The Report committee for Casey Daniel LeMay

Certifies that this is the approved version of the following report:

Refinancing the American Dream:

A Modern History of Federal Policy Aimed at Ending America's Housing Crisis

Approved by
Supervising Committee:

Supervisor: ______________________________
Terry D Kahn

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Lucy F Galbraith

Refinancing the American Dream:

A Modern History of Federal Policy Aimed at Ending America's Housing Crisis

By

Casey Daniel LeMay, B.S.B.A; J.D.

Report

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For My Family

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I love you momma.

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Abstract

Refinancing the American Dream:

A Modern History of Federal Policy Aimed at Ending America's Housing Crisis

Casey Daniel LeMay, MSCRP

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Supervisor: Terry Kahn

This report seeks to outline recent federal policy regarding home mortgage finance, specifically the Home Affordable Refinance Program (HARP), the main tool of the Making Home Affordable Program (MHA), which is aimed at helping the United States recover from the housing crisis it has been experiencing ever since the mid-late 2000s. A modern history of federal policy on home mortgage finance will help to set the stage for the reader for what has been one of the most difficult housing disasters that America has ever seen. After outlining HARP's background, the background of the housing crisis, the roles of Government-sponsored entities, and the effectiveness of the most current federal responses to the crisis, this report will detail policy recommendations and changes to the current programs that may help to further alleviate the problems discussed in this report, and more effectively achieve the stated goals of the MHA and HARP.

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Introduction

On 18 February 2009, U.S. President Barack Obama announced a $73 billion program to help up to nine million homeowners avoid foreclosure, which was supplemented by $200 billion in additional funding for Fannie Mae and Freddie Mac to purchase and more easily refinance mortgages. The plan is funded mostly from the Emergency Economic Stabilization Act of 2008's $700 billion financial bailout fund. It uses cost sharing and incentives to encourage lenders to reduce homeowner's monthly payments to 31 percent of their monthly income. Under the program, a lender would be responsible for reducing monthly payments to no more than 38 percent of a borrower's income, with government sharing the cost to further cut the rate to 31 percent. The plan also involves forgiving a portion of the borrower's mortgage balance. Companies that service mortgages will get incentives to modify loans and to help the homeowner stay current.[1]

This Making Home Affordable Program is a critical part of the Obama Administration's broad strategy to help homeowners avoid foreclosure, stabilize the country's housing market, and improve the nation's economy.

The primary tool of this program is HARP, the Home Affordable Refinance Program. According to the MakingHomeAffordable.gov website, "If you're not behind on your mortgage payments but have been unable to get traditional refinancing because the value of your home has declined, you may be eligible to refinance through MHA's Home Affordable Refinance Program (HARP). HARP is designed to help you get a new, more affordable, more stable mortgage.

[1] (Goldman, "Obama Releases Billions for Public Works Projects", 2009)

HARP refinance loans require a loan application and underwriting process, and refinance fees will apply.”

Both lenders and borrowers may benefit from avoiding foreclosure, which is a costly and lengthy process. Some lenders have offered troubled borrowers more favorable mortgage terms (i.e., refinancing, loan modification or loss mitigation). Borrowers have also been encouraged to contact their lenders to discuss alternatives.[2]

The Economist described the issue this way in February 2009: "No part of the financial crisis has received so much attention, with so little to show for it, as the tidal wave of home foreclosures sweeping over America. Government programmes have been ineffectual, and private efforts not much better." Up to 9 million homes may enter foreclosure over the 2009–2011 period, versus one million in a typical year.[3] At roughly U.S. $50,000 per foreclosure according to a 2006 study by the Chicago Federal Reserve Bank, 9 million foreclosures represents $450 billion in losses.[4]

[2] ("National Data", 2013)
[3] ("S&P Case-Shiller 20-City Home Price Index©", 2013)
[4] ("Graph: S&P 500©", 2013)

Chapter 1: Making Home Affordable

HARP Background

Millions of homeowners found themselves in a difficult predicament after the U.S. housing bubble burst in 2006. As inventories soared nationwide, home prices plummeted. Many new homeowners saw the value of their homes drop below the balance of their mortgages, or nearly so. Later, these same homeowners were prevented from taking advantage of lower interest rates through refinancing, since banks traditionally require a loan-to-value ratio (LTV) of 80% or less to qualify for refinancing without private mortgage insurance (PMI).[5] The loan-to-value ratio is a financial term used by lenders to express the ratio of a loan to the value of an asset purchased.

The term loan-to-value ratio is commonly used by banks and building societies to represent the ratio of the first mortgage lien as a percentage of the total appraised value of real property. For instance, if someone borrows $130,000 to purchase a house worth $150,000, the LTV ratio is $130,000 to $150,000 or $130,000/$150,000, or 87%. The remaining 13% represent the lender's haircut, adding up to 100% and being covered from the borrower's equity. The higher the LTV ratio, the riskier the loan is for a lender.

Loan to value is one of the key risk factors that lenders assess when qualifying borrowers for a mortgage. The risk of default is always at the forefront of lending decisions, and the likelihood of a lender absorbing a loss increases as the amount of equity decreases. Therefore, as the LTV ratio of a loan increases, the qualification guidelines for certain mortgage programs become much stricter. Lenders can require borrowers of high

[5] ("The basics of private mortgage insurance (PMI)", 2001)

LTV loans to buy mortgage insurance to protect the lender from the buyer default, which increases the costs of the mortgage.

Private mortgage insurance in the US, is insurance payable to a lender or trustee for a pool of securities that may be required when taking out a mortgage loan. It is insurance to offset losses in the case where a mortgagor is not able to repay the loan and the lender is not able to recover its costs after foreclosure and sale of the mortgaged property. Typical rates are $55/mo. per $100,000 financed, or as high as $125/mo. for a typical $200,000 loan. The cost of mortgage insurance varies considerably based on several factors which include: loan amount, LTV, occupancy (primary, second home, investment property), documentation provided at loan origination, and most of all, credit score.

This type of insurance is usually only required if the down payment is less than 20% of the sales price or appraised value (in other words, if the loan-to-value ratio (LTV) is 80% or more). Once the principal is reduced to 80% of value, the PMI is often no longer required. This can occur via the principal being paid down, via home value appreciation, or both. In the case of lender-paid MI, the term of the policy can vary based upon the type of coverage provided (either primary insurance, or some sort of pool insurance policy). Borrowers typically have no knowledge of any lender-paid MI, in fact most "No MI Required" loans actually have lender-paid MI, which is funded through a higher interest rate that the borrower pays.

Mortgage insurance became tax-deductible in 2007 in the USA.[6] For some homeowners, the new law made it cheaper to get mortgage insurance than to get a 'piggyback' loan. The MI tax deductibility provision passed in 2006 provides for an itemized deduction for the cost of private mortgage insurance for homeowners earning up to $109,000 annually. [7] The original law was

[6] (Lewis, "In 2007, mortgage insurance will be tax-deductible", 2006)
[7] Ibid.

extended in 2007 to provide for a three-year deduction, effective for mortgage contracts issued after December 31, 2006 and before January 1, 2010. It does not apply to mortgage insurance contracts that were in existence prior to passage of the legislation.[8]

Take for example a house that was purchased for $160,000 but is now worth $100,000 due to the market decline. Further, assume the homeowner owes $120,000 on the mortgage. In this scenario, the loan-to-value ratio would be 120%, and if the homeowner chose to refinance, he would also have to pay for private mortgage insurance. If the homeowner was not already paying for PMI, the added cost could nullify much of the benefit of refinancing, so the homeowner could be effectively prohibited from refinancing.[9]

The Home Affordable Refinance Program (HARP) was created by the Federal Housing Finance Agency in March 2009 to allow those with a loan-to-value ratio exceeding 80% to refinance without also paying for mortgage insurance. Originally, only those with an LTV of 105% could qualify. Later that same year, the program was expanded to include those with an LTV up to 125%.[10] This meant that if someone owed $125,000 on a property that is currently worth $100,000, he would still be able to refinance and lock in a lower interest rate.

In December 2011, the rule was changed yet again, creating what is referred to as "HARP 2.0"; there would no longer be any limit on negative equity for mortgages up to 30 years – so even those owing more than 125% of their home value could refinance without PMI.[11] Also, the program was expanded to accept homeowners with PMI on their loan. Finally, any new

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[8] Ibid.
[9] (Lerner, " "9 Things To Know Before You Refinance Your Mortgage"", 2010)
[10] (Desmond, "Fannie And Freddie To Expand Mortgage Rescue", 2009)
[11] (Sichelman, "HARP 2.0 rules, and who will benefit Realty Q&A", 2011)

mortgage lender was guaranteed not to be held responsible for fraud committed on the original loan. This greatly expanded the willingness of lenders to participate in the program.[12]

Qualifying Criteria

Certain criteria must be met to qualify for HARP. While there may be additional criteria imposed by the mortgage servicer, the government requirements are as follows:[13]

- The mortgage must be owned or guaranteed by Freddie Mac or Fannie Mae. Many homeowners are unaware that their mortgages are linked to one of these organizations, since neither Freddie Mac nor Fannie Mae deals directly with the public.[14]
- The mortgage must have been acquired by Freddie Mac or Fannie Mae on or before May 31, 2009.
- The homeowner must not have a previous HARP refinance of the mortgage, unless it is a Fannie Mae loan that was refinanced under HARP during March-May 2009.
- The homeowner must be current on their mortgage payments, with no (30-day) late payments in the last six months and no more than one late payment in the last twelve months.
- The current loan-to-value ratio (LTV) of the property must be greater than 80%.
- The homeowner must benefit from the loan by either lower monthly payments or movement to a more stable product (such as going from an adjustable-rate mortgage (ARM) to a fixed-rate mortgage).

There is no minimum credit score to qualify for a HARP 2.0 loan. However, there is a maximum debt-to-income ratio for HARP 2.0 participants. If you have a debt-to-income (DTI)

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[12] (Glink, "What HARP 2.0 can -- and can't -- do for you", 2012)
[13] ("Making Home Affordable An official program of the Departments of the Treasury & Housing and Urban Development", 2011)
[14] Ibid.

ratio of 45% or less, you qualify. Meaning if you're total recurring debt (mortgage, credit cards, etc) make up 45% or less of your monthly income, you qualify.[15]

HARP 2.0

Many people who purchased their home with a down payment of less than 20% of the purchase price were required to have private mortgage insurance. This is common practice with Freddie Mac or Fannie Mae loans. Having PMI attached to a loan made that loan easier to sell on the Wall Street secondary market as a "whole loan". PMI hedged the risk brought by the high loan-to-value ratio by offering insurance against foreclosure for whoever owned the "whole loan".[16]

Although HARP 2.0 allows homeowners with PMI to apply through the Making Home Affordable Refinance Program, many homeowners have faced difficulty refinancing with their original lender. HARP requires the new loan to provide the same level of mortgage insurance coverage as the original loan. This can be difficult and time-consuming, especially in the case of lender-paid private mortgage insurance (LPMI). As a result, many lenders are reluctant to refinance a PMI mortgage.[17]

Fortunately, HARP 2.0 enables homeowners to go to any lender to refinance, so the mortgage holder is not stymied if the original bank is unwilling to pursue a HARP refinance. HARP 2.0 refinancing is allowed on all occupancy types: primary residence (owner-occupied), second home, or investment (rental) property. However, HARP 2.0 refinancing of investment

[15] (Duffin-Lutgen, "HARP 2.0 Refinance Eligibility & Qualifications - Lender411.com", 2013)
[16] ("Making Home Affordable Refinance Program", 2012)
[17] (Green, "HARP 2.0 : Lenders Refinancing Loans With PMI And LPMI", 2013)

properties by Fannie Mae and Freddie Mac has higher mortgage rates than for owner-occupied properties

Another feature of HARP is that applicants can forgo a home appraisal if a reliable automated valuation model is available in the area. This can save the borrower time and money, but is subject to the discretion of the mortgage servicer.[18]

As part of the 2012 State of the Union Address, President Barack Obama referenced a plan to give "every responsible homeowner the chance to save about $3,000 a year on their mortgage". Within the mortgage industry, this plan is being referred to as HARP 3.0. The plan has not passed. HARP 3.0 is expected to expand HARP's eligibility requirements to homeowners with non-Fannie Mae and non-Freddie Mac mortgages, including homeowners with jumbo mortgages and Alt-A mortgages, those whose original mortgages were stated income, stated asset, or both.[19] HARP is scheduled to end on December 31, 2015.[20] All changes to mortgage financing made through the program are permanent and do not expire when the Program does.

Other Homeowner Assistance

A variety of voluntary private and government-administered or supported programs were implemented during 2007–2009 to assist homeowners with case-by-case mortgage assistance, to mitigate the foreclosure crisis engulfing the U.S. One example is the Hope Now Alliance, an ongoing collaborative effort between the US Government and private industry to help certain subprime borrowers.[21] Hope Now describes the assistance that it provides to homeowners as loan workouts, a form of loss mitigation. These workouts can either result in establishing a modified

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[18] ("FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers", 2011)
[19] (Green, "HARP 3 : Who May Qualify And Today's HARP Mortgage Rates", 2014)
[20] (Benson, "Fannie Mae Regulator Extends HARP Refinance Program Through 2015", 2013)
[21] ("HOPE NOW Alliance Created to Help Distressed Homeowners", 2007)

repayment plan with the homeowner to bring them up to date, or a loan modification where the terms of the mortgage are modified in order to make the loan serviceable for the homeowner. At its inception the Alliance was composed of lenders representing 60% of all outstanding mortgages in the United States, counseling services, trade organizations and a group representing investors in mortgage backed securities.[22] Additional organizations joined over the following months.[23]

The group promotes a national 24 hour toll-free telephone number (known as the Homeowner's HOPE Hotline), through which the Homeownership Preservation Foundation (a member) offers free counseling to homeowners concerned about foreclosure.[24] It also encourages homeowners in difficulty to contact their lender directly, and provides on its website a list of contact for member organizations. Since its inception in December 2007, the Homeowner's HOPE Hotline received more than 140,000 calls in 2007 (including over 45,000 in the first three days), and an average of 3,200 calls per day in January 2008.[25]

In February 2008, the Alliance reported that during the second half of 2007, it had helped 545,000 subprime borrowers with shaky credit, or 7.7% of 7.1 million subprime loans outstanding as of September 2007. A spokesperson for the Alliance acknowledged that much more must be done.[26]

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[22] ("Statement by Secretary Henry M. Paulson, Jr. on Announcement of New Private Sector Alliance – HOPE NOW", 2007)

[23] ("HOPE NOW Lists All Alliance Members' Service Numbers", 2008)

[24] ("Hope Now - Mortgage Lender Directory")

[25] ("Industry group touts loan workouts", 2008)

[26] ("Hope Now says nearly 8% of subprime borrowers helped ", 2008)

Furthermore, it has been noted that the majority of assistance provided by the group has been to establish repayment plans, rather than actually modifying the terms of the mortgage.[27]

HAMP

In addition to the above programs, as part of the Making Homes Affordable Program, HAMP, or Home Affordability Modification Program, was designed to let homeowners avoid foreclosure by subsidizing mortgage lenders' modifications to borrowers' home loans. To qualify for a HAMP modification, you must:

- You obtained your mortgage on or before January 1, 2009.
- You owe up to $729,750 on your primary residence or single unit rental property
- You owe up to $934,200 on a 2-unit rental property; $1,129,250 on a 3-unit rental property; or $1,403,400 on a 4-unit rental property
- The property has not been condemned
- You have a financial hardship and are either delinquent or in danger of falling behind on your mortgage payments (non-owner occupants must be delinquent in order to qualify).
- You have sufficient, documented income to support a modified payment.
- You must not have been convicted within the last 10 years of felony larceny, theft, fraud or forgery, money laundering or tax evasion, in connection with a mortgage or real estate transaction.

If you qualify, the most advantageous program is HAMP -- it's essentially a refinance that costs you nothing, and your interest rate can be modified to as low as 2%. No private mortgage

[27] (Zibel, "US foreclosure filings surge 48 percent in May", 2008)

product on the market can compete with that. The average modification under this program saves homeowners about $500 a month.

Chapter 2: Background

Housing crisis that made MHA Program necessary

There were many causes of the crisis, with commentators assigning different levels of blame to financial institutions, regulators, credit agencies, government housing policies, and consumers, among others. A proximate cause was the rise in subprime lending. The percentage of lower-quality subprime mortgages originated during a given year rose from the historical 8% or lower range to approximately 20% from 2004 to 2006, with much higher ratios in some parts of the U.S.[28] A high percentage of these subprime mortgages, over 90% in 2006 for example, were adjustable-rate mortgages.[29] These two changes were part of a broader trend of lowered lending standards and higher-risk mortgage products.

When U.S. home prices declined steeply after peaking in mid-2006, it became more difficult for borrowers to refinance their loans. As adjustable-rate mortgages began to reset at higher interest rates (causing higher monthly payments), mortgage delinquencies soared.
A variable-rate mortgage, adjustable-rate mortgage (ARM), or tracker mortgage is a mortgage loan with the interest rate on the note periodically adjusted based on an index which reflects the cost to the lender of borrowing on the credit markets.[30] The loan may be offered at the lender's standard variable rate/base rate. Adjustable rates transfer part of the interest rate risk from the lender to the borrower. They can be used where unpredictable interest rates make fixed rate loans difficult to obtain. ARMs generally permit borrowers to lower their initial payments if they are willing to assume the risk of interest rate changes. Decisions of consumers may also be affected by the advice they get, and much of the advice is provided by lenders who may prefer ARMs

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[28] (Simkovic, "Competition and Crisis in Mortgage Securitization", 2013, p. 213)
[29] (Zandi, Financial Shock, 2010)
[30] (Wiedemer, Real Estate Finance, 2012, pp. 99-)

because of financial market structures.[31] For the borrower, adjustable rate mortgages may be less expensive, but at the price of bearing higher risk. Many ARMs have "teaser periods", which are relatively short initial fixed-rate periods (typically one month to one year) when the ARM bears an interest rate that is substantially below the "fully indexed" rate. The teaser period may induce some borrowers to view an ARM as more of a bargain than it really represents. A low teaser rate predisposes an ARM to sustain above-average payment increases.

The Housing and Community Development Act of 1992 established, for the first time, an affordable housing loan purchase mandate for Fannie Mae and Freddie Mac, a mandate to be regulated by the Department of Housing and Urban Development (HUD). Initially, the 1992 legislation required that 30 percent or more of Fannie's and Freddie's loan purchases be related to affordable housing. However, HUD was given the power to set future requirements, and eventually (under the Bush Administration) a 56 percent minimum was established.[32] To fulfill the requirements, Fannie Mae and Freddie Mac established programs to purchase $5 trillion in affordable housing loans,[33] and encouraged lenders to relax underwriting standards to produce those loans.[34] It is clear that the first wave of troublesome loans was not originated or securitized by Fannie Mae and Freddie Mac, as subprime loans were not a major part of their business until 2005, several years after these loans had been made. Though they were not the original cause of the problem, the GSEs did join the market for products with low credit ratings, and may have "followed the market down."[35]

[31] (World Economic Outlook: September 2004: The Global Demographic Transition, 2004)
[32] ("Financial Crisis Inquiry Report", 2011)
[33] (Zuckerman, The Greatest Trade Ever: The Behind-the-Scenes Story of How John Paulson ..., 2009)
[34] ("Financial Crisis Inquiry Report", 2011)
[35] (Quercia, "The Preventable Foreclosure Crisis", 2008, pp. 775-783)

As a response to difficulty refinancing or modifying home loans, many homeowners in the country started to default on their loans, causing a major housing crisis. In early 2007, the share of all mortgages entering foreclosure rose to 0.58 percent.[36] Subprime loans entering foreclosure rose to a five-year high of 2.43 percent.[37] Finally, median U.S. home price fell for the first time since the Great Depression.[38]

Additionally, the *L.A. Times* reported the results of a study that found homeowners with high credit scores at the time of entering the mortgage are 50% more likely to "strategically default" – abruptly and intentionally pull the plug and abandon the mortgage – compared with lower-scoring borrowers. Such strategic defaults were heavily concentrated in markets with the highest price declines. An estimated 588,000 strategic defaults occurred nationwide during 2008, more than double the total in 2007. They represented 18% of all serious delinquencies that extended for more than 60 days in the fourth quarter of 2008.[39] Needless to say, the results of the housing crisis were felt across the nation.

Role of Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac are government sponsored enterprises (GSE) that purchase mortgages, buy and sell mortgage-backed securities (MBS), and guarantee nearly half of the mortgages in the U.S. The growth in this secondary market, starting in the mid-80s, was explosive. In 1984, some $62 billion of mortgage-backed securities were issued. By 2001, this number had grown to $1.2 trillion.[40] As it became one of the primary sources of credit, the

[36] (Howley, "U.S. Mortgages Enter Foreclosure at Record Pace", 2007)
[37] Ibid.
[38] Ibid.
[39] ("Homeowners who strategically default a growing problem", 2009)
[40] (Colton, "Housing Finance in the United States: The Transformation of the U.S. Housing Finance System, July 2002)

secondary market also helped maintain the liquidity of the market, smoothing the ups and downs that would have been experienced under the earlier systems. It also broadened the investor base of housing by attracting mutual funds, pension funds, and foreign entities whose capital had previously not been invested in housing and further tying the housing market to the economy at large.

During the 1980s, the pendulum of federal financial regulation in the United States swung sharply towards deregulation. As limitations were relaxed on the types of investments that banks and savings and loans could make, investment decisions changed dramatically, and capital was redirected in new ways. Though the capital requirements of the housing sector were never forgotten, they were not the focus of the changes in policy affecting the banks during this period. [41] Fannie Mae and Freddie Mac were not safe from the same problems that plagued the housing market as a whole, with respect to deregulation.

As housing markets and other pieces of the financial sector have become increasingly linked, the federal government has used macroeconomic tools to address problems in the housing market. In doing so, they have addressed concerns related to the availability of financing, but have not addressed social welfare concerns such as ensuring that the financial industry lend responsibly and protect the interests of consumers who are less able to protect their own interests. In addition, these policies do not address community development concerns such as ensuring that credit is provided in ways that will further community goals and build stable and secure neighborhoods. Rather, these policies tend to support the freedom of the private markets to pursue profit-oriented activities. As such, the troublesome loans mentioned above became part of the business of Fannie Mae and Freddie Mac, thanks to this deregulation.

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[41] (Greenspan "Building the Dream: A History of Federal Policy Intervention in Home Mortgage Finance", May 8, 2009)

A variety of political and competitive pressures resulted in the GSEs ramping up these purchases and guarantees of risky mortgages in 2005 and 2006, just as the housing market was peaking.[42] Fannie and Freddie were under both under political pressure to expand purchases of higher-risk affordable housing mortgage types, and under significant competitive pressure from large investment banks and mortgage lenders.[43]

Now, it is important to note that Fannie Mae and Freddie Mac were not the first, nor the overwhelmingly dominant lender of these high-risk mortgages. By some estimates, more than 84 percent of the subprime mortgages came from private lending institutions in 2006 and the share of subprime loans insured by Fannie Mae and Freddie Mac decreased as the bubble got bigger (from a high of insuring 48 percent to insuring 24 percent of all subprime loans in 2006).[44] Another source found estimates by some analysts that Fannie's share of the subprime mortgage-backed securities market dropped from a peak of 44% in 2003 to 22% in 2005, before rising to 33% in 2007.[45]

Accordingly, The Financial Crisis Inquiry Commission (majority report), Federal Reserve economists, and several academic researchers have stated that government affordable housing policies were not the major cause of the financial crisis.[46] They also state that Community Reinvestment Act loans outperformed other "subprime" mortgages, and GSE mortgages performed better than private label securitizations.

The combined GSE losses of $14.9 billion and market concerns about their ability to raise capital and debt threatened to disrupt the U.S. housing financial market.[47] On September 6,

[42] (Smith, "Bringing Down Wall Street as Ratings Let Loose Subprime Scourge", 2008)
[43] (Smith, "`Race to Bottom' at Moody's, S&P Secured Subprime's Boom, Bust", 2008)
[44] (Lewis, The Big Short: Inside the Doomsday Machine, 2010)
[45] (Smith, "`Race to Bottom' at Moody's, S&P Secured Subprime's Boom, Bust", 2008)
[46] ("Financial Crisis Inquiry Report", 2011)
[47] (Kopecki, "U.S. Considers Bringing Fannie, Freddie on to Budget", 2008)

2008, the director of the Federal Housing Finance Agency (FHFA), James B. Lockhart III, announced his decision to Fannie Mae and Freddie Mac, into conservatorship run by the FHFA.[48] The U.S. Treasury committed to invest as much as US$200 billion in preferred stock and extend credit through 2009 to keep the GSEs solvent and operating. The two GSEs have outstanding more than US$ 5 trillion in mortgage-backed securities and debt; the debt portion alone is $1.6 trillion.[49] The conservatorship action has been described as "one of the most sweeping government interventions in private financial markets in decades," and one that "could turn into the biggest and costliest government bailout ever of private companies".[50] Since the conservatorship decision, the companies have drawn $190 billion in aid and paid $105 billion in dividends since being taken over by U.S. regulators.[51] [52] Many critics believe that this move will end up profiting the U.S. in the long run. This is one major step in federal home mortgage finance reform that may help to solve the housing crisis, as well as prevent future crises.

MHA Results

Having explored some of the causes behind this crisis, it would seem that a program like HARP would be exactly what this market needed in order to mitigate damages. Yet, a great number of critiques exist from outside sources that challenge the government's claims of success. The three major critiques are that the eligibility requirements are too strict, that the program itself is difficult to navigate and apply for, and that the overall value of the savings of a

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[48] ("Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers", 2008)
[49] (Kopecki, "U.S. Considers Bringing Fannie, Freddie on to Budget", 2008)
[50] (DUHIGG, "As Crisis Grew, a Few Options Shrank to One", 2008)
[51] (Benson, "U.S. Revises Payment Terms for Fannie Mae, Freddie Mac", 2012)
[52] (Shenn, "Fannie Mae to Pay Treasury $59.4 Billion After Record Profit", 2013)

refinanced mortgage under HARP is often too low to be worth it. Each of these will be examined in depth.

Chapter 3: MHA Results

Eligibility Problems

Originally, the idea of a broad based refinance initiative championed by the federal government was born out of the epidemic of negative amortization "Option ARM" mortgage loans that were crippling consumers with rising principal balances and looming payment resets. These loans were sold to consumers based on the perceived affordability of the low initial (albeit adjustable) interest rate and the option to make minimum monthly payments or interest only payments. The minimum monthly payment did not cover the interest due for the month, and the difference was simply added to the outstanding principal balance. This is negative amortization and consumers with these loans felt the double whammy of the decline in the value of their homes while the principal balance of their mortgage loan increased.[53]

The Center for Responsible Lending (CRL) published findings in 2011 that confirmed that "foreclosure rates are consistently worse for borrowers who received high-risk loan products that were aggressively marketed before the housing crash, such as loans with prepayment penalties, hybrid adjustable-rate mortgages (ARMs), and option ARMs." The CRL concluded that "foreclosure rates are highest in neighborhoods where these loans were concentrated."[54]

MHA initiatives have not helped many homeowners because Option ARMs are not eligible to be refinanced under the HARP or HARP2.0 programs.[55]

[53] (Greene, "Why HARP Isn't Working", 2012)
[54] Ibid.
[55] Ibid.

Option ARMs were packaged and sold to investors as private securities; they were not sold to Fannie Mae or Freddie Mac. To be eligible for a HARP or HARP2.0 refinance, your mortgage loan must be owned by Fannie or Freddie.

Somehow during the formative stages of what was originally conceived as a broad based refinance initiative to "help homeowners avoid foreclosure, stabilize the country's housing market, and improve the nation's economy," things changed. The risk profile of loans not held by Fannie and Freddie is difficult to measure, remember, many Option ARMs and other more exotic loan programs were underwritten when less emphasis was placed on credit quality. High loan-to-value ratios (minimum or no down payment), limited or no documentation requirements for income and lower credit score thresholds were common elements in many of these loan profiles.

HARP/HARP2.0 eligibility requirements are only for mortgage loans with a current Fannie or Freddie family history. This is the "get-out-of-jail-free" card that allows homeowner's that meet expanded credit quality guidelines to take advantage of the current historically low interest rates and reduce their monthly housing payment burden.

There is no alternative broad based refinance plan for anyone outside of the Fannie or Freddie family, yet.

These eligibility requirements preclude many desperate homeowners from receiving the assistance that the MHA Program seeks to provide.

HARP Program Pitfalls

In addition to the access issues due to eligibility requirements, HARP has experienced problems in its implementation. Those who are eligible still find it very difficult and time-consuming to complete the necessary steps to qualify for and receive assistance. Anecdotal evidence is easy to find in the form of blog posts and comments. One site chronicled the HARP pitfalls that were experienced firsthand by an eligible homeowner.[56] These pitfalls were echoed across the internet, during my research, and the most common will be presented as follows:

1. Overlays

Every lender has overlays, their own set of rules about the HARP program that are more restrictive than the official guidelines. Since the application to the HARP program needs to go through a lender, each lender can require different “hoops to be jumped through” HARP 2.0 overlays are underwriting guidelines that are in addition to Fannie Mae or Freddie Mac’s program guidelines.[57]

Personal experience: For 2-3 months, Bank of America had a freeze on approving homeowners with second mortgages for the HARP program. This rendered the subject ineligible, not by HARP standards, but by Bank of America standards.

2. Terms & Naming

There are a lot of programs, many with similar names, and each organization or lender has their own names, in some cases, making it even more confusing. Without a uniform naming process, assistance from helplines or other resources can be difficult to acquire.

Personal experience: Bank of America told the subject that she did not qualify under the Making Home Affordable Program. That is the program that regulates HARP, HAMP and as many as 7 other programs. This was confusing, because the subject didn’t know if the bank was attempting to refinance her under HARP or HAMP (two very different programs). When she asked for

[56] ("5 HARP Program Pitfalls", 2011)
[57] (Porter, "HARP 2.0 Questions to ask your Mortgage Originator", 2012)

clarification, and said she wanted to refinance under HARP, the bank said HARP was the same thing as the Making Home Affordable Program. She still didn't know if the bank had her in the right program.

3. Knowledge Barriers

Lender representatives and community organizations don't always have all the facts, or don't understand them, but will tell you that they do. It was common across many anecdotes that the individual representatives at each lender institutions could possess vastly different levels of knowledge, leading to different handling of each case.

Personal experience: The subject spoke with 2 different people at the Community Neighborhood Housing Agency in St. Paul, MN to get assistance in applying for the HARP program. The 2nd person was extremely helpful and understood the program very well. She said the subject should qualify. The first person the subject spoke with, at the same organization, said she did not qualify and was not underwater (which was extremely incorrect). When the subject asked her to "run" the numbers again, because the subject was sure she was underwater, she aggressively asserted that the subject was NOT underwater. This is an organization that helps homeowners understand programs like HARP every day of the week.

4. Confusing or Vague Guidelines

Many guidelines in the HARP program are vague, allowing for lenders to misinterpret or use vague areas to their advantage. In fact, the program itself, though "strongly encouraged" is optional to any and all lenders, meaning they are not required to participate.

Personal experience:

- Lenders who hold homeowners' 2nd mortgages are encouraged, but not required to subordinate the loan. (If they don't subordinate, HARP refinance is not possible for these homeowners. However, as of HARP 2.0, homeowners can refinance with other lenders.)
- The "No Appraisal" rule is not required, and leaves it up to the lender's discretion as to whether it is needed.
- In lieu of an appraisal, the way a home's value is determined varies widely and can be pulled from a variety of sources (including zillow.com, estimated tax value and lender-generated data, leaving homeowners vulnerable to errors and inconsistencies.)
- The financial documentation checklist varies between lenders, organizations and official guidelines. Some of these are extremely time-consuming to produce (especially for self-employed people), and may or may not be required once the process starts.

5. Program Implementation Delays & Changes

Guidelines take long to implement (4-5 months from release date), and in some cases, will have changed before the lenders finally implement the program. This lessens the amount of time that homeowners can take advantage of the program, and in some cases requires applicants to re-gather documentation.

Personal experience: When the program was officially released, the subject took several half days off to talk to gather federal tax returns, year-to-date monthly expenses (monthly profit and loss), homeowner's insurance statement and other documentation. This was outlined in various places online, and she was told to gather this information from the Community Neighborhood Housing Agency, an assistance resource.

Some items took hours to prepare, and she discovered later that they would not be needed (for example, year-to-date monthly expenses). Having work flexibility, the subject was able to juggle this, though it was not easy. Not everyone is in a position to keep taking off work to gather and re-gather documentation during work hours, only to discover later it wasn't needed in the first place.

Obviously, many of these issues could be avoided if the Neighborhood Housing Agency that the subject contacted was more helpful, but this problem is indicative of the overall difficulty which eligible homeowners have in applying for and getting assistance from HARP. Rather than being able to apply through one entity, using a succinct procedure, many homeowners are left to fend for themselves when it comes to searching for answers to the problems they experience with HARP and MHA.

Is It Worth It?

After navigating the eligibility requirements and program pitfalls, there remains the issue of value that an acceptance into the program would provide. HARP is designed to ease refinancing for homeowners who are underwater or have little equity on their homes, and may sound like a good opportunity on the surface. But is it worth the time, hassle and money you will need to spend on closing costs? As is explained above, the time that is required to go through the HARP process can be significant. Presumably, the money saved would help to counterbalance those time costs. Unfortunately, that may not be the case.

Borrowers who refinanced through HARP in the first half of 2010 saved an average of $125 to $150 a month on their monthly mortgage payments, according to Freddie Mac. [58]

[58] (da Costa, "When is a HARP refinance worth the cost?")

That's not much, considering some of these borrowers spent thousands on closing costs. For instance, a borrower who refinances a $125,000 loan that originally had a 6.5% interest rate will save $90.13 a month in mortgage payments with a refinanced loan carrying a 5.375% interest rate, according to Jim Sahnger, a mortgage consultant for FBC Mortgage, in Jupiter, Fla. But that borrower would have to spend about $3,230 in closing costs, meaning it would take the borrower almost three years to recoup that money.[59]

On the other hand, a borrower who owes $375,000 under the same scenario would save $270.37 a month. With estimated closing costs of $3,915, the borrower would recoup that expense in a little more than a year. On a loan this size, it would make sense to consider it, Sahnger says.[60] Eligible homeowners should consider these closing costs when deciding if HARP is the way to go.

[59] Ibid.
[60] Ibid.

Chapter 4: Recent Results and Recommendations

Program Effectiveness

Despite the above criticisms and pitfalls of HARP and the MHA Program, many recent articles have noted that the number of homeowners helped by these programs has grown substantially, and the programs' effectiveness is increasing. The New York Times noted that, especially at the outset, the initiatives collectively called the Making Home Affordable program did not come near to fulfilling the administration's promise of relief for several million homeowners.[61]

Banks and other financial institutions were slow to participate, while many homeowners were either dissuaded or disqualified by paperwork requirements and restrictions intended to prevent waste and fraud in the $30 billion program. Over time, administration officials refined the initiative (HARP 2.0) and pressured lenders to help borrowers. Participation increased, if not to the anticipated levels of three million to four million homeowners.

Also, in 2012, after widespread reports of foreclosure abuses, five of the nation's biggest banks agreed to a $25 billion settlement with the federal government and 49 state attorneys general that required them to modify homeowners' payment terms. The lenders were Wells Fargo, JPMorgan Chase, Citi, Bank of America and Ally.[62]

According to the Treasury Department, as of May, 2013, about 1.3 million homeowners received direct assistance from the Making Home Affordable initiatives.[63] Another 300,000 have

[61] (Calmes, "Federal Program for Distressed Homeowners Is Extended", 2013)
[62] Ibid.
[63] Ibid.

received other relief, like forbearance in mortgage payments for homeowners who suddenly lost their jobs.[64]

As of March 2013, Treasury said, more than 1.1 million homeowners had moved from trial modifications to permanent modifications of their mortgages, for median savings of $546 a month, an amount that exceeds the median relief resulting from private sector modifications.[65] But the special inspector general charged with overseeing such relief programs, in the most recent quarterly report on April 24, expressed concern at the number of loan defaults among homeowners who have received assistance through mortgage modifications that reduced their payments.[66] The report recommended that Treasury work with lenders to learn why the defaults are happening and to devise "early warning" signs to identify troubled borrowers and try to help them before they default.[67]

While nearly 1.1 million borrowers used HARP in 2012 alone, equaling the 1.1 million in the first three years of the program combined,[68] there may still be as many as 2 million eligible borrowers who haven't taken advantage of HARP, according to analysts at Bank of America Merrill Lynch. HARP loans began to surge in 2012 and now account for almost a third of all refinancing applications, according to the Mortgage Bankers Association.[69]

FHFA data show that servicers are offering HARP loans to a growing number of the riskiest borrowers. About a quarter of HARP loans have gone to borrowers who owe more than their

[64] Ibid.
[65] Ibid.
[66] Ibid.
[67] Ibid.
[68] (Benson, "Fannie Mae Regulator Extends HARP Refinance Program Through 2015", 2013)
[69] Ibid.

properties are worth. In January of 2013, nearly half of HARP refinancings were for such underwater borrowers.[70]

HARP has become more popular among lenders as margins shrink on traditional loans. HARP borrowers are less sensitive to higher rates and fees than homeowners who have other options.[71] Also, securities containing HARP loans bring higher yields because borrowers are less likely to refinance again, preserving the value of the investment.[72]

In conclusion, it would seem that despite the valid criticisms against HARP and other government initiatives, the program, especially after its revision, has been somewhat effective at accomplishing its stated goal.

Policy Recommendations

The above problems that have plagued homeowners since the beginning of this crisis have been addressed partially by revisions to the plans and increased awareness to the programs at homeowners' disposal. This report seeks to provide a number of recommendations to help realize the goals set out by HARP and MHA, in order to more effectively combat the negative effects of this housing crisis.

During late 2008, major banks and both Fannie Mae and Freddie Mac established moratoriums (delays) on foreclosures, to give homeowners time to work towards refinancing.[73] While this was helpful early on, even though many of these troubled homeowners received assistance, they still remain in danger of foreclosure.

[70] Ibid.
[71] Ibid.
[72] Ibid.
[73] (Christie, "No help for 70% of subprime borrowers", 2008)

In order to make accurate policy recommendations, it is important to directly address the three largest problems currently being experienced with regards to HARP. First, less strict eligibility requirements would be required to fully reach the intended aim of these programs. By not allowing any mortgages that haven't been guaranteed by Fannie Mae or Freddie Mac to be refinanced under the program, the federal government is leaving many out in the cold. As was noted before, the GSEs accounted for only 22-48% of all subprime mortgages during any given year during the early stages of the housing crisis.[74] This leaves a huge chunk of potentially troubled mortgages out there with only traditional refinancing options to explore. Some analysts put the number of total eligible homeowners who could take advantage of HARP at over 4 million. [75] A quick calculation shows that up to 16 million homeowners could have been eligible for HARP, had the requirements allowed all subprime mortgages to be refinanced. By now, this figure is probably much lower, due to foreclosures or other means of mortgage modification, but it stands to reason that if some of the eligibility requirements were lifted, a greater number of homeowners could be helped, especially those with Option-ARM mortgages, as explained earlier.

In addition to the eligibility requirements being eased, another solution that might garner greater effectiveness of the program could be an easier, more streamlined application process, perhaps directly through government instead of individual lenders. If, as part of the MHA program, homeowners were able to simply apply to the federal assistance program through a single government entity, and then the government helped talk to individual lenders on the homeowner's behalf, the entire process may run much more smoothly, and congestion could be avoided. Obviously, this sort of system would cost money for the government to set up and run,

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[74] (Lewis, The Big Short: Inside the Doomsday Machine, 2010)
[75] (Benson, "Fannie Mae Regulator Extends HARP Refinance Program Through 2015", 2013)

but the rewards would be in line with the stated goals of the MHA program. This approach would allow the government's negotiating clout to work with individual banks and other lenders to more easily help those in need. Additionally, homeowners would have a singular, reliable source upon which to rely for information, further eliminating inefficiency in the process. While this policy may be difficult to measure regarding the number of added people it could help, it cannot be denied that the process would provide results faster than the current system.

As for the third major problem identified in this report regarding HARP, the overall value that homeowners receive after being approved for the federal program could be substantially improved. The discussion above regarding closing costs is a very real problem for those homeowners who are looking for help, and think they have found a solution, only to realize that the "savings" are minimal, when factoring in other costs beyond the reduced monthly payments. Along the same lines as the policy recommendation regarding the streamlined application approach, this problem could be improved by a more hands-on approach by the federal government when handling these mortgages. If the government was in charge of negotiating and executing these refinancing applications, it would be able to provide a savings on closing costs by taking some of the profit that the individual lenders would normally claim, and taking it for themselves. Since the lenders would essentially be allowing the federal government to use all the resources, it seems reasonable that they would be willing to recoup less closing costs for a chance at less-risky loans across the board. As was explained above, these refinancing programs have become more and more attractive to lenders due to the lowered risk, and better value as an investment. The government could pass the savings from closing costs onto consumers, allowing them to realize better value from the programs.

As an alternative to the systematic addressing of the major problems of the HARP and MHA programs above, perhaps a more broad type of reform should also be considered. Critics have argued that the case-by-case loan modification method is ineffective, with too few homeowners assisted relative to the number of foreclosures and with nearly 40% of those assisted homeowners again becoming delinquent within 8 months.[76] In December 2008, the U.S. FDIC reported that more than half of mortgages modified during the first half of 2008 were delinquent again, in many cases because payments were not reduced or mortgage debt was not forgiven. While the policy recommendations this report suggests could show a much more effective result, perhaps there is another way to help the country pull out of this crisis.

In February 2009, economists Nouriel Roubini and Mark Zandi recommended an "across the board" (systemic) reduction of mortgage principal balances by as much as 20–30%. Lowering the mortgage balance would help lower monthly payments and also address an estimated 20 million homeowners that may have a financial incentive to enter voluntary foreclosure because they are "underwater" (i.e., the mortgage balance is larger than the home value).[77] Obviously, this sort of reduction would require a phenomenal amount of capital, but it would almost certainly help avoid the ill effects that the bursting of the housing bubble has caused.

Along the same lines as the above suggestions, some critics call for a direct application of funds to homeowners, rather than banks. While banks are becoming more likely to refinance loans, a study by the Federal Reserve Bank of Boston indicated that banks were reluctant to modify loans. Only 3% of seriously delinquent homeowners had their mortgage payments reduced during 2008. In addition, investors who hold mortgage-backed securities and have a say

[76] (Christie, "When mortgage rescues go bad", 2008)
[77] ("Charlie Rose-Roubini-Mortgage Solutions")

in mortgage modifications have not been a significant impediment; the study found no difference in the rate of assistance whether the loans were controlled by the bank or by investors. Commenting on the study, economists Dean Baker and Paul Willen both advocated providing funds directly to homeowners instead of banks.[78]

While both of these approaches regarding more direct funding for consumers might garner results faster, the amount of money needed to accomplish these recommendations is probably unreasonable. Therefore, it seems likely that the policy recommendations regarding HARP revisions outlined in this report, would be the most cost-effective means to most efficiently accomplish the goals set forth by this particular federal policy regarding home mortgage finance.

[78] (McKim, "Lenders avoid redoing loans, Fed concludes", 2009)

Conclusion

This report outlined a modern history of federal policy on home mortgage finance that helped to set the stage for what has been one of the most difficult housing disasters that America has ever seen, the roles of Government-sponsored entities in that disaster, and the effectiveness of the most current federal responses to the crisis, HARP and MHA. Despite the causes of the housing crisis and the GSEs' roles, the federal government remains able to react and solve the numerous problems plaguing the country regarding home mortgage issues. Notably, the GSEs were taken over by the FHFA, as an important first step. However, with regard to the most recent programs aimed at alleviating foreclosure pressures across the country, some reform could still greatly increase effectiveness and efficiency. By combining more responsible,, sustainable lending practices, increasing regulation, and improving already-valuable federal programs, the U.S. government can hope to achieve a strong housing economy again.

, this report will detail policy recommendations and changes to the current programs that may help to further alleviate the problems discussed in this report, and more effectively achieve the stated goals of the MHA and HARP.

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Vita

Casey Daniel LeMay was born in Miami, Florida in 1987. After graduating from the University of Florida in 2009, he entered the University of Florida Levin College of Law. He received a bachelor's degree in Business Administration and a Juris Doctor degree, respectively. In August 2012, he entered the Graduate School at the University of Texas at Austin.

E-mail Address: clemay787@gmail.com

This report was typed by the author.