The Federal Housing Administration's Distressed Asset Stabilization Program: An Innovative Solution for Addressing the National and Local Impacts of the Recession

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The housing market and the nation's economy have come a long way over the past year. Construction is growing faster than at any time since the crisis began in 2008 and 2012 was the strongest year of home sales since the beginning of the recession. Rising home values have lifted millions of families back above water on their mortgages, foreclosure starts are down, and unemployment rates continue to fall, putting communities and the national economy on the road to recovery.

Although we are seeing signs of economic rebound, we must remember that the crisis was truly disastrous for many families and communities. When President Obama spoke recently about the role that housing plays in creating a better bargain for the middle class, he was clear that one of our priorities must be rebuilding the communities that were hardest hit by foreclosure. And while the housing market and the economy have continued along the path to recovery, that recovery has been uneven–some areas continue to lag behind. Those places are being held back by high foreclosure rates and vacant properties that drag down home values and slow growth. We need to rebuild these local economies if we want to create opportunities for everyone to reach or remain in the middle class.

Throughout the recession, the Federal Housing Administration (FHA) played a vital role in preventing a larger housing crisis. By providing much-needed liquidity and credit access when the private market contracted severely, FHA has kept the housing market functioning. However, this crucial countercyclical role came at a cost in the form of added stress to FHA's insurance fund. We continue to deal with a sizable portfolio of seriously delinquent loans and, because we could not rely solely on FHA's traditional real estate owned (REO) disposition mechanisms to handle this influx of loans, our team looked for innovative ways to address the challenge associated with nonperforming assets. In addition to seeking higher recoveries for FHA's insurance fund, we also considered ways we could leverage these assets to achieve broader goals, including reducing the concentration of vacant foreclosed properties and contributing to stabilization in areas hit hardest by the recession. These efforts resulted in the development of the Distressed Asset Stabilization Program (DASP).

An Innovative Solution to a Lingering Problem

DASP, which builds on an existing program known as the 601 Accelerated Claims Disposition note sales program, is an innovative strategy to sell severely delinquent loans before they go into foreclosure. Under FHA's traditional claim payment process, foreclosed homes are conveyed to the Department of Housing and Urban Development (HUD) as REO properties. Under DASP, however, FHA-insured loans are sold prior to foreclosure through a competitive bidding process in which loan pools are sold to the highest bidder, including nonprofit and community-based organizations. Once the note is purchased, foreclosure is delayed for a minimum of six additional months, giving the new servicer a chance to work through possible alternatives with the borrower, one of which may be to find an affordable solution to allow the borrower to remain in his or her home. Because the purchaser is able to buy the mortgage notes at the prevailing market rate–which is generally below the outstanding principal balance–they often have an increased ability and incentive to help borrowers prevent foreclosure. If that isn't possible, the purchaser may be able to help the borrower sell the property through a short sale or find some other alternative preferable to foreclosure. Purchasers are required to report on final resolutions of the loans purchased, including the level of loan restructuring received by a borrower. While it is still early in the process of working through loans purchased through DASP, preliminary indications are that many borrowers who would otherwise have faced foreclosure are indeed finding alternative solutions.

DASP also serves an important role in our efforts to increase recoveries on defaulted loans. To achieve higher recovery rates than those associated with FHA's traditional REO disposition process, we have worked to increase the share of loans directed to pre-REO alternatives. As a result of these efforts, our alternative disposition programs have increased recovery rates on defaulted loans by seven percentage points since January 2013. This improvement has had a direct, significant impact on FHA's insurance fund.

In effect, DASP creates a win-win-win situation for all involved. It enables FHA to avoid the carrying and maintenance costs associated with REO disposition while achieving material reductions in FHA's delinquent loan portfolio. For small servicers, assigning eligible loans to HUD through this program reduces the costs of carrying them through foreclosure, benefitting both the servicer and FHA. DASP also provides many borrowers better alternatives than the foreclosure that would be almost certain otherwise, and it contributes to more stable communities as cities and towns work to emerge from the effects of the recession.

Targeted Support Where It Is Needed Most

Some communities need even more help in addressing the high concentrations of seriously delinquent properties, and we wanted to ensure that these communities experienced the stabilizing and revitalizing effects of FHA's distressed asset programs. In the hardest-hit areas, vacant and abandoned properties hurt the community's economic recovery, significantly lowering surrounding home values. For these areas, HUD created specialized pools of loans within DASP called neighborhood stabilization outcome (NSO) pools. These pools carry additional safeguards to ensure that the program contributes to revitalization and stabilization in communities struggling to rebuild from the effects of the recession.

NSO pools require that at least 50 percent of the loans within a purchased pool achieve "neighborhood stabilizing outcomes," which may include resolutions such as holding the property as a rental unit for at least three years or executing a short sale to a new owner-occupant. The six-month delay for foreclosure proceedings applies to the NSO pools as well. Selling these significantly distressed loans located in areas hardest hit by the crisis can encourage investment in these communities, potentially breathing new life into these loans and facilitating proactive steps to make sure homes are occupied.

Parties seeking to bid in the NSO pools are required to meet additional criteria beyond what is required for bidders in national pools to ensure they will comply with the program's goal that fewer homes end up as vacant REO properties. In some of these hard-hit communities, state and local leaders are already acquiring these loans and using HUD tools to offer workable solutions for homeowners and communities. Nonprofit and for-profit investors have shown great interest in using this program to help families in their community find affordable housing options quickly and sustainably. Some have had great success in partnering with state and local government entities to acquire assets through DASP, leveraging their expertise to achieve government goals in targeted areas. Early indications are that some of these nonprofits are achieving strong borrower contact rates and substantial effectiveness in helping homeowners avoid foreclosure, resulting in the positive individual and community outcomes DASP was created to deliver. Because of this success, FHA is working with local leaders to create additional smaller pools to fit their targeted neighborhood strategies.

DASP sales brought an enthusiastic response from the marketplace in fiscal year 2013. FHA sold more than 40,000 notes nationwide, with targeted NSO pools in Chicago, Illinois; Tampa, Florida; Phoenix, Arizona; Newark, New Jersey; the greater Orlando area in Florida; southeastern Florida; Southern California; Cleveland, Ohio; southern Ohio; Atlanta, Georgia; and North Carolina.

Innovation for Restoration

The recent signs of recovery from the worst economic downturn since the Great Depression are promising, largely due to the decisive and aggressive action the Obama administration has taken during the last five years. FHA answered the call to ensure liquidity in a disrupted market, and protected access to homeownership for millions of American families. As a result, FHA has contributed significantly to stabilizing the nation's housing market and to promoting a speedier recovery from the recession. No program or policy will solve all of the problems in a $9 trillion housing market, but as the country emerges from the recession, we must continue to seek out new and innovative ways to strengthen communities and help families while we work to restore FHA's insurance fund. The Distressed Asset Stabilization Program is one way we do just that.

DASP is an important example of how the federal government can work with private and public partners to facilitate greater stabilization in local and national markets and assist hard-hit communities as they recover. DASP is also an example of how we can use existing tools to help better manage the fund, securing it for future generations of homeowners. With DASP and other innovative efforts, HUD is committed to ensuring that the nation's housing market and the broader economy return to full health, and that the American dream of homeownership remains alive and well.

The United States Senate confirmed Carol J. Galante to serve as the Assistant Secretary for Housing/Federal Housing Commissioner on December 30, 2012. Prior to her confirmation, Ms. Galante served as the Acting Assistant Secretary for Housing/FHA Commissioner, having first joined HUD in May 2009 as the Deputy Assistant Secretary for Multifamily Housing programs. Prior to her appointment at HUD, Ms. Galante was President and Chief Executive of BRIDGE Housing Corporation, the largest non-profit developer of affordable, mixed-income and mixed-use developments in California.