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HEARING BEFORE THE

UNITED STATE HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

ENTITLED

"FY09 FHA ACTUARIAL REPORT"

WRITTEN TESTIMONY OF

VICKI COX GOLDER, CRB

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

DECEMBER 2, 2009

Mister Chairman, Ranking Member Bachus, and members of the Committee; my name is Vicki Cox Golder, and I am the 2010 President of the National Association of REALTORS®. I am the owner of Vicki L. Cox & Associates in Tucson, Arizona, and have been a REALTOR® for 37 years.

I am here to testify on behalf of 1.2 million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on the importance of the Federal Housing Administration (FHA) mortgage insurance program. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

FHA is an insurance entity within the Department of Housing and Urban Development (HUD) that provides American homeowners with safe, stable, financing in all markets. FHA is not a subprime lender, and has strong underwriting criteria to protect American taxpayers. FHA has provided access to home financing for more than 37 million American families since its inception in 1934, and has never required a federal bailout. FHA borrowers are not subsidized, and pay both upfront and annual premiums. While the program is experiencing shortfalls in its excess reserves due to our economic crisis, FHA remains financially strong and a critical part of our nation's economic recovery.

Importance of FHA

With the collapse of the private mortgage market, the importance of the Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, FHA is the primary source of mortgage financing available to families today. Without FHA, many families would be unable to purchase homes and communities would suffer from continued foreclosure and blight. On September 30, 2009, the Federal Reserve published its draft explanation of the 2008 Home Mortgage Disclosure Act

(HMDA) data. That report underscores the critical role FHA is playing in the market. According to the Federal Reserve, by the end of 2008, nearly one half of home purchase loans and one quarter of refinancing loans were backed by either FHA or the VA. In addition, minority borrowers rely heavily on FHA. According to the Federal Reserve, "In 2008, more than 60 percent of home purchase loans and almost 40 percent of refinance loans to blacks were from either the FHA or VA. For Hispanic-white borrowers, nearly 50 percent of their 2008 home-purchase loans and 21 percent of their refinance loans were from the FHA or VA."[1] FHA is also the leader in serving first-time homebuyers. In FY2009, nearly 80 percent of all FHA purchases were first time home buyers, and nearly 50 percent of all first-time homebuyers used FHA financing in the second quarter of this year.

In 1934, the Federal Housing Administration was established to provide consumers an alternative during a lending crisis similar to what we face today. At that time, short-term, interest-only and balloon loans were prevalent. FHA was an innovator with the 30-year fixed rate mortgage. Once again, FHA is now the leader in providing safe, affordable financing. Many have argued that FHA is a product for low-income borrowers. In fact, FHA was created to serve the needs of all homebuyers who lacked access to mortgage financing. In FY2009, FHA loans were divided nearly equally between low, middle and high income families. The universal and consistent availability of FHA loan products is the hallmark feature of a program that has made mortgage insurance available to individuals regardless of their racial, ethnic, or social characteristics during periods of economic prosperity and economic downturn. FHA's portfolio grew 64 percent between FY2008 and FY2009 to $656 billion.

FHA Strength/Solvency

FHA's 2009 audit has demonstrated that its capital reserve fund has fallen below the Congressionally-mandated 2 percent ratio. The capital reserve ratio reflects the reserves available (after paying expected claims and expenses) as a percentage of the current portfolio, to address unexpected losses. While this is sobering news, it is important to recognize that this is

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[1] *The 2008 HMDA Data: The Mortgage Market during a Turbulent Year* , http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft.pdf

not FHA's only reserve fund. FHA also has a cash reserve account separate from the capital reserve. Consequently, FHA's actual total reserves are higher than they have ever been with combined assets of $30.4 billion. This is an increase of 13 percent over the previous year. In fact, the audit confirms that FHA has "positive" reserves – meaning they have adequate resources to cover all claims and expenses from their portfolio. It is critical to note that FHA's fully capitalized cash reserves account for paying all claims over a 30 year period. By comparison, the Financial Accounting Standards Board only requires financial institutions to hold reserves for losses over the next 12 months. FHA has 30 times that amount in their cash reserves, with another $2.7 billion in the excess capital reserves. In addition, the audit shows that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years.

The reason the capital reserves have fallen below 2 percent actually has nothing to do with FHA's current business activities. The decline is simply a reflection of falling value of homes in their portfolio. The economic forecaster that FHA uses to conduct its audit dramatically revised their projection of home prices from an expected increase of 2.4 percent to a loss of 10.2 percent. This significant change in assumed home price values and depreciation directly impacted the economic value of the fund. There has not been a significant increase in defaults on the part of borrowers, or underwriting problems suffered by FHA and its lenders. Instead, the decrease in the capital reserve account is a direct reflection of the state of our economy and our housing markets.

Obviously, the economic crisis our country is facing is far beyond the control of FHA. As a Congressional Research Service (CRS) report, published November 23, 2009 stated "FHA would not be able to prevent defaults arising from deteriorating financial and macroeconomic conditions."[2] Given the devastating impact home price declines have had on banks, lenders, and the government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae, FHA has performed remarkably through this crisis. Why? FHA has never strayed from the sound underwriting and appropriate appraisal policies that have traditionally backed its loans. FHA has met the needs of low and moderate income homebuyers, but has never resorted to abusive loans, improper or

[2] CRS Report R40937, *The Federal Housing Administration (FHA) and Risky Lending*, coordinated by Darryl E. Getter.

nonexistent underwriting, or other bad practices. As a participant in the home mortgage process, FHA cannot be immune to the pitfalls of the housing crisis. But solid policies and practices have protected it from the biggest failures.

Today, FHA borrowers' credit profile has never been stronger. The Federal Reserve report shows that FHA is not the new subprime lender - its FICO scores have increased, and its Loan-To-Value ratios (LTVs) decreased. The average credit score for FHA's current customer has grown to 693, and only 13 percent of their purchase borrowers this year had FICO scores below 620. Forty four percent of FY2009 loans have FICO scores above 680, and 30 percent had scores above 720. And those numbers are only improving, according to HUD's recent Report to Congress. In September of this year 45 percent of FHA loans had FICO scores above 700, and less than 5 percent had scores below 620. Borrowers also have more equity, as the percentage of FHA's LTV ratios above 95 percent fell from 72 percent in 2007 to 62 percent in 2008. In fact, the audit shows a record $4.9 billion positive adjustment due to the credit quality of FHA's recent originations.

Over-reaching Changes

Some have introduced proposals that react hastily to FHA's audit findings. We urge Congress and the Administration to exercise caution before introducing proposals that may have a profound adverse impact on our economic recovery and diminish programs that serve such a critical role to our nation's families. Rep. Scott Garrett (R-NJ) has introduced H.R. 3706, the "FHA Taxpayer Protection Act of 2009". We strongly oppose this legislation. Increasing FHA's downpayment would not add a penny to FHA's reserves. While it would increase individual borrower's investment in the home, it would disenfranchise many FHA borrowers. Closing costs average 3-5 percent of the cost of a home. Those costs combined with the current 3.5 percent downpayment requirement are sufficient to insure a borrower's commitment to homeownership, and represents a significant financial burden. Requiring a larger downpayment will make homeownership out of reach for many families and for others could deplete their cash reserves for home and other emergencies.

We believe FHA is taking the necessary steps to assure its financial solvency, and that it remains a critical source of mortgage insurance for America's homebuyers at all times – good and bad.

<u>FHA's New and Proposed Changes</u>

While FHA is not required to do anything when the reserves fall below 2 percent, FHA is appropriately taking steps to improve its financial position. First, it has hired a Chief Risk Officer to oversee FHA's efforts to mitigate risk. This is the first time in the history of FHA that a Chief Risk Officer has been appointed. We applaud the leadership of FHA Commissioner Dave Stevens for making this decision so quickly after taking office. The Chief Risk Officer has the primary responsibility for overseeing risk management across all FHA programs. We believe FHA has taken strong measures to mitigate risk, but assigning one senior staff member with the responsibility for coordinating FHA's risk management activities makes good sense.

FHA also announced that it will modify its procedures for streamlined refinancing. For those borrowers who apply for a simple refinance loan with no cash out, FHA will now require a short seasoning period for the original FHA loan (6 payments), the lender to demonstrate a net benefit to the consumer, and the borrower to exhibit an acceptable payment history. We do not think any of these changes are onerous for consumers or lenders, and strongly admire FHA for including the "net benefit" requirement to assure consumers aren't bearing the costs of refinancing, without receiving any benefit.

In addition, lenders must verify that the borrower is employed and has income at the time they refinance an existing FHA loan into a new FHA loan. While we understand the logic of this requirement, we question what will occur in the case where a borrower is between jobs, is still making their mortgage payments, and the refinance into a lower interest rate or a different type of loan would make it easier for them to make those payments (net tangible benefit). Would those borrowers – whose risk is already borne by FHA – be ineligible for a refinance? Where the borrower will take cash out of the transaction, we support FHA's changes to require additional underwriting and property appraisals.

FHA has also released mortgagee letters on appraiser independence, effective January 1, 2010. We support FHA's guidance related to geographic competence, especially as it relates to the use of Appraisal Management Companies (AMCs). FHA does not require lenders to utilize AMCs, and reinforces the importance of geographic competence. Consumers and REALTORS® have encountered significant problems with appraisals when the appraiser is not familiar with the community in which the home is located. FHA's mortgagee letter states that lenders and appraisers are both responsible for the quality and accuracy of the appraisal. FHA states that the lender is responsible for determining whether an appraiser's qualifications are sufficient prior to assigning an appraisal. Appraisers are reminded that the Uniform Standards of Professional Appraisal Practice (USPAP) applies to all appraisals performed for properties that are security for FHA. In addition, FHA's letter states that if the lender orders an appraisal through an AMC or another third party organization, the lender must ensure that specific guidelines are followed to ensure the FHA appraiser is compensated appropriately and that the fee charged to the consumer for the appraisal report is consistent with the market rate for appraisals.

The letter also provides guidance on the subject of appraisal portability. NAR believes it is important for borrowers to have complete flexibility in choosing a lender, and should not be hampered by having to obtain a second appraisal simply because they switched lenders. NAR feels strongly that consumers should not be required to pay excessive fees for appraisals, nor be subject to appraisals conducted by appraisers who are not familiar with their market. Under the FHA's rules, mortgage brokers' and lenders' underwriting staff will be prohibited from ordering an appraisal. This will create a firewall between lending staff and the appraiser and enhance the independence of the appraisal process. To further support the independence of appraisers and to ensure uniformity in the real estate industry, we have called on FHA to work with the GSEs to establish a combined frequently asked questions (FAQ) document that will be codified in existing appraisal policies. In a recent meeting, FHA Commissioner David H. Stevens has asked his staff to begin discussions with the GSEs to further explore this recommendation. We support these changes by FHA.

FHA will also begin rulemaking addressing mortgage lender and broker net worth. They will propose to increase the net-worth requirements for mortgagees to $1 million (from $250,000) and will place liability for mortgage brokers' actions on the lenders. NAR does not have data or policy on these specific lender issues. However, such actions would put FHA in-line with industry standards, and do not appear to be particularly onerous for lenders. Assuming FHA has data to show that these changes are needed to help retain the safety and soundness of the FHA fund, we would support these proposals.

NAR Additional Recommendations for FHA

NAR advocates additional changes for FHA to ensure its continued strength and availability to homeowners.

Technology and Staffing

NAR strongly supports increased funding for FHA to upgrade its technology. FHA operates with technology that is an average of 18 years old. Quickly upgrading the dozens of incompatible systems, such as the 30 year old Common Business-Oriented Language (COBOL) system, to web based customer-centric applications is necessary for the agency's continued existence and future success. Legislation recently passed the House, H.R. 3146, the "21st Century FHA Housing Act of 2009," which would provide this authorization. This bill, introduced by Representatives Adler (D-NJ) and Lee (R-NY), will provide a number of reforms to modernize FHA. We also understand funding has been included in the Appropriations bill for HUD, and we urge that funding to be included in the final version of the FY2010 Appropriation for HUD.

We also believe HUD should have the ability to hire the professional staff needed to run what is now such a large and critical component of our housing finance system. H.R. 3146 provides HUD flexibility to hire appropriate staff using the compensation guidelines of similar agencies, such as the Federal Housing Finance Agency or the Federal Deposit Insurance Corporation. The legislation would also permit the hiring of expert consultants to work on specific program areas within FHA's operations. We think these changes are necessary to ensure the FHA is able to work efficiently and effectively with qualified, experienced staff.

<u>Condominium Rules</u>

NAR has also been working closely with FHA on their new condominium approval process. As originally published in Mortgagee Letter 2009-19, we have concerns that some components of the new policy may lengthen the real estate crisis, just as some markets are seeing positive growth. We applaud the Department for delaying implementation of this letter, and believe they are making some changes to their policies.

NAR recommends elimination of the owner-occupancy requirement for FHA condo mortgages. The GSEs do not have an occupancy ratio for condominium projects if the borrower is going to occupy the unit, which of course would be the case for all FHA borrowers. Eliminating this requirement will allow more buyers to purchase condominiums (which are often more affordable), raise occupancy levels, and will stabilize these developments and the community. If FHA retains the occupancy ratio, NAR recommends amending the rules so that all bank-owned REOs are not counted for the purposes of the occupancy ratio. FHA amended the rules in their temporary condominium guidance (ML 2009-46 A) but we believe this should be included as a permanent part of the owner-occupancy calculation. Again, this will align FHA with the industry practices in this area.

Condominiums are often the only affordable option for first time home buyers or borrowers with good credit, but small downpayments. NAR recommends amending the FHA concentration requirement. Currently, no more than 30 percent of the total units in a project may have an FHA mortgage. While FHA is temporarily increasing this limit to 50 percent, we believe that making the 50 percent cap permanent or increasing it further, will result in a greater owner-occupied ratio in the project because more borrowers will be able to use FHA to purchase a primary residence.

Many new condominiums remain largely vacant because of our real estate crisis. But FHA requires that at least 50 percent of the units be sold prior to FHA's endorsement on a unit.

This eliminates condominiums as an option for many FHA borrowers. FHA temporarily reduced the requirement to 30 percent. However, this reduction should be made permanent or eliminated so that the borrower has greater choice of available units.

NAR urges FHA to clarify the condominium reserve study requirements. Currently the reserve study requirement can be financially costly for small condominium associations and can cause delays in completing sales. We urge FHA to clearly state what has to be included in the study and who should conduct and bear the costs of the study.

Lastly, NAR recommends FHA reconsider the elimination of the Spot Loan Approval Process. Spot loans can be critical for borrowers who wish to use FHA to purchase a condominium in a project that is not FHA approved. While we applaud FHA for extending the Spot Loans through February 1, 2010, elimination of the Spot Loan Approval Process effectively reduces consumer choice in condominiums as there will likely be many projects not approved by FHA but a logical choice for potential homeowners.

<u>Mortgage Loan Limits</u>

We also strongly support making permanent the FHA mortgage loan limits that are currently in effect. FHA has played a critical role in providing mortgage liquidity as private financing has dried up. We applaud Congress for extending the current loan limits through 2010, but they need to be made permanent.

In today's real estate market, lowering the loan limits further restricts liquidity and makes mortgages more expensive for households nationwide. FHA and GSE mortgages together continue to constitute the vast majority of home financing availability today, which makes it particularly critical to extend the current limits. Without the additional liquidity created by maintaining these loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

Many argue that the loan limit increases help only the higher cost areas, but this is not the case. According to a recent HUD report, only 3 percent of FHA loans are above $362,750, and less than 2 percent are above $417,000. But decreasing the loan limits would impact 612 counties in 40 states plus the District of Columbia. The average decline in limits would be more than $50,000. This decline would have a dramatic impact on liquidity in these markets, and could halt the housing recovery. In addition, higher balance FHA loans perform better than lower balance ones. According to the FY 2009 audit, "FHA experience indicates that larger houses tend to perform better compared with smaller houses in the same geographical area, all else being equal."[3] So despite arguments that FHA higher limits put taxpayers at risk, these loans actually add strength to the program, and reduce risk to the fund.

We strongly support the legislation introduced by Committee members Brad Sherman (D-CA) and Gary Miller (R-CA), H.R. 2483, the "Increasing Homeownership Opportunities Act" to make the current loan limits permanent. We urge the Committee quickly consider this important legislation to ensure that liquidity in this tenuous market is not put at risk.

Conclusion

The National Association of REALTORS® believes in the importance of the FHA mortgage insurance program and believes FHA has shown tremendous leadership and strength during the current crisis. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry. We applaud FHA for continuing to serve the needs of hardworking American families who wish to purchase a home.

We believe the Administration is taking appropriate and expedient steps to maintain a prominent source of homeownership financing in today's economy. We wholeheartedly support the FHA program and we stand ready to work with Congress to enhance FHA's mission, service

[3] *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund (Excluding HECMs)for Fiscal Year 2009,* by Integrated Financial Engineering Inc., November 6, 2009, pg 45.

and purpose. We thank you for this opportunity to testify, and look forward to working with you to accomplish our recommended proposals.