*This presents a brief explanation of why I spent a good part of the last month figuring out how to derive the “discount” realized by the winning bidders of auctions sponsored by the U.S. Department of Housing and Urban Development (HUD). I have pegged the discount at 41 percent through my examination of eight auctions held since October 2013, at which HUD sold for $7.6 billion nearly 74,000 troubled mortgages, worth $12. billion.*

*I will post a more comphrensive story later in the week.*

While attending a community meeting convened in February by Brooklyn Congresswoman Yvette Clarke, I first heard housing advocates criticize the three major federal entities, responsible for maintaining the stability of the nation’s housing market, for selling distressed mortgage loans at substantial discounts to hedge funds and other private equity groups.

In an article I wrote about the meeting in February (link), I reported that housing advocates and public officials attending the meeting raised piercing questions about why government-connected agencies would resort to an auction process that enabled financial institutions to profit from the spread between what winning bidders paid to buy the troubled loans and their estimated value.

Why, they asked, had not those agencies insisted that, in the first instance, the institutions holding the troubled loans work with homeowners to restructure their loans so the monthly payments would be more within reach? After all, most major lenders were under a federal mandate to engage in such a process as a part of the Troubled Asset Relief Program (TARP), enacted in 2008 by Congress, to save the nation’s economy. Additionally, state and local goverments in 20 jurisdictions have enacted laws requiring that lenders engage in such efforts BEFORE foreclosing upon loans.

I felt that I could not report upon those claims without first ascertaining the size of the discount. The level of the discount would allow for assessment of what the buyers’ profits would look like. Conversely, it would show how much room was available for working out a loan modification to allow borrowers to stay in their homes.

The U.S. Department of Housing and Urban Development (HUD) was the first governmental agency to begin auctioning troubled mortgage loans in 2010. The other two entities, Fannie Mae and Freddie Mac, which are officially designated as “government sponsored enterprises,” followed suit in the summer of 2014.

Fannie and Freddie publish quite a bit of data about the results of their auctions. But their data lacks a key ingredient without which the amount of the discount cannot be derived: the amount winning bidders have paid for the loans they have acquired at the auctions.

Fortunately, HUD’s reports of its auction do disclose the amounts paid by winning bidders or, at least, sufficient information from which that information can be gleaned.

In order to derive the 41 percent figure, I first had to determine what percent of value winners paid for the loans they had acquired at the auctions. That percentage (59 percent) was derived by dividing the total winning bids ($7.6 billion) by the total value of the loans ($12.9 billion) determined by the method HUD used in its most recent survey LINK TO HUD SURVEY of the results of its auctions. Under that method, value is ascertained by determining the amount of unpaid principal remaining on the loans that were auctioned, or “Unpaid Principal Balance” (UPB) in real estate parlance.

The discount figure of 41 percent was then yielded by subtracting the percentage of value paid by winners (59 percent) from full value (100 percent). Further details concerning my methodology are contained in the footnotes to the chart.