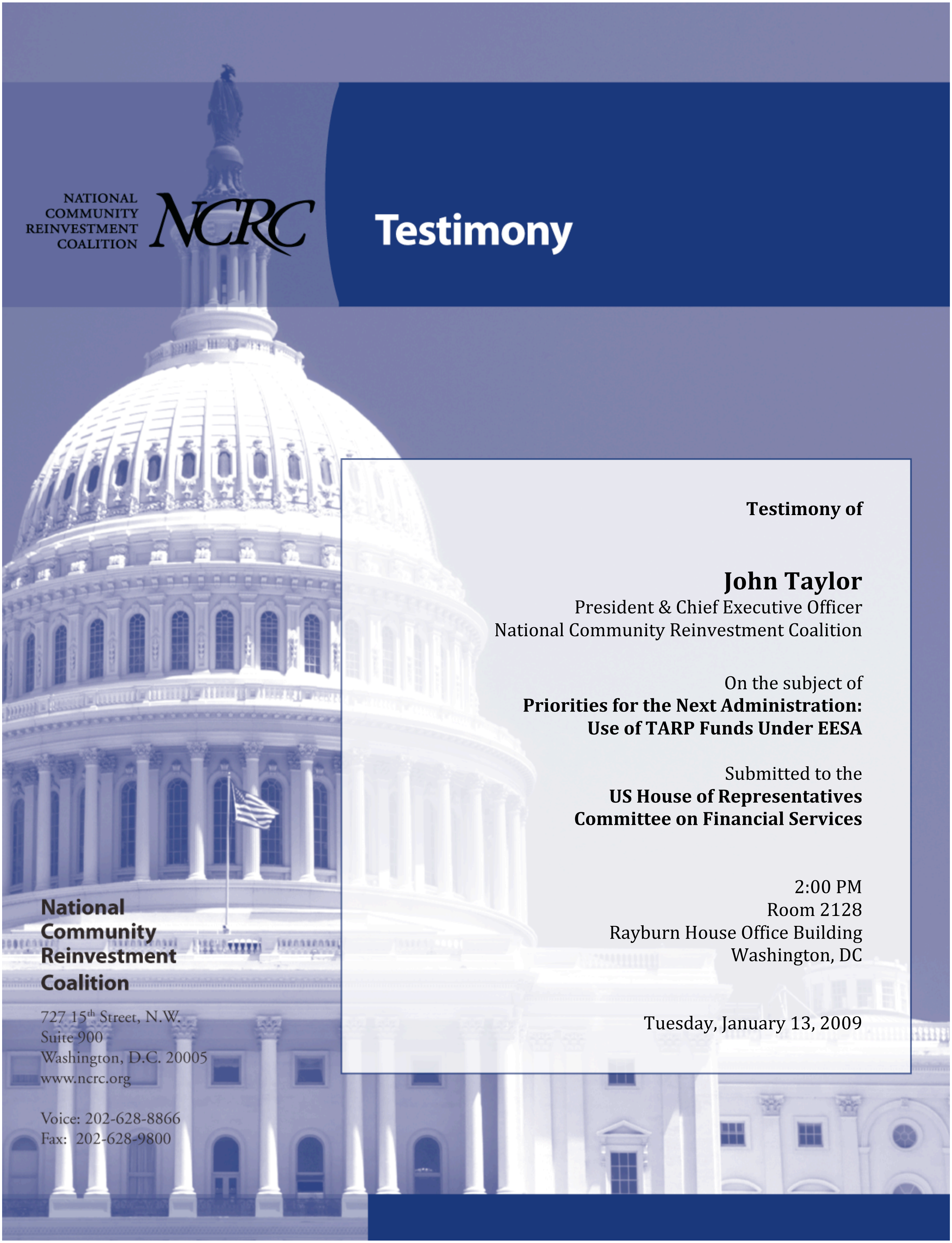

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of

John Taylor

President & Chief Executive Officer
National Community Reinvestment Coalition

On the subject of
Priorities for the Next Administration: Use of TARP Funds Under EESA

Submitted to the
US House of Representatives Committee on Financial Services

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National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

Introduction

Good Morning, Chairman Frank, ranking member Bauchus, and other distinguished members of the Committee. I'm John Taylor and I am the President and Chief Executive Officer at the National Community Reinvestment Coalition (NCRC). NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

I am honored to testify today on behalf of NCRC before the United States House of Representatives Committee on Financial Services regarding the use of Troubled Asset Relief Program (TARP) funds under the *Emergency Economic Stabilization Act of 2008* (EESA). Chairman Frank and other members of the Committee, NCRC commends your efforts to ensure that the remaining TARP funds be prioritized in the most effective and efficient manner. NCRC is also pleased that the Chairman's TARP Reform bill provides significant financing of up to $100 billion for foreclosure mitigation, addresses many of the barriers frustrating loan modifications, and institutes reforms of the Federal Housing Administration HOPE for Homeowners program.

NCRC recommends that a significant portion of the remaining TARP funds be used to address the foreclosure crisis. Financial markets will not stabilize and the economy will not rebound until the foreclosure crisis is addressed by the implementation of a large-scale loan modification program. Moreover, substantial intervention is necessary to respond to the contagion effects of the foreclosure crisis. Failure to address mounting foreclosures continues to drive down home prices, which results in a wide range of problems for the financial system and overall economy, including reduced home equity, decreased consumer confidence, a loss of jobs, and a steeper decline in overall economic activity and performance that go beyond loan modification. Therefore, NCRC recommends the investment of remaining TARP funds in an economic recovery program that promotes infrastructure projects and small businesses that create jobs and rebuild communities. Finally, considering the magnitude of the current financial crisis and its potential long-lasting effects, action should be immediate to address the problems that caused this crisis, which are the unfair and deceptive practices that led to the undermining of the national economy.

I. Use TARP Funds to Address Foreclosures

To date, TARP funds have been spent on efforts that have not stabilized the financial system. The first $350 billion were used to inject liquidity into markets through cash investments into financial institutions and emergency loans to the automotive industry. However, the financial markets remain unstable, as *preventable* foreclosures continue to weaken the national economy and devastate local communities.

Recently, the Second Report of the Oversight Panel criticized the United States Treasury Department for failing to use any of the first $350 billion to alleviate the foreclosure crisis.[1] The Panel called into question the Treasury's stated intent of developing "a plan that seeks to maximize assistance for homeowners."[2] And while helpful, federal programs and voluntary efforts to stem the foreclosure crisis do not address the breadth and depth of arresting this crisis.

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[1] Accountability for the Troubled Asset Relief Fund, The Second Report of the Congressional Panel, January 9, 2009.
[2] Id.

Immediate solutions are needed to restore the health of the financial system and overall economy. Therefore, NCRC recommends that a significant portion of the remaining TARP funds be invested in a large-scale loan modification program that will assist homeowners and prevent additional foreclosures.

i. Voluntary and Federal Loan Modification Programs Are Insufficient[3]

Financial institutions have voluntarily modified loans on a large scale, but these modifications have been disappointing. In a sample of 3.5 million loans, Valparaiso University Law Professor Alan White found that more than half of the modifications did not result in lower mortgage payments.[4]

The federal government has also established loan modification programs that are not of the scale necessary to assist homeowners in a timely manner and prevent foreclosures. For instance, the Hope for Homeowners program offers distressed borrowers an opportunity to refinance into

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[3] **Obstacles to Voluntary and Federal Programs**: Various structural, market, and institutional obstacles have created formidable barriers to current programs and policies intended to modify loans. Programs that rely on voluntary participation of lenders, servicers, and investors have not been effective in overcoming these obstacles. One of these obstacles is the restrictions imposed by Mortgage-Backed Securities (MBS). When investors buy pools of loans called MBS, a pooling and service agreement (PSA) imposes various limits on a servicer (servicers receive borrower payments and then process payments to investors). For example, some PSAs allow just 5 percent of loans in a MBS pool to be modified. Other PSAs are vague and state that loans can be modified as long as servicers comply with "acceptable servicing standards." The outcome of the restrictiveness and vagueness of PSAs is that servicers fear investor lawsuits if they aggressively modify loans. Indeed, investors recently sued Bank of America when that lender tried to modify distressed loans in MBS.

A second obstacle is that compensation methods provide perverse incentives for servicers. Servicers receive fees that are a small part of monthly borrower payments on loan interest. In the case of foreclosure, a servicer can recoup missed borrower payments out of the proceeds of a foreclosure sale. In contrast, when a loan is modified, there is no clear way for a servicer to receive compensation, particularly when borrowers are granted waivers for unpaid past due interest. The current compensation system, therefore, can actually discourage servicers from modifying loans.

A third obstacle is the misaligned incentives of the different lenders that hold first and second mortgages. A prominent feature of high-cost and risky lending of recent years is that lenders would often make a first mortgage and a second mortgage (or piggyback loan) simultaneously to a borrower. When unaffordable piggyback loans need to be modified, one of the lenders may block a proposed modification. For instance, the lender holding the second mortgage may decline to agree to the modification, calculating that borrower payments under the new modification will be too low to payoff the second mortgage.

[4] Alan White, Deleveraging American Homeowners, December 18th Update to August 2008 paper.

loans that are guaranteed by the Federal Housing Authority. While this program had estimated to refinance up to 400,000 loans when it was authorized by Congress this past summer, the program is not demonstrating immediate results, as evidenced by the fact that only 357 applications have been submitted since the program's inception in October 2008.[5]

Under Sheila Bair, the Federal Deposit Insurance Corporation (FDIC) has positioned itself in a leadership role by emphasizing the need to modify loans and implementing a best-practice model based on the IndyMac program. When IndyMac, a large savings-and-loan institution based in California, failed in July 2008, the FDIC instituted an aggressive loan modification program for defaulting IndyMac loans. The FDIC program modifies loans using interest rate reductions, principal forbearance, and extended amortization in order to achieve a monthly housing payment-to-income ratio of no more than 38 percent. However, to date, significant reductions of loan principal have not been a regular component of the FDIC modifications.

Most recently, the FDIC created a plan to modify up to 1.5 million distressed loans based on the IndyMac model and offer a government guaranty of 50 percent for refinanced loans. In an effort to overcome disincentives for servicers, FDIC proposes to pay servicers $1,000 to modify distressed loans.[6] While the IndyMac program has been the most effective mechanism implemented at present, both it and the subsequent FDIC proposal may result in modifications that would not achieve long-term affordability for struggling homeowners, especially if the loan modifications do not reduce outstanding principal loan amounts.

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[5] Michael Corkery, Mortgage 'Cram-Downs' Loom as Foreclosures Mount, Wall Street Journal, December 31, 2008.
[6] http://www.fdic.gov/consumers/loans/loanmod/ and see Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation on Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and Of Government Lending and Insurance Facilities; Committee on Financial Services; U.S. House of Representatives; Room 2128, Rayburn House Office Building, November 18, 2008, http://www.fdic.gov/news/news/speeches/chairman/spnov1808.html

ii. Create a Large-Scale Loan Modification Program that Provides HELP Now

Experts forecast as many as ten million foreclosures will occur before the end of the current economic crisis. Therefore, NCRC recommends that a TARP loan modification program modify between three to five million distressed loans.[7]

In early 2008, NCRC proposed the establishment of a national Homeowners Emergency Loan Program (HELP Now). It would authorize the Treasury Department to buy troubled loans at steep discounts (equal roughly to their current write-downs by financial institutions) from securitized pools. This would result in a relatively low cost to taxpayers. The government would then arrange for these loans to be modified through existing entities such as Fannie Mae and Freddie Mac, and then sell the modified loans back to the private market. The program would be relatively easy to implement, as it does not require the creation of a new entity.

The purchase discounts would be applied to the modification of problem loans to create long-term borrower affordability. Reflecting the write-downs by financial institutions, the government would purchase loans at a 30 percent to 50 percent discount. If the discounted loans are still not affordable for some borrowers, the government could offer a low-interest second mortgage that would be due upon sale of the property.

HELP Now would be an efficient use of government resources. HELP Now would require an initial government outlay of about $50 to $100 billion to purchase loans and would institute a revolving loan fund mechanism. The government would be reimbursed for its loan purchases after it sells the loans (which have been modified) to Fannie Mae, Freddie Mac, or private-sector

[7] Credit Suisse, Foreclosures Update: Over 8 Million Foreclosures Expected, December 4, 2008, Fixed Income Research, http://www.credit-suisse.com/researchandanalystics

investors. Moreover, the government would be able to establish mandatory underwriting criteria in order to guard against re-defaults. Unlike the Hope for Homeowners program, the IndyMac program, and the subsequent FDIC proposal based on the IndyMac model, the government would not guarantee the loans, and would, therefore, not incur significant losses beyond those required to administer the original loan modifications.

(Please see the attached paper on the proposed NCRC HELP Now program.)

iii. Use the Power of Eminent Domain

A number of legal scholars have suggested that there are legal impediments regarding the complexity of selling loans held in securitized pools. Therefore, NCRC recommends the alternative approach of using eminent domain with the HELP Now proposal to purchase loans from investors and servicers. The current economic crisis would justify the government's use of eminent domain laws for a compelling public purpose. In addition, eminent domain would overcome several barriers. Through compulsory purchases of troubled loans, reluctant servicers, investors, and lenders would not need to be persuaded to participate.

Utilizing the federal government's power of eminent domain avoids lawsuits from disgruntled investors. As Harvard Law Professor Howell Jackson points out, eminent domain can solve the barriers related to first and second liens by directly purchasing all mortgages on targeted properties.[8]

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[8] Professor Howell E. Jackson memo to the House Financial Services Committee, November 28, 2009, on file at NCRC.

The use of eminent domain could also alleviate pricing uncertainties to unfreeze the credit market, and it could establish fair prices for mortgages through existing judicial mechanisms.[9] Once fair prices are established, a secondary market can then be re-established and voluntary efforts to refinance mortgages will most likely accelerate. Professor Jackson proposes that eminent domain focus on the most problematic loans in geographical areas of the country where home prices have fallen significantly.

iv. Use Third-Party Counselors

The large-scale loan modification program must also use neutral third-party counselors to ensure its effectiveness and represent the interests of borrowers. The counselors would be able to ensure that borrowers obtain an affordable and sustainable mortgage. Studies have shown that as many as half of consumers in foreclosure have not proactively spoken with their servicers. A lack of trust of consumers' trust of financial institutions is speculated to be a major reason for this disconnect. Under a TARP program, the counselors should be empowered to review the proposed modification and suggest any further alterations necessary to achieve long-term affordability.

v. Protect Renters Interests

The government should ensure that renters receive protections under its program. A sizable number of distressed loans involve investors who do not live in the property they purchase but have rented the properties to tenants.[10] Currently, tenants face eviction with little or no notice

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[9] In cases of price disputes when the government has used eminent domain, a judge or mediator will rule on a fair price.

[10] Fifteen million tenants or about 40 percent of all renters live in single family homes, many of which are owned by small scale investors. A segment of this large population is at risk during the current foreclosure crisis. See J.W.

after a foreclosure. In these cases, the government must provide sufficient time and relocation assistance for the tenants.

vi. Enact Judicial Loan Modification

Judicial loan modification would assist borrowers facing foreclosure that the recommended TARP loan modification program may not reach because of the scale of the crisis. Allowing struggling borrowers access to bankruptcy protection could enable up to 600,000 families to seek immediate help to avoid foreclosure–and at no cost to the taxpayer. At present, the family home is the only asset for which a bankruptcy court cannot modify the terms of repayment to make it affordable to maintain. Yet, bankruptcy courts are able to modify outstanding debt on a luxury yacht, investment property, or even a *second* home.

Recently, Congressman John Conyers introduced the *Helping Families Save Their Homes in Bankruptcy Act of 2009* (H.R. 200) and Senator Dick Durbin introduced the *Emergency Homeownership and Equity Protection Act* (S. 61). Both bills support the enactment of judicial loan modification. NCRC supports the passage of both pieces of legislation as tools to modify loans, save homes, and strengthen the economy. NCRC recommends that Congress seize the opportunity created by the current momentum and immediately pass a judicial modification bill.

II. Address Unemployment, Which Is Now Creating a Secondary Foreclosure Crisis

Any plan to stabilize the economy must address the collateral damage stemming from foreclosures. Frozen credit markets, rising unemployment, and declining home values are

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Elphinstone, What if Your Landlord Faces Foreclosure, Associated Press article appearing in the Washington Post, January 3, 2009.

detrimental to communities hardest hit by the foreclosure crisis. NCRC recommends an economic recovery program that promotes job creation and community building through investments in infrastructure and small businesses. TARP funds and funds from other pools, such as the economic stimulus package that may be proposed by Congress and the President-elect, can be used to finance this program.

i. Invest in an Economic Recovery Program

Allocating a significant portion of the remaining TARP funds to support a well-crafted and consumer-focused economic recovery program can turn a dire state of affairs in the national economy into a major opportunity for the nation as a whole. However, prioritizing spending is essential to maximizing the return on investments. Priority should be given to the areas of greatest unemployment, those most severely devastated by the foreclosure crisis, and areas suffering most from under-maintained infrastructures. A majority of the communities most severely affected by unemployment, high foreclosure rates, and crumbling infrastructures are those communities that have been traditionally plagued with poverty and a lack of socio-economic opportunity and advancement. Though long overdue, the current economic crisis provides an opportunity to channel billions of dollars into rebuilding low- to moderate-income communities.

ii. Infrastructure Investments

By focusing infrastructure investments to promote sustainable employment growth, rebuild communities, enhance the use of clean energy technologies, and lay the foundation for a better trained and highly skilled workforce, the United States will emerge from the current crisis stronger and better prepared to meet the challenges in an increasingly competitive global economy. Moreover, strategically targeted infrastructure investments can also level the playing field of opportunity across diverse communities in a manner not experienced for at least four decades.

For immediate results, new infrastructure investments should be made in housing, transportation, environmental hazard remediation, and green technologies. Regarding housing, there is a current need to reclaim abandoned foreclosed properties [Real Estate Owned (REO)]. REOs present a clear danger to neighborhoods, as abandoned properties are routinely vandalized and used for criminal activity. These activities depress home values and increase physical decay in neighborhoods. Without action to reclaim REOs, it will be difficult for neighborhood housing markets to rebound.

iii. Small Business Investments

Small businesses are a driver of the US economy. Specifically, minority small businesses or "Emerging Domestic Market" (EDM) companies are creating sustainable employment opportunities at a higher rate and growing three times faster than traditional small businesses. However, small businesses are desperately suffering because of the current economic crisis. The decrease in consumer spending, late payments by consumers, and a decline in cash flow are only the latest problems threatening small businesses. Investing TARP funds in small businesses will have the two-fold effect of assisting entities that help power the economy and promoting the creation of sustainable employment.

III. Act Now to Address the Problems That Got Us Here

Arresting the foreclosure crisis, which is the root cause of the current financial crisis, will result in immediate stabilization of the turbulent financial markets. However, the time to act is now. A few months ago, Moody's economy.com predicted an additional 5.2 million foreclosures through 2010. Since then, studies by Credit Suisse and Moody's economy.com predict as many as eight to ten million foreclosure as unemployment increases. In 2008 alone, Americans lost $2 trillion in housing equity and more than $7 trillion in wealth from the stock market.

It is also important to note the effect that unemployment will have on the foreclosure crisis absent immediate and broad-scale intervention. The year 2008 has been named the worst for job losses since 1945.[11] Recent estimates show that 2.6 million Americans lost their jobs in 2008 and the national unemployment rate is now 7.2%.[12] These statistics demonstrate that unemployment rates are increasing at a steady and unprecedented pace. Going forward, foreclosures will be increasingly driven by the effects of workers losing their jobs. These job losses are not expected to be recovered any time soon. With each passing month, Americans are exposed to more difficult economic conditions that limit financial recovery.

As previously stated, while immediate action is necessary to stem the foreclosure crisis, additional consumer protections must also be considered to ensure that the unfair and deceptive practices that led to the foreclosure crisis, and ultimately to the overall economic crisis, are forever purged from the market. Congress should act now to address financial system regulatory reform which, if implemented earlier, would have prevented the abusive practices that caused the

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[11] See http://money.cnn.com/2009/01/09/news/economy/jobs_december/?postversion=2009010908.
[12] Id.

current economic downturn. Therefore, NCRC recommends the enactment of national anti-predatory lending legislation, modernization of the *Community Reinvestment Act* (CRA), and regulatory system restructuring and reform.

i. CRA Modernization

CRA establishes an obligation on banks to serve the needs of all communities, particularly low- to moderate-income neighborhoods, consistent with safety and soundness. In order to build upon CRA's benefits and increase the safety and soundness of credit and capital, NCRC urges Congress to pass CRA modernization legislation—similar to the *CRA Modernization Act of 2007*—and the planned reintroduction of the *CRA Modernization Act of 2009* (to be sponsored by Representatives Eddie Bernice Johnson and Luis Gutierrez). The *CRA Modernization Act of 2009* would apply CRA to non-bank financial institutions, including mainstream credit unions, insurance companies, independent mortgage companies, and investment banks. Moreover, this legislation would strengthen CRA as applied to banks by enhancing publicly available data on lending activity, requiring CRA exams to consider lending to minorities and ensuring that the great majority of bank lending activity be scrutinized.

ii. Regulatory Restructuring and National Anti-Predatory Lending Legislation

Predatory lending has been widely documented for more than a decade. However, failed government regulation allowed unfair, deceptive, and otherwise predatory lending to contribute substantially to the current foreclosure crisis. Hundreds of studies, legislative testimony, and print news stories documented the abusive lending practices, but nothing has been done to purge these practices from the home mortgage market.

Rather than purge predatory lending, federal regulatory policy exacerbated the problem. In response to a robust anti-predatory lending law enacted by Georgia in 2002, the Office of the Comptroller of the Currency ruled in 2004 that federal regulations preempted state law for nationally chartered banks in its entirety. This ruling undermined actions of dozens of states attempting to protect the financial interest of their residents. In addition, the Federal Reserve refused to tighten regulations under the *Homeownership and Protection Act* (HOEPA) until July 2008, after more than two million borrowers lost their homes because of predatory lending.

Regulatory restructuring and retooling are urgently needed to avoid additional regulatory failure in the future. Moreover, in order to prevent another foreclosure crisis of the current magnitude, NCRC supports the enactment of a comprehensive anti-predatory lending law that uproots abusive and predatory lending practices.

Conclusion

The current economic crisis presents an opportunity for America to rebuild both its crippled financial system and its fractured communities in a manner that is far-reaching and sustainable.

NCRC recommends that a significant portion of the remaining TARP funds be used to address the foreclosure crisis. Moreover, substantial intervention is necessary to respond to the contagion effects of the foreclosure crisis. Investments in an economic recovery program that promotes infrastructure projects and small businesses that create jobs and rebuild communities are imperative to mitigating the effects of the declining economy. Moreover, preventive consumer protections to purge the unfair and deceptive practices that led to this crisis must be enacted.

Time is of the essence. Americans continue to suffer under the weight of a collapsing economy. Congress must act swiftly because too many lives—hopes—dreams—will be destroyed the longer our legislators allow Americans to suffer in the gridlock of programs and policies that fail to address the underlying problem that continues to destabilize our national economy—which is rising foreclosures. The resilience of the American economy depends on targeted government spending that will strengthen the housing market and create jobs.

Thank you and we look forward to partnering with you on the long road ahead to economic recovery.

NATIONAL
COMMUNITY
REINVESTMENT
COALITION
NCRC

Policy Recommendations

Recommendation to Establish the Homeowner Emergency Loan Program (HELP Now)

By the
National Community Reinvestment Coalition

Submitted to the
US Senate Committee on Banking, Housing and Urban Affairs

On the Subject of
"Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation"

Thursday, January 31, 2008

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

NCRC's HOMEOWNERS EMERGENCY LOAN PROGRAM (HELP NOW)

Currently no remedy in place is of the scale to seriously tackle the foreclosure crisis. The National Community Reinvestment Coalition, a nonprofit consumer group, is proposing a market-driven solution to the mortgage and foreclosure crisis. Proposals discussed to date; including those proposed by the mortgage industry (Bank of America plan), put taxpayer funds at risk. The Administration has made clear it will not support any plan that does so. For this reason, NCRC has proposed the Homeowners Emergency Loan Program (HELP Now), originally in February 2008, which offers minimal risk to taxpayer funds. This plan still remains the most sensible and promising of any offered.

- With the HELP Now proposal, loans are purchased from investors by the government at discounted rates; loans are then resold to the private market and then modified. The HELP Now program allows the private market to fix the problem it created in the first place.

- HELP Now targets mortgage loans where the homeowner is still employed and where there has been little or no reduction in the source of the homeowner's income. In other words, this program helps borrowers able to pay, but trapped in mortgages that were high cost and unreasonable to begin with.

- HELP Now creates a three-year program, not a new agency. The Treasury Department would purchase loans and/or loan pools held in securitized pools at a steep discount, using the government's authority under the laws of eminent domain. This allows the government to take an asset where a public purpose is served, and it requires that they pay the investor the "fair market value" for this taking.

- The fair market value of these loans would result in a steep discount (at present 30-50% of the current loan value) which could be passed along to the homeowner as a reduction in their mortgage. Discounting the purchase of these loan would strike a balance between assisting homeowners and ensuring that lenders, servicers, and securitizers are not rewarded for financing and servicing predatory and price-inflated loans. The government's taking of these via eminent domain will avoid any threat of litigation by investors against servicers, a commonly cited reason that loans are not being modified at a greater pace.

- The discounted loan price should be sufficient to writedown the loan balance of millions of loans such that they can be permanently refinanced or modified to ensure long-term sustainability.

- By way of example, a mortgage loan may have an outstanding balance of $200,000, but after paying fair market value, via the eminent domain taking, the loan would be at $140,000, (assuming a 30% discount). This outstanding mortgage of $140,000 for most homeowners, and the private banking industry, be immediately refinanced without any government investment or guarantee. Instead, the government would be immediately reimbursed for the entire amount of its purchase and have no other obligation to the investor, lender or borrower. The Treasury would be repaid immediately for this and every other loan refinanced by the banks.

- Banks would be motivated to refinance these loans given the billions of dollars of taxpayer funds used to create liquidity in these institutions. Future uses of TARP funds would mandate participation in this refinancing/modification program.

- In having the private sector refinance or modify these loans, the government would issue mandatory underwriting criteria that insured such loans were fair, non-predatory and matched the borrowers ability to pay. This would hedge against future re-defaults of such mortgages.

- If the discount procured is still not enough to allow the private banks to refinance and take out the government, the Treasury can make a furthur discount in order to match the borrower's ability to pay. The government can recapture this amount when the property is sold or refinanced via a soft second and/or lien placed on the property.

- **The plan is different from other plans offered in several ways:**

  - Solving the problem through widespread loans modifications avoids the technical challenges associated with refinancing all loans.
  - Using Eminent Doman law requires no additional congressional legislative action and can be done immediately.
  - HELP Now does not require refinancing with FHA, so it does not place the government on the hook for 100% of the risk. No massive new government entity need be creating, but rather HELP Now utilizes the private sector to modify and secure these loans. The government will remain responsible for only a very small portion of these loans.
  - Under HELP Now the government could purchase loans in limited amounts, say $50 billion per taking and then when refinanced by the private sector, use those funds to purchase additional loans. The government's investment would be a sort of revolving fund, where the government is made whole via the private sector. This minimizes the government's exposure at any given moment.
  - The government leverages its TARP investments by requiring participation in this program and is paid out, nearly in full immediately upon the refinancing or modification of the loan by the private sector.
  - Requires a soft second for remaining difference between discounted purchase price and the current market value of the loan. This is recaptured upon sale of the property, ensuring the Federal government is not stuck with the bill.