losses. FHFA's proposal fails to provide any data about the distribution of REO among the states, and the carrying periods and losses experienced in those states, again treating cost variables as independent when they are clearly related.

In summary, FHFA's proposal assumes that the GSEs can accurately measure the independent, risk-weighted marginal cost of losses caused by state foreclosure laws and procedures. The proposal falls woefully short of even attempting to adequately measure this marginal cost, and its pricing proposal can thus be seen for what it is: an ideological effort to influence state laws that current FHFA and GSE management disapprove.

Very truly yours,

Alan M. White

	Foreclosed	Voluntary Prepaid	Cured	Active Delinquent	Modified	cure + prepaid
		FinalOutcome - Subprime loans Delinquent 2007 to 2011, at June 2011			*(Excludes unknown outcomes)*	
US TOTAL	**49.10%**	**10.30%**	**18.30%**	**22.30%**	**17.47%**	28.6%
MI	71.20%	6.30%	12.70%	9.70%	13.79%	19.0%
NV	64.80%	6.10%	9.40%	19.70%	13.65	15.5%
MN	63.50%	8.30%	14.70%	13.40%	16.51	23.0%
AZ	62.30%	8.80%	13.40%	15.40%	16.62	22.2%
CO	59.70%	11.60%	15.70%	12.90%	14.63	27.3%
OH	58.40%	7.00%	18.00%	16.60%	15.94	25.0%
CA	56.10%	8.30%	15.50%	20.10%	17.24	23.8%
MO	55.30%	10.60%	19.70%	14.30%	18.19	30.3%
IN	55.10%	8.50%	19.70%	16.70%	14.95	28.2%
RI	54.40%	10.20%	16.70%	18.70%	19.46	26.9%
VA	51.30%	13.00%	18.90%	16.80%	17.15	31.9%
GA	50.80%	10.90%	20.30%	18.00%	17.79	31.2%
KS	50.50%	11.20%	21.40%	16.90%	16.20	32.6%
NH	49.80%	12.80%	19.40%	18.00%	20.07	32.2%
WI	49.80%	10.70%	19.60%	19.90%	20.78	30.3%
IA	49.30%	12.20%	21.90%	16.60%	17.56	34.1%
KY	49.00%	11.90%	21.40%	17.60%	16.40	33.3%
SD	48.50%	17.00%	19.20%	15.40%	18.17	36.2%
ID	46.70%	17.30%	17.70%	18.20%	17.37	35.0%
IL	46.50%	10.00%	19.30%	24.10%	19.66	29.3%
NE	46.50%	12.70%	25.20%	15.60%	18.62	37.9%
MA	46.30%	12.20%	19.50%	22.00%	19.12	31.7%
TN	45.10%	12.20%	23.50%	19.10%	17.36	35.7%
AL	44.30%	13.70%	22.60%	19.40%	17.44	36.3%
FL	43.80%	8.60%	13.00%	34.60%	14.74	21.6%
OK	43.50%	13.70%	24.00%	18.90%	15.95	37.7%
ME	43.40%	13.00%	20.80%	22.80%	19.25	33.8%
TX	42.30%	12.50%	27.50%	17.60%	18.82	40.0%
MS	41.00%	11.80%	26.10%	21.10%	18.92	37.9%
AR	40.40%	12.20%	28.10%	19.30%	16.40	40.3%
SC	39.70%	12.00%	26.10%	22.20%	18.28	38.1%
WV	39.70%	10.80%	29.90%	19.60%	22.27	40.7%
NC	38.60%	13.50%	26.70%	21.20%	20.06	40.2%
XX	38.10%	4.50%	13.10%	44.20%	16.06	17.6%
OR	37.90%	17.10%	19.40%	25.50%	18.01	36.5%
MD	37.30%	12.50%	23.50%	26.80%	22.85	36.0%
AK	36.50%	17.20%	26.20%	20.00%	20.17	43.4%
CT	35.60%	13.90%	23.30%	27.20%	23.37	37.2%
UT	35.20%	27.10%	18.60%	19.10%	15.90	45.7%

ND	34.30%	20.50%	30.30%	15.00%	18.43	50.8%
WA	33.90%	17.80%	19.90%	28.40%	18.15	37.7%
WY	33.90%	25.70%	26.90%	13.50%	17.61	52.6%
DC	33.20%	15.60%	22.50%	28.70%	17.72	38.1%
HI	33.10%	14.60%	20.20%	32.20%	17.87	34.8%
PA	32.10%	13.90%	29.80%	24.10%	22.21	43.7%
MT	31.10%	24.50%	21.40%	23.00%	18.47	45.9%
NM	30.70%	18.50%	25.80%	25.00%	17.32	44.3%
VT	30.70%	18.40%	25.50%	25.50%	22.45	43.9%
DE	29.20%	16.20%	26.50%	28.20%	24.42	42.7%
NJ	27.50%	14.30%	19.80%	38.40%	20.04	34.1%
LA	26.60%	17.70%	31.90%	23.90%	19.28	49.6%
NY	22.10%	13.80%	24.90%	39.20%	21.97	38.7%