NATIONAL ASSOCIATION of REALTORS®
REALTOR®

500 New Jersey Avenue, N.W.
Washington, DC 20001-2020
202.383.1194 Fax 202.383.7580
www.realtors.org/governmentaffairs

Ron Phipps
ABR, CRS, GRI, GREEN, e-PRO, SFR
2011 President

Dale A. Stinton
CAE, CPA, CMA, RCE
Chief Executive Officer

GOVERNMENT AFFAIRS
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

TESTIMONY OF

STEVE A. BROWN
EXECUTIVE VICE PRESIDENT, CRYE-LEIKE REALTORS®

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

HEARING REGARDING

MORTGAGE ORIGINATION: THE IMPACT OF RECENT CHANGES ON HOMEOWNERS AND BUSINESSES

JULY 13, 2011

INTRODUCTION

Madam Chairwoman, Ranking Member Gutierrez, and members of the Subcommittee, I am Steve Brown, Executive Vice President for Crye-Leike REALTORS®, based in Memphis, Tennessee. I thank you for the opportunity to participate in this hearing on behalf of the 1.1 million members of the National Association of REALTORS® (NAR). 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.

Crye-Leike is a full service real estate company founded in Memphis in 1977. Today we are the nation's 6th largest real estate brokerage company and the largest serving markets in Tennessee, Arkansas, Georgia, Mississippi, and across the Mid-South. Crye-Leike has a network of more than 3600 licensed sales associates, 600 staff members and over 130 branch and franchise offices located in 65 counties throughout an eight-state region in Alabama, Arkansas, Florida, Georgia, Kentucky, Mississippi, Oklahoma, and Tennessee.

In my testimony today, I would like to cover a number of issues affecting the real estate and housing finance industry's ability to facilitate home sales and the mortgage origination process. These issues include the ramifications of the U.S. Department of Housing and Urban Development (HUD) 2010 guidance concerning the sale of home warranty contracts, issues arising as a result of the Qualified Mortgage (QM) provisions of the Dodd-Frank Wall Street Reform and Consumer Financial Protect law, the FHA mortgage program, appraisal oversight and proposed changes to the Real Estate Services Procedures Act (RESPA) and Truth in Lending (TILA) Act disclosures. But before I begin, I would like to thank the Chair and the Financial Services Committee for all of their hard work on extending the National Flood Insurance Program. As you know, the flood insurance program is vital to home owners and the housing industry in general and is particularly important where we do business and across the nation.

HOME WARRANTY

One major issue facing real estate firms, home warranty companies, and consumers is the treatment of home warranty under the Real Estate Settlement Procedures Act or RESPA. RESPA was enacted in 1974 to prevent kickbacks for referrals among settlement service providers for settlement services. A settlement service is customarily a service required to close the mortgage or settle a real estate transaction. The traditional settlement service providers are lenders, real estate agents and brokers, title agents and companies, appraisers, and attorneys. A home warranty is an insurance product that covers future repairs for a specified set of appliances or home systems and a period of time spelled out in the warranty contract. NAR has never believed home warranties are, in fact, a settlement service, and therefore subject to RESPA. Rather, we believe that this is an issue rightly regulated under state law as they currently are.

Despite the fact that a home warranty is clearly not a requirement for the origination of a mortgage or the sale of a home, the U.S. Department of Housing and Urban Development (HUD) nonetheless included home warranties in a list of settlement services in the RESPA regulation decades ago. The author of those regulations actually once told industry members that there was really no reason to include home warranty but since home warranties are often paid for at closing and that payment is reflected on the closing statement, home warranties were deemed a settlement service.

For nearly twenty years, this situation was not a problem until HUD issued a letter to a private citizen in 2008 that suggested the sale of home warranties by individual real estate agents was essentially a per se violation of RESPA. This arrangement has long been the business model of half the warranty industry. Their sales force are real estate agents and brokers who make the product known to their clients, explaining its features, processing the paperwork, and a number of other things, receive a small stipend for each completed transaction. This method of compensation is appropriate under RESPA's long-standing exception to its kickback provisions that allow a person to be paid for services actually performed. But the 2008 HUD letter made a significant change that has resulted in numerous class action lawsuits across the country.

NAR and its industry partners have spent over two years working with HUD to try to convince them the 2008 letter was harmful and incorrect. Home warranties are not a settlement service. They are not required by lenders to complete the transaction as settlement services are. They are purely optional. Many times, they aren't even purchased by buyers; sellers often offer them as a way to make the buyer feel more comfortable about the transaction. The fact that they typically are paid for at closing is simply due to the fact that most people want the coverage to take effect when they take possession of the property. That is just the right time to do it.

After years of working with HUD, the agency finally issued guidance in 2010. Unfortunately, that guidance is even more harmful than the original HUD letter. It is wholly unrealistic and ignores the actual services agents and brokers provide. Worse, it has led to even more class action lawsuits that are crippling real estate brokers and home warranty companies that are already strained by the current real estate market conditions. The lawsuits are likely to hurt consumers as well who won't have easy access to the product or will have to pay more for what is now a very reasonably priced product because warranty companies will have to hire a sales force and pay considerably more for the sales services currently provided by agents and brokers.

For these reasons, NAR and its industry partners are looking to Congress to correct this problem. We urge the subcommittee to pass H.R. 2446, the RESPA Home Warranty Clarification Act of 2011, introduced by Representatives Judy Biggert (R-IL) and Lacy Clay (D-MO), to countermand the HUD guidance and remove home warranties from RESPA and provide for appropriate consumer disclosure. Home warranties are already regulated at the state level; there is no need for another level of bureaucracy. HUD should never have included it all those years ago and the time is right to remove it now. Doing so will help save jobs and prevent consumers from having to pay more for a product they like.

DODD-FRANK 3% CAP ON AFFILIATES

Another area of concern to the industry is the definition of points and fees in the Qualified Mortgage (QM) provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The definition is complicated but the effect is that mortgage companies with affiliates in the transaction such as a title company, must also count those charges towards a 3% cap on fees and points required by the bill's predatory lending safe harbor. A mortgage company without affiliates does not have to do so. So in many cases, affiliated companies would not be able to offer full service to clients because in doing so they would violate the 3% cap.

This is unfair for a number of reasons. First, the likelihood that the affiliate title company would charge an uncompetitive rate is slim. The title industry and title insurance rates are heavily regulated by the states. So the rates charged by affiliated and unaffiliated firms are will vary little. Second, a lender cannot "mark-up" affiliate charges because to do so would violate RESPA. Third, surveys show that consumers say they save money by using the affiliates and it makes transactions easier.

The House addressed this issue in its version of Dodd-Frank through an amendment by Representative Clay of Missouri. However, for some unknown reason, it was removed during the conference. To this day, no explanation has been given for its removal other than it might have been a mistake. Congress should fix the 3% cap issue at its earliest opportunity so consumers can fully benefit from greater competition in the lending industry between affiliated and unaffiliated lenders.

FHA

I would also like to take time to reiterate the importance of the FHA program and making permanent the existing FHA and GSE loan limit formula. With credit already tight, FHA is playing a vital role in providing affordable, well-underwritten mortgage credit to American families. This is a role that FHA has long played without costing taxpayers a penny. In fact, FHA throughout its history has routinely returned funds to the Treasury.

Loan limits

Changing the FHA and GSE loan limit formulas will result in significant declines in the current loan limits. In fact, we have already heard that one of the nation's largest lenders has already dropped their loan limits effective July 1, 2011 in anticipation of the expiration of current loan limits on September 30, 2011. This will hurt the housing recovery by reducing access to safe affordable FHA loans in 669 counties in 42 states plus the District of Columbia; only eight states would not be impacted.[1] The resulting average reduction in limits will be more $68,000. With this decline, 27 percent of all owner-occupied homes in the United States will be ineligible for GSE financing, and more than 59 percent of all owner-occupied housing will be ineligible for FHA financing.[2] In states where we operate, FHA is used by more than 60 percent of our buyers. These declines will have a dramatic impact on liquidity in our markets, and could halt the housing recovery.

Reducing the loan limits could also result in a greater risk to the stability of the FHA program since higher balance FHA loans perform better than lower balance ones. According to the FY 2009 FHA Mutual Mortgage Insurance Fund (MMIF) audit, "FHA experience indicates that larger houses tend to perform better compared with smaller houses in the same geographical

1. Arkansas, Iowa, Kansas, Mississippi, Nebraska, Oklahoma, North Dakota, and South Dakota.
2. According to data compiled by the National Association of Home Builders, "GSE and FHA Loan Limit Changes for 2011: Scope of Impact"

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.

Many critics calling for a rollback of loan limits have justified their position by arguing that the FHA loan program was always intended to only benefit low-income or first time borrowers. However, this is a misconception. If you take a look back at the program's history, you will find that this is not the case. A review of the program's earliest loan limits indicates that the FHA loan limit in 1930 was $16,000. The national median home value in 1930 was $4,778.[4] The majority of homes were valued between $2,000 and $7,500, with the largest number of them falling between $3,000 and $5,000.[5] Only 3.2 percent of homes were valued between $15,000 and $20,000.[6] So the upper limit of $16,000 was more than 330 percent of the median American home value at that time. Contrast that with today, where even the current higher loan limits are set at 125 percent of the local area median home price. Even at its inception, FHA was intended to provide safe, affordable mortgage financing for all homebuyers in all markets – high and low cost.

With housing markets struggling to recover, the last thing we need to do is to put an avoidable stumbling block in the path of a much needed housing recovery. I know that it has been said before, but I believe it bears repeating – without a housing recovery, the nation's economy as a whole will struggle to recover its balance. This is not the time to be scaling back mortgage loan limits.

For these reasons, I and my fellow REALTORS® strongly urge this Subcommittee to approve H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act." This bill, introduced by Representatives Gary Miller (R-CA) and Brad Sherman (D-CA) will make the current limits for FHA and the GSEs permanent and ensure that families across the country have ongoing access to safe, affordable mortgages.

Downpayment Requirements

We also believe the downpayment for FHA should remain at 3.5% and that other requirements should also remain at current levels. FHA's book of new business (written since 2009) is performing extremely well and there is no reason to make more restrictive changes in the name of creating a false sense of "cleaning up" the real estate financing problems of the past. In fact, the current stagnant market could be sent in to a deeper, more serious downward spiral with any increase in the downpayment requirement.

In the case of downpayments, proposals to further increase FHA downpayment requirements are not only unwarranted but will not serve the purposes that proponents seek. First of all, increasing FHA's downpayment will not add a penny to FHA's reserves. The reserves can only

---

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.
4. Id. at 18
5. Id.
6. 15th Census of the United States, Population, Volume VI: Families, U.S. Census Bureau, 1930, P. 17

be increased by collecting premiums, and rising home prices. Increasing downpayments does not put any additional money into reserves; it simply reduces the amount of the mortgage.

Second, while a higher downpayment requirement would increase an individual borrower's investment in a home, such an increase will disenfranchise many of the borrowers that the FHA has successfully served throughout its history. According to our estimates based on very conservative assumptions, it would take the average American family, acting frugally, nearly 7 years to save for a 5 percent downpayment and the closing costs that average 3-5 percent of the purchase price on a $200,000 home, and more than 10 years to save 10 percent down. A 20 percent downpayment on the same home would require 17.3 years of saving for this same family. Given the very conservative assumptions inherent in our calculations, it is apparent that increasing downpayment requirements will create a substantial burden for all American homebuyers and especially younger families.

This increased burden comes with only marginal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default, but can strip homebuyers of their savings and increases the number of borrowers who would be ineligible for homeownership.

A recent study demonstrated that:

- Increasing a downpayment requirement from 5 percent to 10 percent reduces default rates by only 2/10ths of one percent, but could disenfranchise more than 8 percent of homebuyers.
- Increasing the downpayment requirement from 5 percent to 20 percent would reduce default rates by only 6/10ths of one percent, but would disenfranchise over 20 percent of homebuyers.[7]
- For FHA, increasing the downpayment requirement from 3.5 percent to 5 percent would disenfranchise more than 300,000 responsible homebuyers.[8]

If there is one lesson to be learned from the recent housing crisis, it is that the key to minimizing foreclosures and defaults is sound and careful underwriting and NOT downpayments.

Condominiums

HUD could further help the housing recovery by leveling the playing field for condominium loans. FHA recently unveiled new condominium rules in an effort to clarify, expand, consolidate and update existing guidance. The new guidance provides increased flexibility for FHA to address individual circumstances so that the agency can be more effective at the neighborhood level. While we applaud their efforts, we recommend further changes to FHA's condominium rules that will provide greater liquidity to this sector of the real estate market

7. Study done by the Community Mortgage Banking Project, "Study of 33 Million Home Loans Shows that Quality Underwriting Standards Reduce Default More than mandatory Down Payments."
8. HUD Testimony, before the House Financial Services Subcommittee on Housing and Community Opportunity, March 11, 2010

without causing additional risk to the MMIF. We support enhancements made to the rules but believe more needs to – and can - be done.

After taking numerous steps to mitigate risk, FHA's purchase activity is performing as well as it has in any period since Neighborhood Watch was established in 1999. For the quarter ending on March 31, 2011, the Seriously Delinquent and Claims Rate was 2.26 percent, which is the lowest rate for any quarter over the last two years. Condominium loans are performing even more strongly than other purchase loans. According to the most recent data, condominium purchases had a delinquent/claims rate of 1.01 percent for existing condominium projects and 1.28 percent for new projects, both of which are less than half of the overall claims rate.

Further amending the rules for condominium developments will benefit all parties in the real estate transaction. Lenders will have the opportunity to move more REO properties off their books because more units could be eligible for buyers with FHA mortgages. Individuals and families purchasing units in these developments with FHA loans will have access to more flexible and affordable financing opportunities. Potential buyers with FHA mortgages will have a wider choice of condominium developments. Existing owners in these developments benefit as vacant units are purchased and occupied and the owner-occupied ratio increases. Improving the health of condominium developments will reduce risk to the insurance fund. Considering the strong performance of recent loans made under the revised underwriting criteria makes a compelling case that more relaxed rules would be beneficial.

APPRAISALS

REALTORS® support and encourage credible, independent appraisals and valuations of real property, which are critical to the health of the overall real estate industry. A trustworthy valuation of real property 1) ensures the real property value is sufficient to collateralize the mortgage, 2) protects the homebuyer, 3) allows secondary markets to have confidence in the mortgage products and mortgage backed securities, and 4) builds public trust in the real estate profession. Professionally developed valuations provide an independent, objective analysis of real property. Valuations that are not credible or not independent harm communities and result in unintended consequences. The purchase of a home is the largest investment most people make. A valuation that does not properly reflect the owner's equity and may require the owner to pay increased fees or inject unneeded additional liquidity into a collateralized loan to meet higher lending requirements. Valuations of real property that are too high give a false sense of security to homeowners seeking access to the equity in their homes and to lenders making a determination as to the security of their loan. Valuations that are too low may create a downward cycle of economic deterioration for neighborhoods and communities and cause increased cash requirements on lenders.

NAR supports the appraisal provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including language that enhanced federal oversight of state appraisal programs. The Appraisal Subcommittee is primarily responsible for this oversight and in fiscal year 2010 conducted 34 on-site visits of which, 26 were full Compliance Reviews. The oversight work will increase for ASC in the coming years as states implement legislation and rules on the registration of appraisal management companies (AMCs).

One of the biggest challenges to federal oversight of state appraisal programs is the current funding structure of appraisal programs at the state level. Typically, licensing and certification fees paid by the appraisers to the state are to be used for funding state appraisal boards. However, in many cases these fees are directed to a state's general fund, causing the state appraisal board to compete with other state discretionary programs for funding. Inadequate funding of state appraisal boards means that recommendations offered by ASC through site visits and Compliance Reviews are difficult, if not impossible, to implement.

RESPA/TILA DISCLOSURES

NAR is participating in the effort by the Consumer Financial Protection Bureau (CFPB) to combine the Truth in Lending Act (TILA) Disclosure with the RESPA Good Faith Estimate (GFE). NAR has been a strong supporter of reducing duplicative paperwork and combining these two forms provided the combined document includes the statutorily required elements of both laws. To date, NAR has been pleased with the manner in which the CFPB is handling its task. It has been open and sought input regularly as it combines and makes adjustments to its proposed forms. Any concerns we have expressed have been addressed in subsequent drafts. We have found the process so far to be superior to many previous regulatory experiences with other agencies.

Our only concern over the long term is that when new forms are implemented, every effort must be made to reduce the costs of transition and that there is adequate educational effort made to explain the new forms, how they work and how they are properly completed and used.

CONCLUSION

These five issues are but a few of the headwinds facing the housing industry. NAR opposed risky lending in 2004 when it issued its subprime lending policy that called for strong underwriting on mortgages and measuring a person's ability to repay. We feel now that the pendulum has swung too far and with new regulations on the horizon, fewer and fewer otherwise qualified people will be able to get a loan and there will be fewer lenders to lend. Congress and the Administration need to seriously re-examine the many well-meaning laws and regulations that have come out of the financial and mortgage crisis. Some have merit and need minor fixes; others may have sounded good at the time but are proving problematic at best. They deserve a second look to ensure the still fragile recovery stays on track and protect the long-term value of homeownership in the U.S.

NAR thanks the Subcommittee members for their attention to these vital issues. We look forward to working with Congress on efforts to address the challenges still facing the nation's housing markets.