United States Senate
WASHINGTON, DC 20510

April 4, 2012

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

Dear Mr. DeMarco:

We are writing to express our serious concerns with the recent analysis put forth by the Federal Housing Finance Agency (FHFA) on whether principal forgiveness would serve taxpayer interests, as compared to principal forbearance.

We believe that the analysis has several critical flaws and also has not been updated for new developments. We respectfully request that FHFA update its initial study, refining the earlier analysis and including new developments - especially the Administration's tripling of incentives for principal reduction. We believe that FHFA must be fully transparent with this new analysis and look at targeted solutions for borrowers in different situations, rather than the "all or nothing" approach that was used in the previous analysis.

While we appreciate the work that was put into the previous analysis, we believe the methodology should take into account recent expert testimony provided to the Senate Banking Committee's Subcommittee on Housing, Transportation, and Community Development on March 15th.

First, the original analysis did not consider mortgage insurance. At least one witness testified that a more complete analysis would have shown principal forgiveness to be a better alternative for loans without mortgage insurance. As noted in testimony, almost 70% of the seriously delinquent loans at Fannie Mae and Freddie Mac (the Enterprises) do not carry mortgage insurance

Second, a hypothetical model (the Treasury NPV Model) was used for the analysis, rather than actual HAMP results. As you know, the HAMP Principal Reduction Alternative (PRA) went into effect in October 2010, so there should be more than 16 months of data on this forgiveness program available. Other sources of real world data should be considered as well.

Third, testimony indicated that there are several technical flaws that skewed the analysis. Specifically:

- State level price indices were used, rather than Metropolitan Statistical Area indices. This likely resulted in an undercounting of high-LTV borrowers, and these borrowers are aided more by principal forgiveness than low-LTV borrowers would be.

- The results were done on a portfolio level, rather than an individual loan level. Thus, an all or nothing approach was used in the analysis even though it's possible that principal

forgiveness may yield better taxpayer results for certain categories of borrowers, while forbearance would be more appropriate for others.

- The HAMP PRA program was not properly evaluated, leading to an analysis that overestimated the amount of principal forgiveness that higher income borrowers would receive.

- The current profiles of borrowers should have been used, not borrower attributes at the time of origination. By relying on borrower characteristics at the time of origination, such as credit scores, the financial health of the borrower is inflated, which overstates the cost of forgiveness.

Fourth, and perhaps most importantly, since the time the original analysis was done, the Administration has tripled the financial incentives for principal reduction that are now available to the Enterprises. Since FHFA's own analysis concluded that principal forbearance would be only marginally better for taxpayers than principal forgiveness, it would not be surprising if this factor alone changed the results.

With respect to moral hazard concerns regarding principal forgiveness, the hearing witnesses discussed several ways to mitigate or eliminate this issue. Some of their suggestions that you could explore include using underwriting criteria that ensure that the borrower has a genuine hardship such as a documented drop in income or other comparable financial circumstances, permitting only those borrowers who met the eligibility criteria prior to the official beginning of the program to participate so that borrowers could not strategically insert themselves into the pool of eligibility later on, or using a shared appreciation modification that would improve borrower and lender incentives. Hearing witnesses also pointed out that in the private sector, banks, which seek to maximize their own shareholder returns, are using principal reduction as one tool for about 20% of their own portfolio loans. Finally, in response to claims that principal reductions unduly benefit junior lien holders, it is worth noting that at least one witness testified that as part of his firm's principal reduction efforts, all junior liens are extinguished, leaving the borrower with one lien.

We seek an accurate analysis but not a particular result. Conducting an accurate analysis of this issue is not only part of your responsibility as conservator to conserve taxpayer assets, but also part of your statutory responsibility to maximize assistance for homeowners to minimize foreclosures, and it is our responsibility in overseeing FHFA to ensure that FHFA conducts an accurate analysis. With taxpayers having subsidized Fannie and Freddie and with approximately 11 million homeowners underwater and several million seriously delinquent, the public deserves transparent, fair, and complete answers.

We request that this updated study be completed no later than 30 days after receipt of this letter, given the urgency and importance of this issue with underwater homeowners struggling every day. Please do not hesitate to contact us if you have any questions or if we can assist, and we look forward to your response.

Thank you for your kind attention to this important matter.

Sincerely,

Frank R. Lautenberg

Jeff Bingaman

Charles Schumer

Ben Cardin

Mark Pryor

Maria Cantwell

Kirsten E. Gillibrand

Richard Blumenthal

Barbara Boxer

Patrick Leahy

Patty Murray