Center for American Progress

Protecting Communities on the Road to Recovery

Why Strong Standards are Critical for the Distressed Asset Stabilization Program

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Introduction and summary

More than 778,000 homeowners with loans backed by the Federal Housing Administration, or FHA, and the two government-backed mortgage corporations—Fannie Mae and Freddie Mac—are at serious risk of foreclosure.[1] A full housing recovery in the fragile neighborhoods where many of these loans are located largely hinges on how well agencies and investors are able to help these homeowners stay in their homes. And in those cases where foreclosure is unavoidable, it is important to ensure that vacant properties are well-maintained and do not further erode home values in a neighborhood.

In 2012, the FHA launched the Distressed Asset Stabilization Program, or DASP, to sell seriously delinquent single-family loans and vacant properties facing near-certain foreclosure through regular auctions to private investors—mostly private equity firms and hedge funds.[2] Sales of nonperforming loans through programs such as DASP are often called "note sales," as notes refer to the promissory record documenting that a borrower owes money to a lender.[3] Thus far, the note sales through DASP appear to have helped the FHA reduce the costs and legal risks associated with maintaining and selling foreclosed properties.[4]

However, DASP needs additional protections to ensure that note purchasers handle the assets they purchase responsibly. Moreover, DASP in its current form appears to shift some of the costs associated with foreclosures from the federal government to neighborhoods and local governments. Stronger standards—for loss mitigation, a process that can help borrowers avoid foreclosure; for how investors deal with vacancies; and for neighborhood stabilization—would better ensure that homeowners get a fair chance to stay in their homes when their properties are sold through DASP. These improvements also could control vacancies, which put a drag on local economies, and bolster FHA finances over the long term.

In May, *The New York Times* reported that the U.S. Department of Housing and Urban Development, the federal agency that houses the FHA, would soon announce improvements to DASP.[5] Further improvements would be a critical step in the right direction, and the FHA should continue efforts to quickly finalize the improvements. Unfortunately, some investors and members of Congress oppose such moves. Senate Banking Committee Chairman Sen. Richard Shelby (R-AL) and House Financial Services Committee Chairman Rep. Jeb Hensarling (R-TX) wrote to the FHA in March, arguing that changes would hurt private market participation in DASP and should be rejected.[6] Improvements to DASP, though, are unlikely to reduce private-sector participation and would improve neighborhood stabilization efforts.

Those who oppose changes to DASP may argue that protections for homeowners, neighborhoods, and local governments are unnecessary because investors' economic incentives are well-aligned with the needs of homeowners and therefore are likely to guide business in ways that benefit all parties. This report challenges claims that relying on investor market incentives alone is a sufficient strategy to protect vulnerable communities, underscoring the importance of strong standards for DASP.

The Center for American Progress' analysis shows that relying on assumptions about investor market incentives without accounting for the range of companies buying assets, or the characteristics of the assets sold and the markets in which they are located, is a dicey approach that could put taxpayers and neighborhoods at greater risk. Private-sector investors may not always have a strong economic incentive to offer long-term, sustainable loan modifications or to invest in the maintenance, demolition, or rehabilitation of properties. Moreover, firm incentives may vary depending on the characteristics of the market in which an asset is located, and purchased assets located in distressed communities may be at greater risk of neglect.

In preparing this report, CAP analyzed more than 70,000 loans across the national pools of mortgages sold through DASP in six national auctions from April 2012 to June 2014.[7] The analysis shows that about two-thirds of the notes are located in ZIP codes suffering from higher-than-average rates of negative equity, a term that means a homeowner owes more on a home than it is worth. A staggering 83.5 percent of notes in the report sample are in ZIP codes with a higher concentration of people of color than the national median.[8] In short, the majority of nonperforming loans are attached to properties located in communities particularly hard hit by the housing crisis or that are home to racial and ethnic groups that have lost a disproportionate share of wealth throughout the foreclosure crisis.[9]

At the same time, a significant share of notes in the sample is located in ZIP codes that may be on the road to recovery. Overall, 60 percent of notes are located in ZIP codes with negative equity levels that, although higher than the national average, are improving, and 66 percent of the notes are located in ZIP codes that experienced job gains from 2010 to 2013. These trends suggest that assets sold through DASP tend to be located in struggling communities but that many of these communities are experiencing improvements in their housing markets and local economies. If investors handle the notes responsibly, they can help push improving communities toward recovery. On the flip side, if investors do not treat homeowners fairly or do not adequately maintain foreclosed properties, they could undermine or delay a full recovery in these communities.

The FHA should take additional steps to ensure that note buyers are offering sustainable loan modifications and handling foreclosed or vacant properties responsibly. And policymakers should not obstruct such improvements, which are critical to ensure that DASP does not derail communities still very much on the road to recovery. By increasing loss mitigation standards[10] and creating stronger requirements for how investors handle foreclosures and vacant properties, the FHA can signal a critical step forward in DASP that can help ensure positive outcomes for homeowners, neighborhoods, and ultimately the FHA itself.

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And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

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