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HEARING BEFORE THE

U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

ENTITLED

REFORMING THE REGULATION OF THE GOVERNMENT SPONSORED ENTERPRISES

WRITTEN TESTIMONY OF VINCENT E. MALTA

NATIONAL ASSOCIATION OF REALTORS®
MARCH 6, 2008

Chairman Dodd, Senator Shelby and Members of the Committee, thank you for inviting me to testify today on the important issue of reforming the regulation of the government-sponsored enterprises (GSEs). My name is Vince Malta. I am the owner and broker of Malta & Co., Inc., a San Francisco, California firm handling real property sales and management of over 300 residential rental units. I am a member of the California Association of REALTORS® and National Association of REALTORS® and have held a number of leadership positions in both associations, including serving as the 2006 President of the California Association of REALTORS® and the 2008 Chair of the Public Policy Coordinating Committee for the National Association of REALTORS®. I also serve on Fannie Mae's National Housing Advisory Council which is comprised of mortgage bank officials, financial services companies, homebuilders, real estate professionals, leaders of affordable housing groups, and governmental officials. My tenure on the National Housing Advisory Council is voluntary and I am not compensated for my service.[1]

I am here to testify on behalf of our more than 1.3 million REALTOR® members who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®. We commend the committee for holding today's hearing on the enhancing the GSEs regulatory system. Fannie Mae and Freddie Mac are partners in the housing industry. As such, we believe today's hearing is an important step towards consideration of

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[1] The National Housing Advisory Council was created by Fannie Mae in 1971. It meets with Fannie Mae's senior management team throughout the year to help the company better address challenges and maximize market opportunities. Council members serve two-year terms and do not receive compensation for their service. Members are, however, reimbursed for travel related expenses when attending Council meetings.

legislative proposals designed to strengthen the regulation of the housing GSEs and the Federal Home Loan Banks.

NAR actively supported H.R. 1427, the "Federal Housing Finance Reform Act of 2007," introduced by Chairman Barney Frank (D-MA) together with Representatives Richard Baker (R-LA), Mel Watt (D-NC) and Gary Miller (R-CA). That bill overwhelmingly passed the House of Representatives on May 29, 2007, by a bipartisan vote of 313 to 104. We are eager for the Senate Banking Committee to pursue similar GSE reform legislation and ask you to consider the following elements, which we believe are important considerations in any effort to improve the regulation of the housing GSEs. They are:

1. Strong regulator and GSE governance;
2. Conforming loan limits;
3. Housing mission;
4. New program approval;
5. Separation of mortgage origination and the secondary market ("bright line"); and
6. Portfolio limits.

Strong Regulator and GSE Governance

Over the last two years, general agreement has evolved on a basic framework for a new GSE regulatory structure. That consensus strongly suggests that the current regulatory responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO), the Department of Housing and Urban Development (HUD), and the Federal Housing Finance Board should be transferred to a single, independent safety and soundness regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. This new housing enterprises regulator should have the authority to set capital standards; liquidate a financially unstable enterprise through a conservator or receiver; and approve new programs and products. The Federal Home Loan Banks should be regulated under the same framework, with due concern for its cooperative ownership by member financial institutions.

NAR supports legislation strengthening the financial soundness regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks through the creation of an independent regulatory agency. Having independent, expert financial oversight will only serve to enhance confidence in the nation's housing finance system. This new regulator should have the appropriate authority and resources to oversee safety and soundness of the GSEs. The regulator also should understand and support the GSEs' vital housing finance mission and the role that housing plays in the nation's economy and public policy.

NAR also supports a continued independent, public voice in the corporate governance of the GSEs. We believe that the boards of directors of Fannie Mae, Freddie Mac and the Federal Home Loan Banks should be well balanced, composed of individuals with the knowledge and expertise necessary to oversee the full range of GSE-related issues and activities. NAR supports legislative efforts to address concerns regarding the governance of the Federal Home Loan Banks by enhancing the Banks' direct role in selecting board members, increasing the number of independent directors, adding community and economic development expertise, and allowing appointed independent directors to continue their service until a successor is in place.

Conforming Loan Limits

Under current statute, Fannie Mae and Freddie Mac may only purchase mortgages that are within a cap that is determined based on an annual survey of house prices and applied nationally. While we greatly appreciate the temporary loan limit increase included in Congress' economic stimulus package it is just that – temporary – and will expire on December 31, 2008. NAR has concerns as to whether the increase will be in place long enough to ameliorate the difficult housing cycle we are experiencing. Thus, NAR urges the Senate to permanently increase the national conforming loan limit to an amount no less than 50 percent higher than the current conforming loan limit ($625,500 or higher). In addition, NAR asks the Senate to make the temporary conforming loan limit increase for high cost areas as provided in the economic stimulus legislation permanent. Accordingly, for high cost areas, the conforming loan limit would be increased to 125 percent of the local median home sales price, but not to exceed $729,750.

The GSEs were created to provide liquidity to the mortgage market. Over the decades, they have developed a secondary market for conforming loans that has generated a reliable, low-cost supply of mortgage credit in both good times and in bad. The same cannot be said of the secondary market for jumbo mortgages. By the end of 2007, the volume of jumbo loans had dropped sharply to half of the total originations at the beginning the year. The little, if any, investor appetite for securities backed by nonconforming mortgages has resulted in a spike in interest rates for jumbo borrowers to about 1 percentage point higher than conforming loans.

Permanently increasing the national conforming loan limit to $625,500, together with allowances for higher limits in more expensive areas of the country, will significantly bolster homebuyer confidence and will bring families back to the marketplace. Furthermore, the loan limit increases will offer more families more affordable interest rates, regardless of where they live. The result will be new additional sales, which lowers inventories and strengthens home prices.

Many research studies have found that home prices have the biggest impact on foreclosures. Therefore, any strengthening of home prices could have the biggest impact in reducing the number of foreclosures. The micro-level solution of loan modifications for financially stressed homeowners and the FHA Secure program will no doubt help lessen the foreclosure problems. However, a broad stroke that would lift housing demand will do more to restore the housing market and the economy to their normal healthy conditions.

The critical role that the GSEs play in providing liquidity to the mortgage market has never been more evident than it is today. Based on 2006 Home Mortgage Disclosure Act (HMDA) data, jumbo mortgages represented almost one million single-family, first lien mortgages originated in almost every state. While jumbo mortgages may be associated with luxury housing in some parts of the country, they are a critical financing vehicle for large numbers of working class families who happen to live and work in more expensive areas of the country. Raising the GSEs' conforming loan limits will provide much-needed relief to jumbo borrowers and homebuyers by increasing access to safer mortgages, which is especially important for first-time homebuyers and borrowers with abusive subprime mortgages who need to refinance. Evidence indicates that borrowers in expensive markets such as California currently account for a disproportionate share of subprime mortgages. Greater access to GSE-qualifying mortgages will help promote homeownership in a safer, more sustainable way.

NAR estimates that increasing the national GSE loan limit to $625,500 and establishing high cost area limits of 125 percent of the local median home sales price, not to exceed $729,750, will result in:

- More than 348,000 additional home sales;
- Over $44 billion in increased economic activity;
- $274 to $411 savings per month in interest payments for consumers who get new "conforming jumbo" loans versus current private jumbo loans;
- More than 500,000 loans above $417,000 refinanced to lower interest rates;
- A reduction of the national supply of homes on the market by 1 to 1 1/2 months;
- A strengthening of home prices by 2 to 3 percentage; and
- A reduction of foreclosures by 140,000 to 210,000.

Finally, we note that there is precedent for regional adjustments for high cost areas. In 1980, Congress designated Alaska, Hawaii, Guam, and the U.S. Virgin Islands as high cost areas. The conforming loan limit in these statutory high cost areas is 50 percent higher than for the rest of the nation, but housing prices in these areas are no longer uniquely high. In fact, housing prices in many areas of the country now exceed those in Honolulu. NAR urges the Senate to include in any GSE reform bill a permanent increase of the national conforming loan limit to no less than 50 percent higher than the current conforming loan limit (to $625,500 or higher) and to make permanent the temporary conforming loan limit increase for high cost areas, as provided in the economic stimulus legislation.

Housing Mission and the Secondary Mortgage Market

Congress chartered Fannie Mae and Freddie Mac with advantages unavailable to commercial banks and other financial institutions. Fannie Mae and Freddie Mac enjoy lower funding costs, the ability to operate with less capital, and lower direct costs. These advantages were and are an integral component of the GSEs' public policy mission. The advantages of GSE status have helped the secondary mortgage market grow and provided much needed stability to our nation's housing financial system.

Very simply, Congress created Fannie Mae and Freddie Mac to do what no fully private company could or was willing to attempt. Unlike private secondary market investors, Fannie Mae and Freddie Mac remain in housing markets during downturns, using their federal ties to fulfill their public purpose obligation to facilitate mortgage finance and support homeownership opportunity.

In their own ways, each of the housing enterprises has used their federal charter advantages to meet their missions. The "mechanism that widens the circle of ownership," as one observer defined the secondary mortgage market, is dynamic, robust and continually evolving – all to the benefit of mortgage originators, homebuyers, and other industry participants.

The broad expansion of homeownership, mortgage markets, as well as the related rapid growth of the GSEs has also had another effect. Until the recent credit crunch, financial services providers, many of which compete with Fannie Mae and Freddie Mac, questioned the GSEs' activities, function, and the continuing need for their government-chartered status. These financial companies argued that Fannie Mae and Freddie Mac had an unfair advantage because of their federal charters. Yet these same lenders' parent banking companies have their own federal subsidies that come in the form of deposit insurance and other benefits derived from the nation's banking and financial system safety net.

REALTORS® believe that the GSEs' housing mission, and the benefits that derive from it, play a vital role in the continued success of our nation's housing system. Fannie Mae and Freddie Mac have demonstrated their commitment to housing by staying true to their mission during the current market disruptions. We have opposed and will continue to oppose legislative proposals that would reach beyond safety and soundness regulation and diminish the housing mission and role of the GSEs.

New Program Approval

Currently, Fannie Mae and Freddie Mac cannot initiate a new program without first obtaining the approval of HUD. While NAR has not objected to the new program approval approach in H.R. 1427, we believe that some improvements could be made in a Senate bill to give the GSEs more flexibility to respond effectively to changing mark conditions. NAR would be concerned if Congress enacted legislation that included additional regulatory requirements which could unduly delay or prevent the GSEs from developing new programs and products that support their missions.

For example, such authority should not undermine secondary market innovations based on Fannie Mae and Freddie Mac credit risk management technologies. These innovations assure a smooth supply of reasonably priced mortgage credit and allow homebuyers to manage their interest rate risk when locking loans rates and terms before closing.

NAR believes that whatever approach Congress takes to address the shortcomings of the current statutory framework, the result must be flexible to promote product and program innovation and allow for prompt responses to housing market needs.

Separation of Mortgage Origination and Secondary Market

REALTORS® recognize and support the role that program, business and activity approval may have on the financial safety and soundness of the GSEs. However, not every new activity of the GSEs should be subject to an extended regulatory public comment process. This requirement could directly damage the GSEs' housing mission, and stifle innovation and programs that would help Americans achieve the dream of homeownership.

In the 109th Congress, one legislative proposal that NAR cautioned against was the "bright line" regulation, which would have distinguished mortgage origination from GSE secondary market activities and imposed restrictions on Fannie Mae and Freddie Mac mission-related activities. One "bright line" proposal would have specifically prevented the GSEs from directly or indirectly participating in mortgage origination and may have required Fannie Mae and Freddie Mac to divest themselves of their automated underwriting systems, upon which many banks rely.

REALTORS® oppose overly restrictive "bright line" legislative proposals that explicitly limit GSEs business to the secondary markets, strictly defined. Such a test would instantaneously preclude many of the GSEs' existing products and activities that were designed to increase access to mortgage credit, lower the costs of homeownership, and foster innovations in home financing.

For example, the "bright line" provision would seriously hinder (and possible prohibit) the array of mission-related, consumer outreach activities by lenders and housing counselors that are supported by the GSEs. The GSE-designed counseling and education programs that help lenders, mortgage brokers, REALTORS®, and housing counseling agencies determine a consumer's financial readiness for homeownership are technically on the "wrong side" of the "bright line" and would be prohibited.

This is just one example of the negative impact such a standard would have on critical components of the housing market. REALTORS® urge you to reject the rigidity and arbitrary nature of a statutory "bright line" test.

Portfolio Limits

One of the most widely debated GSE reform issues has been the size of the portfolios currently held by the GSEs and whether these portfolios contribute to the GSEs' mission. Then Federal Reserve Board Chairman Alan Greenspan was one of the most vocal advocates of legislative proposals to shrink the size of the GSEs' retained portfolios. Chairman Greenspan and others have argued that the size of the portfolios, together with the perceived incentives for the GSEs to pursue portfolio growth, increase the possibility of GSE insolvency and destabilization of our nation's financial markets.

Significantly, those advocating retained portfolio limitations do not identify any systemic financial risk. Viewed strictly from a systemic risk perspective, GSE retained portfolios, just like the portfolios of the 5 largest banks in the U.S., are vulnerable to interest rate changes and could pose a risk to taxpayers should the enterprise or the bank become insolvent or improperly hedge risk. We do not see a need to impose additional regulatory authority that goes beyond that of bank regulators. REALTORS® believe that GSE reform legislation should clearly indicate that any portfolio standard must be based solely on safety and soundness of the enterprises, and not on any broader concern such as systemic risk.

REALTORS® also oppose rigid statutory limits on the GSEs' portfolio size. Instead, we believe a better legislative approach would be to create a sufficiently strong regulatory authority over capital that would limit portfolio risk and may also moderate portfolio growth, when appropriate.

While it is obviously important to consider the safety and soundness implications of GSE portfolio size and the associated risks, we would ask that the Congress not ignore the advantages that portfolio holdings and size have on mission-related activities and housing markets. The GSEs point out that the returns earned on retained portfolios help support the enterprises' affordable housing programs and also contribute to the availability of financing for low-income borrowers. For example, in testimony before the House Financial Services Committee last spring, Freddie Mac indicated that about two-thirds of its retained portfolio supported affordable housing and first-time homebuyers.

Simply stated, REALTORS® oppose portfolio limits imposed just for the sake of shrinking the GSE mission. Portfolio limits should not be prescribed in statute. Instead, we believe the portfolios should be regulated by the GSEs from a risk perspective, and the regulator should determine if one or both of the GSEs' retained portfolios affect safety and soundness.

Conclusion

The National Association of REALTORS® shares the belief of our industry partners that Fannie Mae, Freddie Mac and the Federal Home Loan Bank System are integral components of this nation's highly successful housing finance system. Homebuyers depend on the secondary mortgage market to supply a continued and stable source of funding for single-family and multifamily housing.

NAR believes legislation to reform the housing GSEs should be principally focused on safety and soundness regulation and expanding the role of Fannie Mae and Freddie Mac to provide liquidity to the secondary market based on permanent higher conforming loan limits. We hope that Congress can reach a consensus on GSE reform, so that all in the housing industry can focus our efforts on the full range of challenges that lie ahead. The National Association of REALTORS® pledges to work with the Senate to enact GSE reform legislation that achieves our mutual goals and protects the vibrancy, liquidity and evolution of the housing finance system.

NAR Analysis of Housing Market
January 17, 2008

Current Housing Market Conditions - Very Weak

- ***Existing home sales*** have been at roughly 5 million for the past three months, possibly hinting at stabilization and the formation of a bottom. But the current sales pace would only match the 1998 figures (10 years ago) and are down 20% from a year ago and 30% from the cyclical peak in 2005.

- ***New home construction and new home sales*** have contracted even more with the recent new single-family housing starts registering from 800,000 to 900,000 and new home sales falling well below 700,000. Those figures are down by roughly 50% from their respective peak annual figures in 2005.

- ***Home prices*** continue to move lower at the national level. The most timely and broadest measure from NAR based on multiple listing service information indicates a 3% to 6% decline compared a year ago. If sustained in 2008, such a price decline would correspond to a housing equity loss of $700 billion to $1.4 trillion for American homeowners. Correspondingly, consumer spending is expected to contract by $150 billion - easily knocking off 1% point off GDP growth.

- ***The near-term forecast*** continues to point to weak conditions. Housing permits continue to fall - indicating further declines in new home construction and new home sales. NAR's pending home sales index also remains weak.

Pent-Up Housing Demand - Sizable

- ***Job gains and income gains*** have been solid over the past two years – this corresponds with the time period when home sales were falling. Net job gains increased by 4.3 million according to both company payroll data and household survey data. U.S. aggregate personal income rose by $1.4 trillion over the past two years. Such job gains should have translated into about 2 million additional homeowners, yet the actual rise over this two-year span was only 600,000. Over the same time period, housing affordability improved due to incomes rising, home prices falling, and *conforming* mortgage rates at near historic lows, yet … there was a very slow number of net new homeowners.

- ***Household formation*** has mysteriously slowed. With the normal population and job increases, household formation typically expands by 1.2 million to 1.5 million per year. The latest Census data points to only 650,000 net new households formed in 2007. Many people have evidently doubled-up with additional roommates or have moved back with their parents or family members.

Buyer Hesitancy - Why?

- ***Anticipation of lower home prices*** is holding back many people from buying a home today. Foreclosures will continue to rise in 2008. There are many research reports (irrespective of validity) pointing to further price declines.

- ***Anticipation of lower interest rates*** is holding back many potential buyers. It is widely believed that the Federal Reserve will cut rates in the next two meetings. Though there is no direct relationship between a Fed rate cut and mortgage rate changes, many consumers perceive that mortgage rates will fall with the later Fed rate cut. NAR advocates a one-time large rate cut rather than a series of small rate cuts in order to end the delay in home buying.

- ***Subprime lending has virtually disappeared*** since August, 2007. It had comprised about 20% of mortgage originations. Some aspects of subprime lending will return with improved underwriting standards, stricter and sounder regulatory environment, and the proper pricing of risk. But the timing of this return remains very uncertain. A recent pick up in FHA loan endorsement is very encouraging as it brings some would-be subprime borrowers into a loan with much safer interest rates and it helps some homeowners refinance out of their riskier subprime loans.

- ***The Jumbo mortgage market is not functioning***. The current conforming mortgages average is about 6.0%. Based on historical trends, rates on jumbo loans would be about 6.2% or 6.3%. Rather, current jumbo rates are closer to 7.0% due to investor fears of any U.S. mortgage that does not have the (perceived) backing of the U.S. government. Any rational homebuyer will balk at such a higher interest rate.

Summary Table

There are more people with the capacity to buy a home at lower prices and improved affordability, yet home sales have been drastically reduced.

	2005 Peak Housing Year	***2007***	***Difference***
Pent-Up Demand			
Jobs (payroll survey)	133.7 million	138.0 million	+ 4.3 million
Personal Income)	\$10.3 trillion	\$11.7 trillion	+ \$1.4 trillion
Household Net Worth	\$52.1 trillion	\$58.6trillion	+ \$6.5 trillion
Home Buying Condition			
Home price (median)	\$219,600	\$217,600	- \$2,000
Mortgage Rate	5.9%	6.3%	+ 0.4% points
Affordability Index	113	114	+ 1
Housing Activity			
Total home sales	8.4 million	6.4 million	- 2 million