Link to Index Entry:

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TESTIMONY
of
the NATIONAL ASSOCIATION OF REALTORS

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES, AND GOVERNMENT-SPONSORED ENTERPRISES
OF THE
COMMITTEE ON BANKING AND FINANCIAL SERVICES

PRESENTED
BY
MARTIN EDWARDS, JR.
President-ELECT, NATIONAL ASSOCIATION OF REALTORS

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Introduction

Mr. Chairman, Congressman Kanjorski, members of the Subcommittee I am Martin Edwards, President – Elect of the National Association of REALTORS. I am a REALTOR® from Memphis, Tennessee, and will become the president of the NATIONAL ASSOCIATION OF REALTORS® next year. I am a partner in Wilkinson & Snowden, Inc., a commercial and industrial real estate firm.

As members of the Subcommittee know the National Association of REALTORS 780,000 members are involved in all aspects of the residential and commercial real estate industry. One of the REALTORS principal goals is that America's homeownership opportunities expand and that our housing finance system remains strong, vibrant and responsive to demand. I am pleased to present the Association's views on H.R. 1409, the "Secondary Mortgage Market Enterprises Regulatory Improvement Act."

The National Association of REALTORS is concerned that H.R.1409 taken as a whole is significantly at odds with the legislation Congress adopted in 1992 amending the GSEs' charters and laying out the current regulatory framework. When Congress adopted the Secondary Mortgage Market Enhancement Act of 1992, it reaffirmed the role that Fannie Mae and Freddie Mac should play as government-sponsored enterprises facilitating the expansion of the nation's residential secondary mortgage market and expanding American homeownership opportunities. The 1992 Act not only sharpened the mission and public purpose of the enterprises, it established the Office of Federal Housing Enterprise Oversight (OFHEO) to regulate the GSEs' financial operations and risk management. In the same legislation, Congress mandated affordable housing targets for Fannie Mae and Freddie Mac that formally charged the enterprises with the responsibility of promoting homeownership for families with incomes generally below the gross national median household income, which was $40,816 in 1999 according to the most recent data.

The 1992 Act reaffirmed that Fannie Mae and Freddie Mac as unique American financial institutions. All observers acknowledge that as government-sponsored enterprises, Fannie Mae and Freddie Mac are well-capitalized and well-managed corporations. Because of the two enterprises' activities, today's homeownership costs are lower and access to mortgage credit -- even for borrowers with blemished credit -- is easier and more equitable. Much of what Fannie Mae and Freddie Mac are doing in the current mortgage finance environment relates to lowering the costs of homeownership. The two enterprises are working to lower the two largest barriers to homeownership in this country -- the mortgage loan down payment and costs associated with closing the mortgage transaction. REALTORS applaud and support these activities.

REALTORS and the GSEs

REALTORS and homebuyers rely on the GSEs to provide liquidity in the mortgage marketplace. That is the essence of why Congress created these enterprises. In the nearly thirty years that Fannie Mae and Freddie Mac have existed they have fulfilled their congressionally chartered mission in good economic times and in less prosperous economic times.

Creating homeownership opportunities at affordable costs to more Americans is the cornerstone of the National Association of REALTORS business and public policy objectives. REALTORS believe that Congress created Fannie Mae and Freddie Mac for that purpose and the enterprises consistently demonstrate their commitment to home ownership and housing affordability.

REALTORS know from painful experience that booming mortgage lending and real estate cycles inevitably turn downward. Fannie Mae and Freddie Mac, unlike primary market lenders, remain in markets during these downturns. REALTORS also support the federal ties and subsidies that flow to the GSEs because of their federal charters. In exchange, the GSEs fulfill their charter obligations -- they do what Congress, homebuyers, and most lenders want.

Despite REALTORS general support for the GSEs, we do have our criticism of Fannie Mae and Freddie Mac. REALTORS do not support Fannie Mae's and Freddie Mac's efforts to expand their foreclosed property disposition activities to include bidding on third party foreclosed properties. In addressing our concerns, REALTORS did not seek legislation to hobble the enterprises, nor was there a concerted public effort to eliminate their activities. REALTORS raised our concerns about the GSEs' third-party REO activities directly with the enterprises and both companies agreed not to expand their third-party REO activities.

We strongly disagreed when the GSEs opposed increasing the FHA mortgage limits. It is likely that we will not agree in the future on this issue.

More recently, there has been growing concern among some REALTORS about the need to revise the conforming loan limits. As home prices and economic conditions converge to diminish housing affordability in a growing number of real estate markets on the West Coast, in some fast growing Mountain States, and along the Eastern seaboard. REALTORS, believe that there are very solid reasons for selective loan limit increases to match the 'high cost area' limit currently in effect in Alaska, Hawaii and the Virgin Islands. These 'high cost areas' enjoy a conforming loan limit that is 50 percent higher than the standard conforming loan limit of $275,000.

We raise these issues to make this point: The current regulatory structure facilitates REALTORS working with GSEs to address housing and homeownership problems. The proposed regulatory scheme introduces considerable uncertainty into the process.

Issues Raised by the Secondary Mortgage Market Enterprises Regulatory Improvement Act

H.R. 1409 proposes to make the Federal Reserve Board the regulator for Fannie Mae and Freddie Mac. The bill transfers safety and soundness regulation from the Office of Federal Housing Enterprises Oversight (OFHEO) and moving mission and new program and product regulation from the Department of Housing and Urban Development (HUD). The Board will have new authority to govern GSE activities. Its supervisory powers would parallel those that the Federal Reserve and other bank regulators already have over financial institutions. Unlike last year's GSE regulatory reform bill, the Federal Home Loan Banks and the Federal Housing Finance Board are unaffected by the bill.

The bill proposes prompt corrective action and enforcement similar to those for banks. However, the bill is extremely ambitious, going beyond the GSE regulatory structure. The bill raises questions about the mission, operations and activities of Fannie Mae and Freddie Mac that would be particularly troublesome for REALTORS if enacted.

First, the Federal Home Loan Bank System, the nation's third housing-related GSE is excluded from the bill's scope. Significant disparities among the housing-related GSEs could likely result regarding capital, regulation, and activities.

Second, it is unclear whether the Federal Reserve Board is willing to take on the task of regulating Fannie Mae and Freddie Mac. Chairman Baker acknowledged that he had not consulted with the Board regarding the prospect of taking regulatory authority for these GSEs in addition to regulating bank holding companies and financial holding companies, as required by the Gramm-Leach-Bliley Act.

We would note that the Board has no experience regulating housing and real estate-related entities. Neither the Board nor its regional banks are experienced in regulating housing and real estate. As the nation's central bank, the Federal Reserve Board has historically held a negative view of the special status that the housing finance enterprises benefit from as a matter of public policy.

There is pending a major expansion of regulatory responsibilities for the Federal Reserve under the Gramm-Leach-Bliley Act through a proposed regulation to allow financial services holding companies sell and manage real estate. Governor Laurence Meyer recently affirmed the controversial nature of this proposed regulation.

A critical concern for REALTORS regarding the Federal Reserve as the prospective GSE regulator is this: As the nation's central banker the Board could potentially have a conflict of interest regulating Fannie Mae and Freddie Mac. The Federal Reserve Board controls the nation's money supply and is the regulator for money center banks and financial services holding companies. REALTORS are concerned, for example, that the Federal Reserve Board would not be unbiased in deciding whether to increase the GSEs' conforming loan limits when bank holding companies and financial holding companies that have huge stakes in mortgage lending subsidiaries would prefer that loan limits not increase. Arguably it is in the banks' interest to see conforming loan limits lowered or frozen.

Third, paradoxically the proposal to assure the prudent regulation of the GSEs seems to disregard a principal lesson that the nation learned during the savings and loan crisis of the 1980s. The old Federal Home Loan Bank Board regulated savings and loan associations and administered the S&L deposit insurance fund. The Financial Institutions

Reform, Recovery and Enforcement Act of 1989 (FIRREA) institutionalized the principle of "constructive friction," effectively creating tension between mission and safety and soundness regulation in financial regulation. Admittedly the regulatory issue is not exactly the same. However, the proposal could create situations where the Board could well find itself making regulatory decisions that might favor one regulated industry over another.

Fourth, the bill goes beyond improving GSE regulation. The bill proposes to address issues associated with mission. It raises the public policy issues associated with the GSEs' federal charter to support the secondary mortgage market, and how conforming loan limits are established and revised. H.R. 1409 proposes limiting the Treasury Department's authority to purchase GSE obligations to provide liquidity to the mortgage markets in addition to removing the GSEs' exemption from Securities Exchange Commission registration. These provisions attack the premise for the GSEs' creation and existence and should be addressed separately.

For these reasons, the National Association of REALTORS cannot support the bill in its entirety. However, REALTORS do not take issue with the need for a strong and credible GSE regulatory structure. Congress came to the current regulatory structure after nearly two years of review and debate. The proposed focus on a single regulator as opposed to the current regulatory scheme is rooted in the difficulties that led to abolishing the Federal Home Loan Bank Board and separating mission regulation and safety and soundness regulation for thrifts in the wake of the savings and loan debacle of the 1980s. Congress deemed it prudent to separate mission and purpose from safety and soundness to avoid the regulatory and political conflicts that contributed to the savings and loan industry crisis.

The GSE safety and soundness and risk management concerns have not gone unaddressed. Last year the GSEs committed to Chairman Baker to institute new financial management and disclosure commitments intended to strengthen capital adequacy, transparency and market discipline. Recent oversight hearings in this Subcommittee about the GSEs' commitments to more disclosure and transparency regarding the risk management confirm that the GSEs are holding up their end of the bargain.

REALTORS are concerned that GSE regulatory reform could well be the stalking horse for eliminating Fannie Mae and Freddie Mac as significant facilitators of housing finance. This does not mean that REALTORS believe that regulatory scrutiny of Fannie Mae and Freddie Mac is unnecessary or could not be improved. Congress has oversight authority that it is clearly exercising. The bill, however, is extremely ambitious and like its predecessor may only serve as an impediment to focused discussion about regulating Fannie Mae and Freddie Mac.

Financial Marketplace, Competition and Innovation

What then are the issues that are really driving this debate?

Fundamental forces are transforming the U.S. housing finance system. There are implications for the primary and secondary mortgage markets, the capital markets, the financial system, homebuyers, Congress, and the GSEs' regulators. Traditional mortgage lenders and mortgage lending relationships are changing and creating significant uncertainty among industry competitors. The largest financial institutions are positioning to take advantage of the sweeping changes in the nation's banking laws. Their goal is to concentrate financial services mortgage financing in the hands of a few financial conglomerates that are emerging in the wake of new banking and financial laws.

Several of these financial conglomerates, once based in mortgage lending, consider themselves in competition with Fannie Mae and Freddie Mac. These financial services providers actively work to impede the GSEs' growth and innovation in the marketplace. These financial institutions are the same entities that petitioned the Federal Reserve Board and the Secretary of the Treasury to permit them to sell and manage real estate less than two years after sweeping banking and financial services reform legislation, the Gramm-Leach-Bliley Act, went into effect.

These lenders lament not having the financial advantages that Congress granted to the GSEs and advocate containing them. These financial companies are willing to argue that Fannie Mae and Freddie Mac have an unfair advantage because of their federal charter ties. Yet these same mortgage companies' parent banking companies have their own federal subsidies that come in the form of deposit insurance and other benefits that derive from the nation's banking and financial system safety net.

Fannie Mae and Freddie Mac were created to do what no fully private company could or was willing to attempt. Fannie Mae and Freddie Mac stabilize the residential secondary mortgage market. The GSEs have federally mandated goals that require investment in housing for low- and moderate-income families. These are families whose incomes are at or below area median incomes in specified geographic areas and other underserved markets. The price that Congress extracted from the GSEs for the federal charter and other benefits was to limit these enterprises to a single line of business. REALTORS wonder if the lamenting financial institutions would give up their other lines of business to do solely what Fannie Mae and Freddie Mac do within the constraints of their federal charter.

Today's mortgage marketplace is extremely competitive and rapidly changing. Improvements in technology are largely driving the primary and secondary mortgage markets. REALTORS are working with the GSEs to forge partnerships to use technology to speed the real estate transaction, lower origination and settlement costs, and open markets to creditworthy borrowers. Many of these potential homeowners were shut out by traditional underwriting and credit risk assessment practices.

Need for GSE Regulatory Reform

REALTORS believe that Congressional oversight is an important mechanism for scrutinizing Fannie Mae and Freddie Mac. The current regulatory framework adopted in the 1992 Act is fundamentally sound, though it may need to be fine-tuned. Vigorous regulation of the GSEs does not require radical changes, such as empowering the Federal Reserve Board to spread its regulatory clout into housing and real estate. Even the Federal Reserve Board has its limits and its own share of controversy associated with the prospect of regulating financial holding companies selling and managing real estate as a “financial activity” under the Gramm-Leach-Bliley Act.

GSE regulatory reform should not significantly alter the critical roles that Fannie Mae and Freddie Mac play as investors in home ownership. GSE regulatory reform should not result in a structure that effectively hamstrings the GSEs and leaves them vulnerable to cumbersome or burdensome oversight that stifles competition in the marketplace, reduces their effectiveness as mortgage investors, or makes them vulnerable the megabanks attempts to control financial markets and limit consumer financial choices and homeownership opportunity.

Congressional oversight of the GSEs' performance and a measured deliberate review of their mission are important undertakings. Congress created the housing enterprises to accomplish specific and, at the time, nearly revolutionary housing policy objectives. The current federal relationship with the GSEs is more than 20 years old and the residential secondary mortgage market is mature and efficient. The federal ties and charter issues are legitimate concerns for public debate and congressional review. It is appropriate for the Subcommittee to ask if the GSEs should have a new or continued role in the housing finance system. But it is our view that this review should occur against a background of what the GSEs currently do to promote homeownership and further refine the nation's housing finance system that is the envy of every country abroad.

REALTORS believe that the public policy decision that created Fannie Mae and Freddie Mac and established these companies as government-sponsored housing enterprises continues to be relevant and necessary. The residential secondary mortgage market works to the benefit of the mortgage lending industry, homeowners, and the nation's housing policy.

Conclusion

When Congress created Fannie Mae and Freddie Mac it set in motion a commonly shared public policy regarding American homeownership. The residential secondary market has evolved into a highly efficient, flexible system that is based on the premise that federally sponsored enterprises should be the engines that facilitate homeownership. Under changing economic conditions, the residential mortgage lending industry evolved to satisfy the needs of the market. Congress created the GSEs and empowered them to become critical intermediaries in the flow of consistent, affordable housing finance through the mortgage delivery system, and *de facto* regulators of the terms under which most mortgages are made.

Developments in the secondary mortgage market played critical roles in the advancement of mortgage liquidity and the reshaping of the nation's mortgage finance system. First, it forced the conformance of most underwriting, documentation and other essential terms of mortgage lending to the standards set by Fannie Mae and Freddie Mac. Conventional market mortgage pricing is directly tied to the capital markets, which reduced the volatility of mortgage rates and makes funding sources more reliable.

Second, Fannie Mae and Freddie Mac created new housing investment products and facilitated a broader investor base for mortgages. Cash flows from a single pool of fixed rate mortgages could be structured in a variety of ways to suit investor needs regarding maturities and call protection. Finally, the technological tools needed for the development of these new securities, primarily computers and software that could perform a complex array of underwriting, pooling, structuring and pricing analyses, brought mortgage finance to a new level of sophistication.

The economic success and the function the GSEs serve have generally been unquestioned. Homeownership rates pushed past the 67 percent mark last year due in significant part to the activities of the GSEs. The appropriateness of government fulfilling this market function, however, continues to invite periodic attempts at controls and limitations.

The challenge is to devise reasonable rules of operation that maintain fiscal integrity without unduly hindering the operation of the enterprises and the national mortgage markets. REALTORS urge that this Subcommittee not undertake dramatic reforms for Fannie Mae and Freddie Mac such as those contemplated in H.R. 1409.

REALTORS urge this Subcommittee to consider these questions before embarking on sweeping changes affecting the GSEs. What would housing finance be like without the GSEs? Would this nation be as well housed? Would as many families have access to the American Dream? Would housing be as strong a sector of the economy as it is today?

The GSEs' mortgage product innovations facilitate lenders and others committed to expanding homeownership. NAR, in partnership with five minority real estate professional associations, has just embarked on a major program to achieve parity for white and minority home ownership rates. NAR's Home Ownership for People Everywhere awards -- the HOPE Awards -- will recognize unsung heroes across the country that help to break down the barriers to minority homeownership. As we go forward, we want to be sure that the mortgage market remains accessible to minorities. Two of the very strongest voices for minority homeownership have been Freddie Mac and Fannie Mae.

Mr. Chairman, we believe that the current regulatory structure best serves the interests of the nation. We believe that the secondary mortgage market works to the benefit of the mortgage lending industry, homeowners, and the nation's housing policy. Fannie Mae and Freddie Mac activities deepen housing markets, reduce transaction costs, streamline the process, empower mortgage credit consumers, and integrate new products and financing options into the residential real estate transaction. REALTORS believe that this nation would not be nearly as well housed and that we could not achieve our current homeownership rates without Fannie Mae and Freddie Mac backed by the federal charter and mission.