NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

TO THE

HOUSE FINANCIAL SERVICES COMMITTEE

ENTITLED

"LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES"

SEPTEMBER 20, 2007

On behalf of 1.35 million members of the National Association of REALTORS®, we present our views on the federal role in mitigating and minimizing mortgage foreclosures. 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.

The current crisis in the mortgage market is troubling to all of us. In 2006, 1.2 million families entered into foreclosure, 42 percent more than in 2005[1]. Abusive lending, exotic mortgages and a dramatic rise in subprime lending – coupled with slowing home price appreciation – have all contributed to this crisis.

The National Association of Realtors® supports a number of short-term, intermediate and long-term actions needed to address the current crisis and minimize the likelihood that the nation faces such a situation again.

Remedies for the Current Crisis

Increased FHA Loan Program Flexibility. NAR supports changes to the FHA loan program recently announced by the President to allow homeowners with loans they can no longer afford to refinance into an FHA loan product. *FHASecure* will allow homeowners with good credit to refinance their existing loans with FHA loans, even if they are not current on their existing loans. These borrowers will have to have proven good payment histories prior to the interest rate reset on their current loans, and will have to meet all other FHA underwriting criteria.

FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization. It is predicted that *FHASecure* will assist 240,000 households who otherwise would face foreclosure.

In April of this year the National Association of REALTORS® sent a letter to HUD Secretary Alphonso Jackson asking for regulatory action to allow FHA to refinance loans that were in delinquency. We applaud the Administration for making this welcomed change

Mortgage Cancellation Relief. The National Association of REALTORS® has also been a strong advocate for mortgage cancellation relief. NAR believes that Congress should provide tax relief to borrowers in the event a lender excuses some portion of a mortgage debt. Current law provides tax relief for owners of investment real estate when some portion of their mortgage debt is forgiven. No tax relief mechanism has ever been available, however, for owner-occupied residences. Today's market conditions and fundamental fairness make such a mechanism essential.

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[1] A Flood of Foreclosures, But Should You Invest?, Market Watch, February 18, 2007.

The policy considerations that support tax relief arise from questions about taxing phantom income. When a residence is sold, a seller may experience a so-called "short sale" in which the proceeds realized from sale are insufficient to cover the outstanding balance on the mortgage. A lender might forgive the shortfall amount, but, under current law, the individual would still be required to pay tax, even though there is no cash with which to pay it. Similar situations could arise on a foreclosure. As a matter of policy, tax writers have generally tried to assure that there is no tax on phantom income in cases when the individual has generally complied with tax laws. The current phenomenon of short sales and foreclosure generates phantom income that should not be taxed.

Current law provides an asymmetric result for taxation on the sale of a principal residence. There are only two instances in which an individual will pay tax on the sale of a principal residence. The truly fortunate will pay tax only if their *gains* exceed $250,000 ($500,000 on a joint return). The tax on any amount in excess of $250,000/$500,000 is imposed at capital gains rates. The other category of individuals who pay tax on the sale of a principal residence are the truly *un*fortunate who must pay tax on the phantom income generated when they sell for less than they owe or lose their home through foreclosure. To add insult to injury, the phantom income is taxed at ordinary rates.

Fundamental fairness would dictate that those who sell their properties in situations where there is true economic loss should be relieved of any requirement to pay tax, just as most individuals who benefit from a true economic gain are relieved of any requirement to pay tax.

NAR supports H.R. 1876 (and its companion, S. 1394), bipartisan legislation that would provide mortgage cancellation tax relief. The legislation includes many safeguards to prevent abuses, and NAR is working with tax staff to assess the need for any additional anti-abuse rules. Congress has previously provided mortgage cancellation tax relief to individuals affected by hurricane Katrina. Legislation is currently under consideration that would also provide mortgage cancellation relief to individuals in the military. NAR urges Congress to extend this relief to *all* individuals affected by the challenges facing some borrowers in today's housing market.

Foreclosure Forbearance and Mitigation. NAR supports legislative, regulatory, and private-sector foreclosure avoidance and mitigation efforts. We urge lenders, especially lenders that have made loans without considering the ability of the borrower to make payments under the loan, to act promptly to help borrowers resolve the problem. Possible steps could include recasting the mortgage, forbearance, favorable refinancing, waiving of prepayment penalties, and other appropriate tools. Prompt action will almost always be in the best interests of the lender, as well.

NAR also supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure or minimize its impact. We also believe that Congress and the regulators should examine alleged abuses by mortgage servicers, some of whom are engaging in predatory servicing by imposing unjustified high fees on borrowers. These abusive practices can contribute to, or even cause, delinquencies and foreclosures.

Furthermore, NAR has taken the lead within the industry to partner with the Center for Responsible Lending and NeighborWorks® America to create a brochure that can help financially stressed consumers having problems paying their mortgage understand their options and offer guidance on how to avoid foreclosure. Our foreclosure avoidance brochure is available at www.realtor.org/subprime along with additional consumer education tools, including a brochure on avoiding the trappings of a predatory loan.

Future Prevention

The full impact of this crisis remains to be seen, but with 2.2 million American households projected to lose their homes, the National Association of REALTORS® strongly believes that legislation must be enacted to prevent a similar disaster from happening again. These foreclosures will cost homeowners as much as $164 billion, primarily in lost home equity.[2]

Responsible Lending Principles. NAR supports a detailed list of protections for consumers in the mortgage transaction, which were included in our statement submitted for the July 25, 2007 House Financial Services Committee hearing entitled, "Improving Federal Consumer Protection in Financial Services – Consumer and Industry Perspectives." In short, NAR strongly believes all mortgage originators should:

- Treat all parties in the transaction honestly and fairly, which is consistent with REALTORS®' responsibilities under NAR's Code of Ethics.
- Verify the borrower's ability to repay the loan, based on all terms, including property taxes and insurance, without having to refinance or sell and considering the totality of the borrower's circumstances with some flexibility to accommodate those with unique circumstances.
- Underwrite using a reasonable debt-to-income ratio, making sure borrowers have enough residual income after making their monthly mortgage payment, including property taxes and insurance, to meet their needs for food, utilities, transportation and other essentials;
- Generally require that, for subprime loans, the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower's payment of property taxes and insurance;
- Underwrite loans based on verified income and assets, with few exceptions;
- Ensure that any refinanced mortgage provides a significant benefit to the borrower;
- Eliminate prepayment penalties, or at least make them for the shortest time and the lowest amount possible;
- Consider alternative payment history, such as rent, utilities, and telephone and report payment history of borrowers on a monthly basis;
- Offer a choice of mortgages with interest rates and other fees that reflect the borrower's credit risk; and
- Face strong penalties for abusive lending acts.

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[2] Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners, Center for Responsible Lending (December 2006).

FHA Reform Legislation. HR 1852, the "Expanding American Homeownership Act of 2007", sponsored by Chairman Barney Frank (D-MA) and Subcommittee Chairman Maxine Waters (D-CA) passed the House by a vote of 348-72 earlier this week. The Senate bill is making its way to the Floor. We urge you to quickly conference this bill and get it on the President's desk as soon as possible. Without the measure's reforms – increased loan limits, modified downpayment requirements, and streamlined condominium loan program requirements - FHA loans will remain inaccessible to many homebuyers and owners, including those who need to refinance out of problem loans or are unable to find conventional mortgage financing in today's markets.

Conclusion

Today, our nation faces three challenges in dealing with the aftermath of this year's mortgage turmoil. First, we must help those families threatened with the loss of their homes as the result of changing economic conditions and skyrocketing mortgage terms. Second, we must make sure that today's mortgage market turmoil does not spread to the economy as a whole. And, finally, we must make the changes necessary to ensure that American families do not face such a situation again. Both private industry and the federal government have an important role to play in each these challenges. The National Association of REALTORS®stands ready to work with you on implementing these most important measures and thanks you for holding this important hearing and taking a vital first step.