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TESTIMONY OF

RON PHIPPS, ABR, CRS, GRI, GREEN, E-PRO, SFR
2011 PRESIDENT
NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

HEARING TITLED

PUBLIC PROPOSALS FOR THE FUTURE OF THE HOUSING FINANCE SYSTEM PART II

MAY 26, 2011

INTRODUCTION

On behalf of the 1.1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), thank you for holding this hearing on the need to reform our Nation's secondary mortgage market infrastructure.

My name is Ron Phipps, and I am the 2011 President of the National Association of REALTORS®. I am proud to be part of a four-generation, family-owned residential real estate business in Rhode Island. As I have mentioned to you during prior testimony, my passion is making the dream of home ownership available to American families. I am proud to testify today on behalf of the more than 1.1 million REALTORS® who share that passion, and the 75 million Americans who own homes and the 310 million Americans who require shelter.

REALTORS® agree that the existing housing finance system failed and that reforms to our secondary mortgage market are needed. We applaud the Committee's caution as you take up this very important and complex issue. You are truly heeding the words of Treasury Secretary Timothy Geithner and the Committee's Ranking Member, Senator Richard Shelby when they said earlier this year that "… federal housing policies must be adequately assessed, and proper homework must be done before action is taken."

HOUSING MISSION AND THE SECONDARY MORTGAGE MARKET

REALTORS® are fervent in their belief in "free markets", and the need for private capital to reduce the Federal government's financial support of the housing sector if the housing finance system is to right itself. However, REALTORS® are also practical and understand that in extreme economic conditions, private capital will retreat from the market, requiring the participation of entities that will participate in the marketplace regardless of economic conditions. The government-sponsored enterprises (GSEs) were created to support this specific mission within the secondary mortgage market, and any replacements must meet this criterion as well. Future secondary mortgage market entities must be created with this mission as their basis in order to ensure that citizens will always have access to affordable mortgage capital.

REALTORS® agree that taxpayers should be protected, open-ended bailouts should end, private capital must return to the housing finance market, and that the size of the government participation in the housing sector should decrease if the market is to function properly. Where we disagree with some is "how" these aspirations should be accomplished. When reviewing current legislation that effectively constrains, or shuts-down, Fannie Mae and Freddie Mac and relies only on private capital to operate the secondary mortgage market (e.g. S 693, the "GSE Bailout Elimination and Taxpayer Protection Act"), one need only examine the miniscule activity in the jumbo and manufactured housing mortgage markets in order to understand the implications of just having private capital form the foundation of the housing market. In both instances, mortgage capital became nearly non-existent, which prohibited qualified borrowers from access to the funds required to purchase a home.

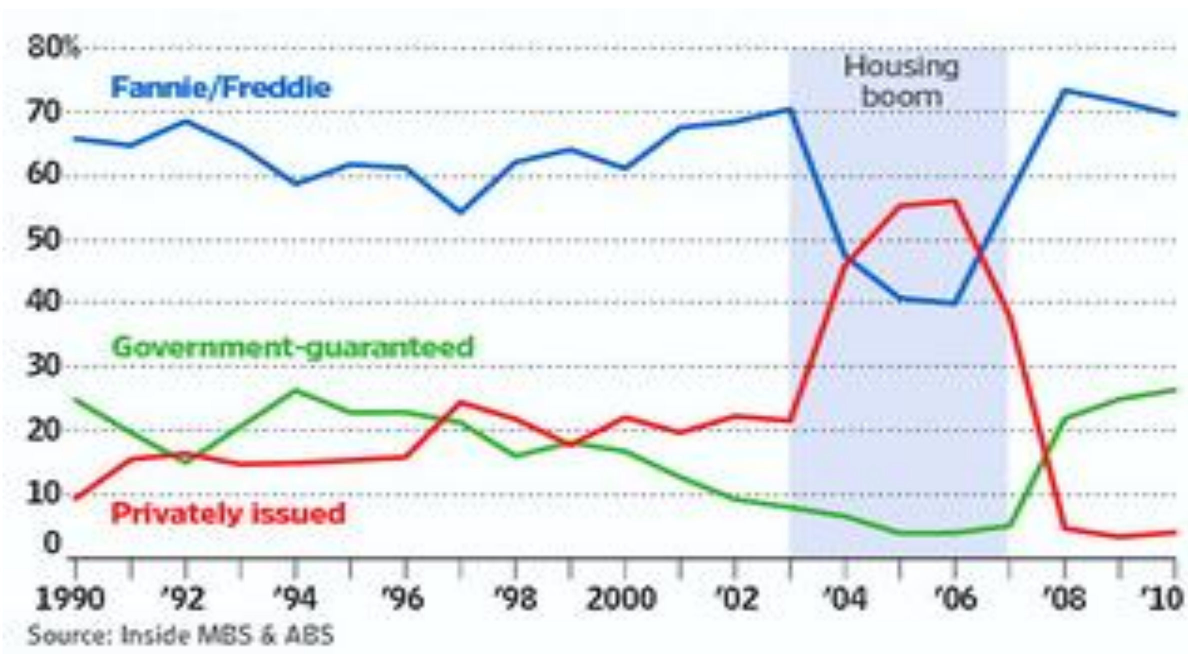
Congress chartered Fannie Mae and Freddie Mac to expand homeownership and provide a solid foundation for our nation's housing financial system. Unlike private secondary market investors, Fannie Mae and Freddie Mac remain in housing markets during downturns, using their federal ties to facilitate mortgage finance and support homeownership opportunity for all creditworthy borrowers.

REALTORS® believe that the GSEs' housing mission, and the benefits that are derived from it, played a vital role in the success of our nation's housing system, and continue to play that role today. Without Fannie Mae and Freddie staying true to their mission of providing affordable mortgage capital during the current market disruption, there would have been a more serious disruption to the market.

Since being placed in conservatorship, NAR has closely monitored the impact of the current market turmoil on both Fannie Mae and Freddie Mac. As previously mentioned, REALTORS® are extremely aware that the role of the GSEs is crucial to housing consumers' ability to obtain fair and affordable mortgages, which stimulate real estate transactions, and thus the overall U.S. economy.

As the market turmoil reached its peak in late 2008, it became apparent that the role of the GSEs, even in conservatorship, was of utmost importance to the viability of the housing market as private mortgage capital effectively fled the marketplace.

Table 1
Share of Mortgage Securitization Market By Segment



As you can see from the above chart, if no government-backed entity existed as private mortgage capital fled to the side lines, the housing market would have come to a complete halt and thrown our nation into a deeper recession, or even a depression.

REALTORS® believe that reform of the U.S. housing finance system must be a methodical, measured, and comprehensive effort based on practical market experience, and not just theory.

Earlier this year, NAR signed onto an industry letter that espouses the fundamental principles that we all believe are required to ensure a viable secondary mortgage market going forward (see appendix). NAR believes that the industry letter's basic principles, in concert with our own, form a good foundation on which the secondary mortgage market can be reformed. NAR's principles are as follows:

KEY GSE REFORM POINTS BASED ON NAR's PRINCIPLES

- An efficient and adequately regulated secondary market is essential to providing affordable mortgages to consumers. The secondary market, where mortgages are securitized and/or combined into bonds, is an important and reliable source of capital for lenders and therefore for consumers.

  Without a secondary market, mortgage interest rates would be unnecessarily higher and unaffordable for many Americans. In addition, an inadequate secondary market would impede both recovery in housing and the overall economic recovery.

- We cannot have a restoration of the old GSEs with private profits and taxpayer loss system. The current GSEs should be replaced with government chartered, non-shareholder owned entities that are subject to sufficient regulations on product, revenue generation and usage, and retained portfolio practices in a way that ensures they can accomplish their mission and protect the taxpayer.

- Government-chartered entities have a separate legal identity from the federal government but serve a public purpose (e.g. the Export-Import Bank). Unlike a federal agency, the entities will have considerable political independence and be self-sustaining given the appropriate structure.

- The mission would be to ensure a strong, efficient financing environment for homeownership and rental housing, including access to mortgage financing for segments of the population that have the demonstrated ability to sustain homeownership. Middle class consumers need a steady flow of mortgage funding that only government backing can provide.

- The government must clearly, and explicitly, guarantee the issuances of the entities. Taxpayer risk would be mitigated through the use of mortgage insurance on loan products with a loan to value ratio of 80 percent or higher and guarantee or other fees paid to the government. This is essential to ensure borrowers have access to affordable mortgage credit. Without government backing, consumers will pay much higher mortgage rates and mortgages may at times not be readily available at all (as happened in jumbo and commercial real estate loans)

- The entities should guarantee or insure a wide range of safe, reliable mortgages products such as 30 & 15 year fixed rate loans, traditional ARMs, and other products that have stood the test of time and for which American homeowners have demonstrated a strong "ability to repay."

- For additional safety, sound and sensible underwriting standards must be established for loans purchased and securitized in MBSs, loans purchased for portfolio, and MBS purchases.

- The entities should price loan products or guarantees based on risk. The organization must set standards for the MBS they guarantee that establish transparency and verifiability for loans within the MBSs.

- Political independence of the entities is mandatory for successful operation (e.g. the CEOs will have fixed terms so they cannot be fired without cause, they should not be allowed to lobby, and the authorities should be self-funded – no ongoing appropriations).

- In order to increase the use of covered bonds, particularly in the commercial real estate arena, the entities should pilot their use in multifamily housing lending and explore their use as an additional way to provide more mortgage capital for residential housing. The entities should be allowed to pave the way for innovative or alternative finance mechanisms that meet safety criteria.

- There must be strong oversight of the entities (for example, by the Federal Housing Finance Agency – FHFA or a successor agency), that includes the providing of timely reports to allow for continual evaluation of the entities' performance.

PRIVATE CAPITAL PARTICIPATION, BUT NOT A FULLY PRIVATE SECONDARY MORTGAGE MARKET

REALTORS® believe that full privatization is not an effective option for a secondary market because private firms' business strategies will focus on optimizing their revenue/profit generation. This model would foster mortgage products that are more aligned with the business' goals (e.g. based upon significant financial risk-taking) than in the best interest of the nation's housing policy or the consumer. This situation, we believe, would lead to the rescinding of long-term, fixed rate mortgage products (e.g. 30-year fixed-rate mortgage products), and an increase in the costs of mortgages to consumers, or both.

According to research by economist Dr. Susan Woodward, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without government urging. Dr. Woodward points out that a few developed countries have encouraged the use of amortizing long-term loans, but in all instances (save for Denmark), the loans have adjustable rates and recast every 5 years. She goes on to indicate that the United States is unique in supporting a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable, and that Americans have come to view this product as one of their civil rights. Dr. Woodward points out that in early 2000, when Former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he eagerly abandoned that position.

Second, the size of the US residential mortgage market is also a consideration. Currently, the US residential mortgage market stands at $10.6 trillion, with the GSEs owning or guaranteeing $5 to $6 trillion of mortgage debt outstanding and providing capital that supports roughly 70% of new mortgage originations. REALTORS® believe that it is extremely unlikely that enough purely private capital – without government backing - could be attracted to replace existing mortgage funding, assume the GSEs market share, or make mortgage lending available in all types of markets.

Finally, our members fear that in times of economic upheaval, a fully private secondary mortgage market will largely cease to exist as has occurred in the jumbo mortgage, the commercial mortgage, and the manufactured housing mortgage markets. When the economy turns down, private capital understandably flees the marketplace. Should that happen in the residential mortgage market space, the results for the entire economy – because of the plethora of peripheral industries that support and benefit from the residential housing market – would be catastrophic.

REASONABLE QUALIFIED RESIDENTIAL MORTGAGE DEFINITION

Another issue that will dramatically impact the future of housing finance and the secondary mortgage market is the definition of what constitutes a qualified residential mortgage (QRM). NAR believes that Federal regulators should honor the intentions of the concept's authors, Senators Isakson, Hagan, and Landrieu, by crafting a qualified residential mortgage (QRM) exemption from the risk retention requirements of the Dodd-Frank Act that includes a wide variety of traditionally safe, well underwritten products such as 30-, 15-, and 10-year fixed-rate loans, 7-1 and 5-1 ARMs, and loans with flexible down payments that require mortgage insurance. A QRM policy that does not heed their intention will displace a large portion of potential homebuyers, which in turn will slow economic growth and hamper job creation.

Strong evidence shows that responsible lending standards and ensuring a borrower's ability to repay have the greatest impact on reducing lender risk. A balance must be struck between reducing investor risk and providing affordable mortgage credit. Better underwriting and credit quality standards will greatly reduce risk. Adding unnecessarily high minimum down payment requirements, overly stringent debt-to-income ratios, and onerous payment performance criteria, will only exclude hundreds of thousands of homebuyers, despite their creditworthiness and proven ability to afford the monthly payment, because of the dramatic increase in the wealth required to purchase a home.

According to a white paper compiled by a cross-section of housing and consumer lending groups titled, "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery of Housing" (2011)[1]:

> *The impact of the proposed rule on existing homeowners is also harmful. Based on data that the coalition received from CoreLogic Inc., nearly 25 million current homeowners would be denied access to a lower rate QRM to refinance their home because they do not currently have 25 percent equity in their homes (Table 2). Many of these borrowers have paid their mortgages on time for years, only to see their equity eroded by a housing crash and the severe recession. Even with a 10 percent minimum equity standard, more than 16 million existing homeowners – many undoubtedly with solid credit records – will be unable to obtain a QRM. In short, the proposed rule moves creditworthy, responsible homeowners into the higher cost non-QRM market.*

1- Qualified Residential Mortgage Coalition, "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery", May 2011.

Table 2
Equity Position of U.S. Homeowners with Mortgages

47.9 million U.S. homeowners with mortgages:	**30% equity**	**25% equity**	**20% equity**	**10% equity**
# with less than…	27.5 million	24.8 million	21.9 million	16.3 million
% with less than…	57%	52%	46%	34%

Source: Community Mortgage Banking Project; based on data from CoreLogic Inc.

As now narrowly drawn, QRM ignores compelling data that demonstrate that sound underwriting and product features, like documentation of income and type of mortgage have a larger impact on reducing default rates than high-down payments.

A further analysis of data from CoreLogic Inc. on loans originated between 2002 and 2008 shows that boosting down payments in 5 percent increments has only a negligible impact on default rates, but it significantly reduces the pool of borrowers that would be eligible for the QRM standard. Table 2 shows the default performance of a sample QRM based on the following attributes of loans: Fully documented income and assets; fixed-rate or 7 year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years. These QRM criteria were applied to more than 20 million loans originated between 2002 and 2008, and default performance is measured by origination year through the end of 2010.

As shown in Tables 2 and 3, moving from a 5 percent to a 10 percent down payment requirement on loans that already meet the defined QRM standard reduces the default experience by an average of only two- or three-tenths of one percent for each cohort year. However, the increase in the minimum down payment from 5 percent to 10 percent would eliminate from 7 to 15 percent of borrowers from qualifying for a lower rate QRM loan. Increasing the minimum down payment even further to 20 percent, as proposed in the QRM rule, would amplify this disparity, knocking 17 to 28 percent of borrowers out of QRM eligibility, with only small improvement in default performance of about eight-tenths of one percent on average. This lopsided result compromises the intent of the QRM provision in Dodd-Frank, which is to assure clear alignment of interests between consumers, creditors and investors without imposing unreasonable barriers to financing of sustainable mortgages.

Table 3
QRM: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

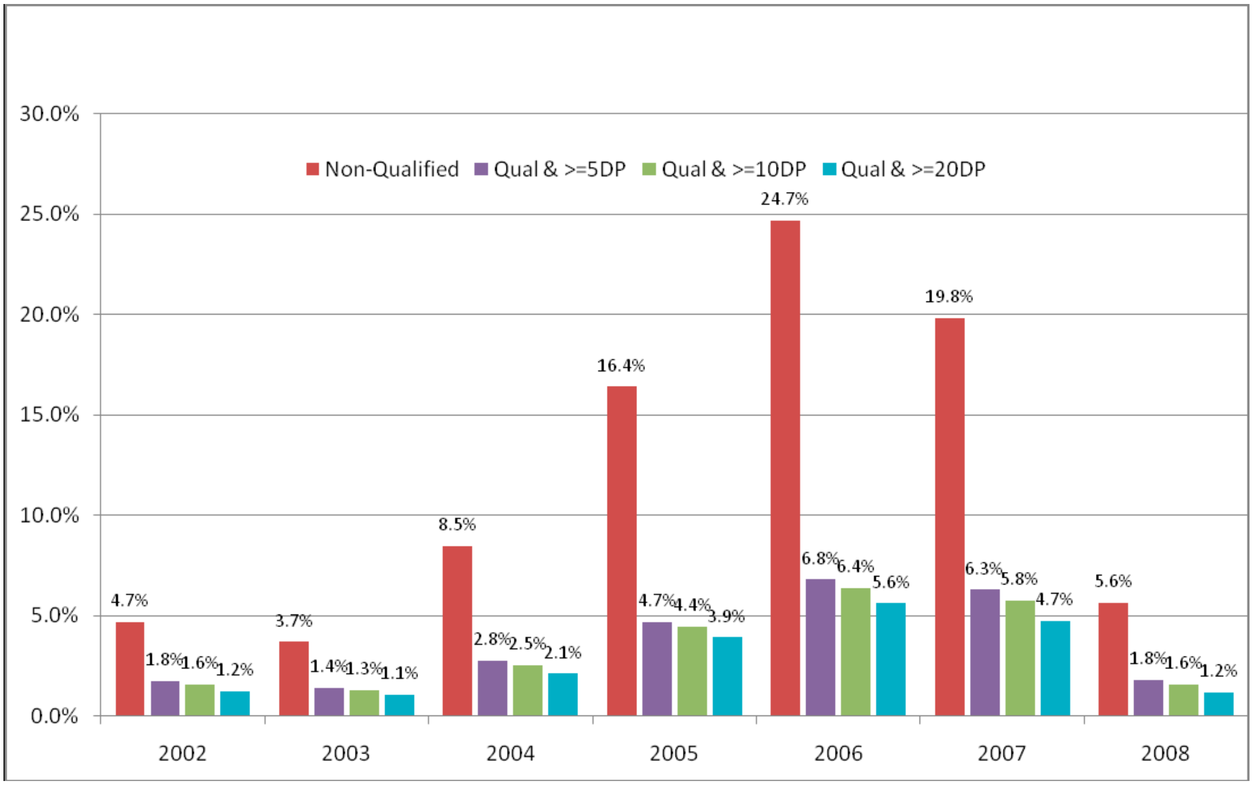
Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment **from 5% to 10%**	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers **not eligible** for QRM at 10% Down	7.6%	6.6%	9.0%	8.4%	10.9%	14.7%	8.4%
Reduction in default rate* by increasing QRM down payment **from 5% to 20%**	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM at 20% Down	19.2%	16.7%	23.0%	22.9%	25.2%	28.2%	20.7%

* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.

Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm, conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008.

Importantly, this analysis takes into account the impact on the performance of the entire cohort of defined QRMs that would result from moving from a 5% minimum down payment on QRMs in that cohort, to a 10 percent and a 20 percent minimum down payment. As such, it shows the broad market impact of a QRM with a 5 percent down payment requirement compared to a QRM with a 10 percent or 20 percent down payment requirement, rather than simply comparing default risk on 5 percent down loans to 20 percent down loans. Clearly, moving to higher down payments has a minor impact on default rates market-wide, but a major adverse impact on access by creditworthy borrowers to the lower rates and safe product features of the QRM.

Table 4
IMPACT OF INCREASING MINUMUM DOWNPAYMENT ON DEFAULT RATES FOR LOANS THAT MEET QRM STANDARDS
Low Down Payments not a Major Driver of Default when Underwritten Properly

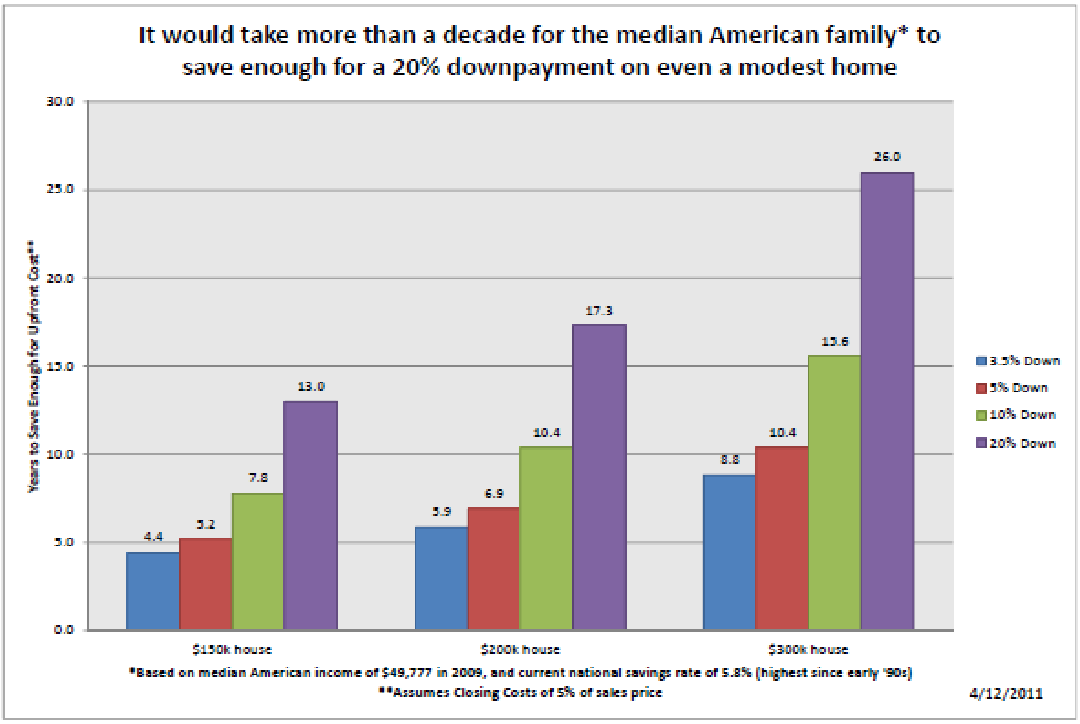


Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008. The qualified mortgage in this analysis is based on fully documented income and assets; fixed-rate or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.

NAR is concerned that a narrowly defined QRM will also require severe tightening of FHA eligibility requirements and even higher FHA premiums to prevent huge increases in its already robust share of the market, adding additional roadblocks to sustainable home ownership.

Lastly, saving the necessary down payment has always been the principal obstacle to buyers seeking to purchase their first home. Proposals requiring high down payments will only drive more borrowers to FHA, increase costs for borrowers by raising interest rates and fees, and effectively price many eligible borrowers out of the housing market.

Table 5
Number of Years Needed to Save Required Down Payments
By Home Price and Down Payment Level



Source: National Association of REALTORS®

MOTRGAGE LOAN LIMITS

NAR strongly supports making permanent the GSE and FHA mortgage loan limits that are currently in effect. The GSEs and FHA have played a critical role in providing mortgage liquidity as private financing has dried up. The current loan limits are set to expire in just a few months, on September 30, 2011. In early 2010, when the limits temporarily expired, many communities saw dramatic declines in mortgage liquidity. More than 612 counties in 40 states and the District of Columbia saw their limits fall. The average decline in the loan limits was more than $51,000.

In today's real estate market, lowering the loan limits and changing the formula on which they are calculated 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 that the current limits be extended. 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.

GSE DIVIDEND PAYMENTS

Since August 2010, NAR has requested that the punitive dividend payments placed on the GSEs be reduced from 10% to 5%, in line with other Federal financial support recipients. Such a move is necessary in order to relieve the unnecessary drag that this assessment imposes on the housing industry's recovery. We believe that reducing the current punitive dividend will enhance the GSEs' ability to eliminate losses, which will be further enhanced as the housing markets continue to stabilize and recover. This will give the GSEs the flexibility to adjust their underwriting standards to take into account reasonable lending risks, which will benefit the consumer and the entire economy, without further risk of additional cost to the consumer.

More importantly, it makes no apparent sense for the Treasury Department to transfer amounts to the GSEs so they, in turn, will have enough money to make the dividend payment back to the Treasury. If the GSEs were not required to pay the 10% dividend, which significantly increases each of their quarterly losses, it would reduce the amount of capital Treasury is called upon to provide them. It would make more sense to charge the GSEs an amount equal to the Treasury borrowing cost, or borrowing cost to the GSEs based on the current federal assurance that they will maintain a positive net worth. Both of these amounts are far less than 10%.

CONCLUSION

The National Association of REALTORS® supports a secondary mortgage market model that includes some level of government participation, but protects the taxpayer while ensuring that all creditworthy consumers have reasonable access to mortgage capital so that they too may attain the American Dream – homeownership. We believe that the key points that we mentioned will help Congress and our industry partners design a secondary mortgage model that will be in all of our nation's best interest today, and in the future.

I thank you for this opportunity to present our thoughts on reforming our housing finance system, and as always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.