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500 New Jersey Avenue, N.W.

Washington, DC 20001-2020

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HEARING BEFORE THE UNITED STATE SENATE COMMITTEE ON APPROPRIATIONS SUBCOMMITTEE ON TRANSPORTATION, HOUSING AND URBAN DEVELOPMENT AND RELATED AGENCIES

ENTITLED

THE ROLE OF THE FEDERAL HOUSING ADMINISTRATION (FHA) IN ADDRESSING THE HOUSING CRISIS

WRITTEN TESTIMONY OF J. LENNOX SCOTT NATIONAL ASSOCIATION OF REALTORS®

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Chairwoman Murray, Ranking Member Bond, and members of the Subcommittee, thank you for inviting me to testify today on the role of the Federal Housing Administration in addressing the housing crisis.

My name is Lennox Scott, and I am the chief executive officer of John L. Scott Real Estate in Bellevue, Washington. I am here today to represent the views of the nearly 1.2 million members of the National Association of REALTORS®, who are involved in every aspect of the real estate business.

The members of the National Association of REALTORS® have had 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. With the collapse of the private mortgage market, the importance of Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, the FHA is one of the primary sources of mortgage financing available to families today. Without FHA financing, families would be unable to purchase homes and communities would suffer from continued foreclosure and blight.

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. The universal and consistent availability of FHA loan products is the principal hallmark of the 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 market share has grown from less than 3% to more than 30% in a very short time. While this change was necessary to provide a functioning mortgage market, it also provides concern for the safety and soundness of FHA. With such dramatic growth comes increased responsibility, and the need for increased infrastructure and staff.

We believe FHA is doing its best to step up to the challenge. Over the last 18 months, FHA has demonstrated it can handle volume increases at four times 2007 levels while its market share increased to over 30 percent. Despite receiving minimal additional resources, there are two reasons why FHA has been capable of handling the volume. First, once lenders have been approved by FHA, they perform all of the loan processing, underwriting, closing and insuring functions without HUD review. This takes the burden off FHA, although additional oversight in approval may be needed. Second, FHA's technology, despite being 25 years old, remains resilient and fundamentally sound. That said, there are a number of changes that should be implemented to ensure that FHA's Mutual Mortgage Insurance Fund (MMIF) remains strong and healthy.

Need for Increased Capacity

For years FHA has been hampered by a lack of investment in staff and information technology. The Single Family FHA program currently operates with a nation-wide staff of about 900, which is approximately 160 positions less than needed. In addition, FHA operates with technology that is an average of 18 years old. FHA Commissioner Brian Montgomery had said the software programs FHA uses are, in many cases, older than the staff maintaining it. Quickly upgrading the dozens of incompatible systems, such as the 30 year old COBOL system, to web based customer centric applications is necessary for the agency's continued existence and future success.

Our membership believes that FHA cannot continue to serve its constituency without rapidly implementing a quality and systems initiatives. Other financial institutions more adequately staffed and with more advanced technology have already gone out of business. It has been estimated that $65 million is required to upgrade the FHA systems and add the appropriate number of staff. These expenditures could save the taxpayer tens of millions of dollars per year and result in a more efficient government mortgage insurance program.

Increased Oversight/Risk Management

Recent articles have expressed concern about FHA's oversight of loan originators. In order for a lender to be a direct endorser for FHA (and not require HUD approval on every loan), they must submit an application to HUD. The number of applications has skyrocketed in recent months, and we agree with the concerns expressed about both time to process applications and provide the necessary oversight of lenders.

Despite media concern that FHA has become a “dumping ground” for subprime loans and high-risk borrowers, the FY 2008 independent Actuarial Review demonstrates that the FHA Mutual Mortgage Insurance Fund (MMIF) is fiscally sound, and projected to remain so over the next seven years. While the MMIF has experienced a decline in value, it remains above the congressionally mandated 2% capitalization ratio. A high percentage of the decline was the result of falling house prices – something everyone has been facing. In addition, the quality of borrowers utilizing FHA has improved. Borrowers now have higher credit scores and lower loan-to-value ratios; these changes are expected to further improve the financial status of the FHA MMIF.

The Actuarial Review suggests that if current conditions continue, FHA will be able to handle the increased claim activity and decreased valuation of the housing market while meeting its current capital reserve requirements. However, it is important to note that the Actuarial Review is based on July 2008 data, and may not take into account the full impact of actual home value declines since then. The review also does not take into account the latest estimates of anticipated employment decline, which could impact borrower incomes and ability to pay. These factors -- higher than expected home price declines and higher than expected unemployment—could present a troubling macroeconomic picture for FHA going forward. While current borrowers’ higher credit quality provides some protection from these trends, it cannot eliminate all risks. The most recent data shows that FHA’s delinquency rate is climbing at a troubling rate.

Additional personnel are needed to assure that FHA does not fall victim to fraud or abuse. Recent reports indicate an increase in early payment defaults, i.e those loans that are delinquent with just their first or second payment. Currently monitoring of these loans is limited due to staffing constraints. Increasing lender oversight and staff to monitor fraud and abuse will help keep FHA fiscally strong, and will protect the taxpayers’ interest.

<u>Technical Corrections to FHA Programs</u>

The Housing and Economic Recovery Act (HERA) of 2008, signed into law in July 2008, provided a number of valuable reforms to FHA. However, not all of them have been able to be implemented due to confusion over implementation or interpretation of the law.

HERA included provisions intended to ease financing of condominiums for FHA. However, HUD's attorneys have stated that the legislation does not specifically remove the requirement for an environmental review of the property for a condominium loan to be processed. This review is very time consuming and complicates the home purchase process. Since Congressional intent was to ease financing for condominiums, this matter should be clarified in the law so HUD may implement the new HERA provisions.

Condominiums remain one of the more affordable housing options for American families. NAR further recommends that the FHA reduce the 51 percent occupancy ratio to a number below 50 percent for all condominium developments. Amending the owner-occupancy rules for condominium developments for buyers with FHA mortgages will benefit all parties in the real estate transaction. Individuals and families purchasing condominiums will have access to more flexible and affordable financing opportunities. Potential buyers with FHA mortgages will have a wider choice of condominium developments. Finally, existing owners in these developments benefit as vacant units are purchased and occupied and the owner-occupied ratio increases.

HERA also promoted the use of FHA's energy efficient mortgage (EEM) product. Currently an EEM may include up to $8,000 of energy efficient improvements to a home. However, HERA increased that amount up to 20% of the value of the home. FHA has been unable to implement this provision due to a technical flaw in the statute. Given the Administration's support of energy efficiency, we urge this technical correction be made to allow borrowers purchasing homes to use FHA to get the full benefit.

Chairman Murray and the Subcommittee members have been strong supporters of increasing the FHA loan limits, which was done in both the HERA legislation and in the American Recovery and Reinvestment Act (ARRA) passed earlier this year. ARRA reinstated the 2008 loan limit levels, at 125% of local area median home price, capped at $729,750. ARRA also provided the HUD Secretary with discretion to increase the limits in "sub-areas," where home prices may far exceed the county average. However, HUD has chosen not to exercise this authority. We believe the loan limits need to be made permanent at the current levels, as to provide some stability to the market. We also believe that FHA should be encouraged to use their authority to increase the limits in communities that simply have prices higher than their surrounding counties.

<u>FHA and Use of the Homebuyer Tax Credit</u>

The Housing and Economic Recovery Act of 2008 also includes a first-time homebuyer refundable tax credit up to $7,500 to first-time home buyers for the purchase of a principal residence on or after April 9, 2008 and before July 1, 2009. This was followed by the American Recovery and Reinvestment Act, which offers a tax credit of up to $8,000 for first-time homebuyers who purchase on or after January 1, 2009 and before December 1, 2009.

Enabling homebuyers to have access to their tax credit funds at the time of closing, through a collateralized loan against the tax credit, would allow the home buyer to use the credit toward a down payment. The repayment of the funds borrowed against the credit would be obtained through use of the tax refund. During his confirmation hearings, HUD Secretary Shaun Donovan stated that FHA has the discretion to permit this type of financing mechanism. FHA regulations permit a borrower to use loan proceeds for a home purchase as long as the loan is "secured by property or collateral owned by the borrower independently of the mortgaged property." Loans may be used for a down payment, and secured by the mortgaged property, in certain circumstances and assuming the loan is not provided by a party having a direct or indirect interest in the real estate transaction. This use of the tax credit benefits potential first-time homebuyers with little down payment available for purchase.

Monetizing the tax credit through a loan combined with FHA's low 3.5 percent down payment requirement would offer a strong incentive to buyers who would otherwise not purchase a home this year. NAR estimates that hundreds of thousands of buyers will take advantage of the tax credit. However, proactive use of the tax credit will release even more pent up demand in real estate markets across the country. Granting borrowers access to their tax credit through collateralized loans will further ensure FHA products are the mortgage products of choice for homebuyers.

Conclusion

Today's FHA is not your father's FHA. Congress and HUD have made a number of important and valuable changes to FHA over the last several years that have enabled it to stand up to the challenges of today's mortgage market. FHA is now the principal source of financing for millions of American families. Without FHA our economic crisis would be significantly prolonged.

There are a number of reforms that can be made to FHA to ensure its continued success and its availability to hardworking families. We urge the Subcommittee to review our proposals and consider using these suggestions to strengthen FHA. We thank you for your continued support of federal housing programs, and stand ready to work with you to keep these programs viable.