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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
COMMITTEE ON BANKING AND FINANCIAL SERVICES
BY
DENNIS J. CRONK
PRESIDENT, NATIONAL ASSOCIATION OF REALTORS
July 20, 2000**

INTRODUCTION

Chairman Baker and members of the Subcommittee, I am Dennis R. Cronk, president of the NATIONAL ASSOCIATION OF REALTORS. I am a REALTOR and broker/owner with the firm of Waldvogel, Poe and Cronk Real Estate Group, Inc., a full service residential and commercial real estate brokerage and management firm headquartered in Roanoke, Virginia. On behalf of the NATIONAL ASSOCIATION OF REALTORS I am pleased to offer our views on H.R. 3703, the "Housing Finance Regulatory Improvement Act." REALTORS believe that it is prudent that Congress consider the workings of the residential secondary mortgage market from time to time and evaluate the effectiveness of Fannie Mae and Freddie Mac in their capacity as facilitators of the secondary mortgage market and investors in home mortgage loans. Recent revisions in the mission of the Federal Home Loan Banks whereby member banks, moving beyond their traditional role of providing advances to member institutions for housing finance, are participating in a fledgling secondary market alternative to that provided by Fannie Mae and Freddie Mac also merits attention.

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS appreciates your invitation to present our viewpoint on H.R. 3703. Mr. Chairman, members of the Committee, while the NATIONAL ASSOCIATION OF REALTORS speaks for 760,000 real estate professionals engaged in the industry, REALTORS are also advocates for homeowners and those who aspire to own homes. It is our view that any oversight or review of the housing GSEs should also consider the public policy issues that affect homeownership opportunities for Americans. I hope that our testimony can be helpful in focusing the debate on how to strengthen oversight of the housing enterprises.

H.R. 3703 has been a lighting rod for criticism of the GSE these days. A recent witness before this Subcommittee characterized the growth and financial activities of Fannie Mae and Freddie Mac to a financial crisis similar to the savings and loans crisis of the 1980s just waiting to occur. *[**See** Statement of Peter J. Sepp on behalf of the National Taxpayers Union before the Subcommittee on Capital Markets, Securities, and Government-Sponsored Enterprises Banking and Financial Services Committee, U.S. House of Representatives, June 15, 2000.*] A number of lenders maintain that Fannie Mae and Freddie Mac exceed their charters when purchasing subprime loans. These lenders make this argument despite the fact that the enterprises recently agreed to the affordable housing goals proposed by the Department of Housing and Urban Development, the GSEs' mission and program regulator, that specifically direct the GSEs to purchases more so-called A-minus loans that may facilitate homeownership among for more low- and moderate-income households. Some consumer and housing advocates maintain that Fannie Mae and Freddie Mac should purchase more mortgages that meet the Department of Housing and Urban Development affordable housing goals, but these same critics assert that the enterprises facilitate predatory lending by purchasing these subprime loans, which assumes that subprime lending is prima facie predatory.

According to the *Wall Street Journal*, executives of some of the largest financial institutions in the country are making the political rounds in Washington advocating "containment" of Fannie Mae and Freddie Mac. ***[See** "Top Financial Executives to Seek Tighter Reins on Mortgage Lenders,"* ***Wall Street Journal**, July 12, 2000, p. A2]* These financial institution executives support legislation that would restrict the GSEs' investments and lending programs and remove the federal ties that lower the GSEs' borrowing costs and the implied federal backing for debt and mortgage backed securities issues. The GSEs' critics are certainly entitled to their views. REALTORS, however, do not share them.

GSEs AND THE HOUSING FINANCE SYSTEM

For more than fifty years, the federal government has had a fundamental role in the nation's housing finance and homeownership policy. For nearly thirty years, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks have used their federal charter benefits that Congress granted to help build a housing finance system that is the envy of most other countries that want increase homeownership. The United States is the best housed nation in the world due in no small part to the mortgage investment activities of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

The long economic expansion, together with innovative mortgage products in the primary and secondary mortgage markets, contributed to unprecedented five-year gain in homeownership rates between 1995 and 1999. National homeownership is at nearly 67 percent. According to NATIONAL ASSOCIATION OF REALTORS research, forty-two percent of these homeowners are first-time purchasers. Homeownership among minorities and America's immigrant population account for almost 40 percent of the recent growth in homeownership. [***See*** *Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing. Cambridge, Harvard University, 2000, p. 17.*]

Innovation of the mortgage-backed security

Congress deliberately established the Fannie Mae and Freddie Mac and charged these enterprises, as a matter of public policy, with the mission to facilitate a secondary market in conforming mortgages by purchasing investment quality loans. These two enterprises created the pass-through mortgage-backed security and its variants to attract investors in the full knowledge of the risks associated with tying up capital in long-term fixed rate instruments. This financial innovation created and maintained liquidity in the otherwise illiquid mortgage investment market. When Congress chartered Fannie Mae and Freddie Mac, the intention was to eliminate interest rate differences between regions of the country and to promote a national mortgage market. The mortgage-backed security and debt offerings of the GSEs effectively linked Wall Street to Main Street. Over time geographic shortages of mortgage funds and the cyclical availability of mortgage credit were minimized. There can be no denial that the GSEs benefit from their federal charter and associated benefits, but so do American homeowner and those lenders and others in the housing finance and real estate industries that support homeownership. Analysts estimate that mortgage interest rates are lower by between one and one half percent because of the secondary mortgage market. Homeowners benefit directly, which is a reflected in historically high homeownership level.

Increases in the mortgage interest rate can dramatically affect housing affordability by increasing the monthly cash costs of owning. Prospective buyers either fail to qualify at the higher rate or are unwilling to increase the share of their income going to shelter. Estimates of the number of buyers lost as rates increase depend on a complex array of factors – level of interest rates, income and house price distributions, mortgage underwriting standards, and demographic changes. It is important to note that the number of households that would fail to qualify as rates increase is a much larger number than the number who fail to purchase. This is because only between five and six percent of households buy a home in a given year.

Using data from the 1995 American Housing Survey [***See*** *U.S. Department of Housing and Urban Development and U.S. Bureau of the Census, American Housing Survey, 1995.*] , it is estimated that if mortgage interest rates rose by one percent, the number of households who would fail to qualify to buy a home is approximately 4,000,000 of which approximately 178,000 households per year would be unable to purchase a home.

Today's homeownership costs are lower and access to mortgage credit -- even for borrowers with blemished credit -- is easier and more equitable. Two primary obstacles remain as barriers to homeownership in this country, however -- the mortgage loan downpayment and costs associated with closing and settling the mortgage. Much of what Fannie Mae and Freddie Mac are doing in the current mortgage finance environment relates to lowering the costs of homeownership. REALTORS applaud and support these activities.

Financial Marketplace, Competition and Innovation

Fundamental forces are transforming the U.S. housing finance system, with implications for the primary and secondary mortgage markets, the capital markets, the financial system, homebuyers, Congress, and the GSEs' regulators. All of these changes are occurring during the longest sustained economic expansion in U.S. history.

This current economic expansion heightens competition and consolidation among mortgage lenders and banking institutions. Traditional mortgage lenders and mortgage lending relationships are changing and creating significant uncertainty among competitors. The largest financial institutions are positioning to take advantage of the sweeping changes in the nation's banking laws to become financial services providers. 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 with proposals that, if adopted, would be a torturous "death by a thousand cuts." The GSEs are being punished for their success, for doing what Congress directed.

These lenders lament not having the financial advantages that Congress granted to the GSEs and argue now for containing them. These financial companies are willing to argue that the Fannie Mae and Freddie Mac have an unfair advantage because of their federal charter ties. At the base of this lament and expressions of concern about the threat that the GSEs pose to the financial system, there is an unwillingness to admit that mortgage lending has changed significantly. The GSEs were created to do what no fully private company could or was willing to attempt. 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 in this grave new financial services world to do solely what Fannie Mae and Freddie Mac do with the constraints of the federal charter.

Casual observation alone would confirm that mortgage lending is significantly different now than from even five years ago. Mortgage loans are more a commodity than ever before, while mortgage funding and investment sources are more diverse. Even international mortgage investors are looking more closely to the U.S. housing finance model for emulation and investment purposes.

Today's mortgage marketplace is extremely competitive and changing at the speed of technology. Now improvements in technology are largely driving the primary and secondary mortgage markets. The impact of technology is not lost on REALTORS. REALTORS embrace the marriage of technology and the real estate transaction. Realtor.com and the developing real estate transaction with GMAC Mortgage, Fannie Mae, and other mortgage finance and real estate industry firms are a testament to how things have changed. 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 whom were shut out by traditional underwriting and credit risk assessment practices as well.

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 existed they fulfill their congressionally chartered mission in good economic times and in not so prosperous economic times. Despite this current long economic expansion, REALTORS know from painful experience that when the booming mortgage lending and real estate cycle will slow. Fannie Mae and Freddie Mac, unlike primary market lenders, will 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 and homebuyers and most lenders want.

Despite REALTORS general support for the GSEs, we do have our criticism of Fannie Mae and Freddie Mac. We strongly disagreed when the GSEs opposed increasing the FHA mortgage limits. REALTORS' and the GSEs' positions divergence on increasing the FHA mortgage limits. It is likely that we will not agree in the future.

Another concern that the REALTOR community has relates to the property disposition activities Fannie Mae and Freddie Mac. REALTORS do not support Fannie Mae's and Freddie Mac's current efforts to expand their foreclosed property disposition activities to include bidding on third party foreclosed properties. We understand that licensed real estate agents are involved in the management and listing of these properties, though the limited inventory of real estate-owned of necessity narrows the number of REALTORS who may broker and list these properties. As a part of their normal business activities, both GSEs have property disposition programs to dispose of properties acquired through foreclosure on mortgages held in portfolio. (These foreclosed properties are generally referred to as real estate-owned or REO.) Over the course of the past two years, both Fannie Mae and Freddie expanded these internal programs and contracted with banks to handle the disposition of bank-owned residential properties acquired through foreclosure.

Freddie Mac created its HomeSteps division to market its own and contracted REO properties. Many REALTORS consider third party REO disposition as Freddie Mac's entry into the real estate brokerage franchise business.

Fannie Mae undertook a pilot program that successfully bid on a portfolio of properties seized by the U.S. Marshal's Office. In some cases, the seized properties included very expensive estates. Fannie Mae also contracts with several communities to manage and dispose of foreclosed properties.

In 1998, the California Association of REALTORS, the largest state REALTOR organization, investigated these new “third party” disposition programs. The primary concern raised was that many REALTOR brokerage firms that had traditionally provided disposition services for the banks were being forced out of this line of business as the result of their inability to compete with the GSE operations.

A working group of members and the leadership of the California association examined two questions: Is it appropriate for a federally chartered and subsidized entity like Fannie Mae or Freddie Mac to be competing with the private sector REALTOR firms when the properties involved were not the GSE's own? Is acting as a third party disposition firm an activity allowed by the GSE's federal charters or is it, as some alleged, a violation of the secondary markets federal charter?

The Association's Board of Directors concluded that the while the GSEs' disposing of their own portfolio of properties was appropriate, the third party operation was not. The third party REO activities are outside the GSEs' charters and the firms' secondary mortgage market mission. Consequently, the California Association spent the last eighteen months in talks with both enterprises in an effort to resolve the association's concerns. These discussions are ongoing.

The Federal Home Loan Bank System

REALTORS do not have the same direct relationship with the Federal Home Loan Banks as with Fannie Mae and Freddie Mac. The Home Loan Bank System is a cooperative with broad lending mission rooted in the savings and loan industry as the principal source for mortgage and housing finance. We note, however, that the System's Mortgage Finance Program as an alternative to delivering mortgages into the secondary market via Fannie Mae and Freddie Mac. REALTORS appreciate the Mortgage Finance Program as an additional source of funds for homeownership. The competition that the Home Loan Banks secondary market alternative provides to Fannie Mae and Freddie Mac may benefit mortgage lending and homeownership in the end.

ISSUES RAISED BY H.R.3703

Judging from the hearing record to date, if the objective of the bill was to generate controversy about the GSEs we must all conclude, "mission accomplished". As drafted, H.R.3703 is an extremely ambitious bill. The bill brings together several significant issues that could be addressed better in perhaps two or three stand-alone bills. In addition to consolidating GSE regulation under a single entity, the bill raises issues regarding the fundamental role the federal government should play in housing finance, the GSEs' mission, and the risks that GSE debt and securities may pose should there be a disastrous economic downturn.

H.R.3703 raises two extremely important questions that should be considered separately from GSE regulatory reform. The first is should Congress revise the GSEs' federal ties, mission and charter. The second question whether Fannie Mae and Freddie Mac may pose systemic risk to the financial system. The current GSE regulatory scheme reflects the historic roots of national housing policy, and a heightened awareness of the risks associated with the now highly sophisticated financing techniques that of the housing finance markets. The lessons learned in the wake of the savings and loan industry crisis of the late 1980s strongly influenced the current regulatory scheme.

GSE REGULATORY REFORM

Arguably, the current GSE regulatory framework for Fannie Mae and Freddie Mac, on the one hand, and the Federal Home Loan Banks, on the other, should be revised. The Department of Housing and Urban Development regulates Fannie Mae's and Freddie Mac's products and programs while overseeing the two enterprises' affordable housing goals performance. The Office of Federal Housing Enterprise Oversight administers with financial safety and soundness examinations and is nearing completion of the risk-based capital standard that once in place would ensuring that Freddie Mac and Fannie Mae maintain sufficient capital to be economically viable during economic downturns.

The Association believes that these oversight functions are the more appropriate mechanism for monitoring whether the GSEs are meeting their federally mandated mission without stifling innovation. Innovation in the mortgage delivery system has significantly reduced the transaction costs of homeownership and thereby assisted many households to own a home they previously would not have been financially able to buy.

We believe that Subcommittee should closely reexamine the Housing Finance Oversight Board as proposed by H.R. 3703. The Subcommittee's concentration on this aspect of the bill and creating a credible regulatory framework as a work product could be its fundamental contribution to building on the success of the secondary mortgage market and the federal role in housing finance.

If devising a new regulatory scheme for the housing GSEs becomes the principal focus of any proposed GSE reforms, there are some concerns that should be addressed. First, there are significant corporate and charter differences between the FHLBanks and Fannie Mae and Freddie Mac that need resolving. As the General Accounting Office indicated in a 1997 report responding to Rep. Richard Baker's request, the GSEs operate differently, but the risks they manage are similar. *[**See** Report to the Chairman, Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises, Committee on Banking and Financial Services, House of Representatives. Government-Sponsored Enterprises: Advantages and Disadvantages of Creating a Single GSE Regulator GAO/GGD-97-139. U.S. General Accounting Office, Washington, D.C., July 1997.]* An effective single regulator for these three GSEs would probably require revising the FHLBanks, its mission, and capital requirements to make them more like the other two housing GSEs. Second, 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 to changes in the financial markets.

Finally, and probably most important, the proposed consolidated regulator must be independent. H.R.3703 seems to point in this direction by establishing an oversight board that includes presidential appointees and places the new regulatory body outside the federal appropriations process. Nevertheless, the experience with the Federal Home Loan Bank Board regulating the thrift industry regarding programs and safety and soundness should raise caution given the bill's proposal for configuring the new oversight board. We would recommend a new set of Subcommittee hearings to examine the oversight board proposal.

A final observation: The OFHEO risk-based capital standards should not be derailed or stymied in any new regulatory scheme. Though nearly seven years separate the establishment of OFHEO and the agency's bringing state of the art risk-based capital standards to the fruition, OFHEO is almost there. REALTORS believe that much of the concern about the GSEs' systemic risk would be addressed when OFHEO's risk-based capital standards are in place.

Other Issues Raised by H.R. 3703, as drafted

Congressional oversight of the GSEs' performance and a measured deliberate review of their mission are important undertaking. 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 do to promote homeownership and further refining the nation's housing finance system that is the envy of every country abroad.

There are several critical questions. Should Congress change the federal role in the nation's housing finance system? Should the federal subsidy that Fannie Mae and Freddie Mac receive as a result of the federal charter and related benefits are changed? What is the advantage of such change? What would our housing finance system be without Fannie Mae and Freddie Mac? How expensive would homeownership be without the federally mandated role of the GSEs? REALTORS support the federal ties that current shape the GSEs. The secondary mortgage market works to the benefit of the mortgage lending industry, homeowners, and the nation's housing policy. The GSEs' never-used lines of credit to the Treasury may well be symbolic in today's capital markets. The other federal benefits that Congress gave to the GSEs are integral to the dynamics of the secondary mortgage market. Proposals to remove the lines of credit and to limit other GSE federal benefits to have real consequences for capital markets and for homeowners. REALTORS believe that the lines of credit to the Treasury should not be removed or compromised.

GSEs' Systemic Risk

The question of whether Fannie Mae and Freddie Mac pose a systemic risk to the federal government and taxpayers is legitimate. Housing finance is risky, but profitable now given the secondary mortgage market. To contend otherwise simply ignores facts and begs the question: is this not what the nation and Congress want?

Clearly, there are risks should an economic downturn of any severity come about. It has happened before and that was why the GSEs were created. During the financial crunch of the '70s and '80s, the Fannie Mae and Freddie Mac stayed in markets when the private lenders and mortgage insurers left to limit their risk or moved away from housing finance into other investments to maintain income streams.

CONCLUSION

When Congress created Fannie Mae and Freddie Mac it set in motion a secondary market that evolved into a highly efficient, flexible system that is based on the premise that federally sponsored enterprises should be the engines that facilitate homeownership is a commonly shared value. 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 was directly tied to the capital markets, which assured greater price volatility and more reliable funding sources. Second, Fannie Mae and Freddie Mac created new 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. First quarter 2000 homeownership rates pushed past 67 percent mark 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 devise reasonable rules of operation that maintain fiscal integrity without unduly hindering the operation of the national mortgage markets. Critics have charged that the GSEs are exceeding their federal charters' and have entered the primary mortgage market. These critics desire legislation that would specifically define secondary and primary market activities. Others charge that because of their size, the GSEs are a financial time bomb in the making, and stricter regulatory oversight is necessary. Still others charge that the GSEs are not meeting their legislative mandate of helping low and moderate-income households obtain homeownership.

REALTORS urge the Subcommittee to back away from the rhetorical criticism of the GSEs. The physician's motto should be heeded as Congress considers dramatically reforms for the housing GSEs. "Do not harm" is an even more vital admonition should Congress fundamentally alter the federal ties that shaped the nation's secondary mortgage market and Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. REALTORS cannot support removing the GSEs' lines of credit to the Treasury or otherwise limiting the federal ties of the GSEs. REALTORS have vividly painful memories of how well meaning reform can have unintended consequences. The tax reforms of 1986 devastated the real estate industry. REALTORS beseech this Subcommittee -- do no harm to the housing GSEs and the residential secondary mortgage market; they are integral to homeownership.

REALTORS urge this Subcommittee to consider this principal question before embarking on sweeping changes affecting the GSEs. What will housing finance be like without the GSEs and a federal policy mission that seeks to broaden homeownership, deepen housing markets, reduce transaction costs, streamlines the process, empowers mortgage credit consumers, and integrates new products and financing options into the transaction. REALTORS believe that this nation would not be nearly as well housed and homeownership aspiration could not be satisfied to the extent of the current homeownership rates without the housing GSEs backed by the federal charter and mission.