NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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HEARING BEFORE THE

UNITED STATE HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

ENTITLED

"THE STATE OF THE NATION'S HOUSING SECTOR: AN EXAMINATION OF THE FIRST TIME BUYER'S CREDIT AND FUTURE POLICIES TO SUSTAIN A RECOVERY"

WRITTEN TESTIMONY OF

MR. JOSEPH CANFORA

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

OCTOBER 7, 2009

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EQUAL HOUSING OPPORTUNITY

Madame Chairwoman and Ranking Member Graves: I am Joseph L Canfora, broker and owner of Century 21 Selmar Realty in East Islip, New York. I am pleased to appear here today on behalf of the National Association of REALTORS®. I serve as an elected volunteer officer of the organization as the Regional Vice President for New York, New Jersey and Pennsylvania.

The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®. NAR has approximately 30,000 appraiser members from across the country and approximately 750 have earned our Residential Accredited Appraiser (RAA) and General Accredited Appraiser (GAA) designations.

Our oral testimony will focus on the first-time homebuyer tax credit and the challenges our members and consumers alike are facing as new appraisal standards are being put into place. Our written statement will also include discussion of challenges in Federal Housing Administration (FHA) programs.

FIRST TIME HOMEBUYER TAX CREDIT

Congress did a good thing when it enacted the $8000 first-time homebuyer tax credit earlier this year. The program brought prospective purchasers off the sidelines and gave them an incentive to take the plunge and become homeowners. By now, most members of Congress are familiar with the statistics: Between 1.1 and 1.4 million home sales this year have been to first-time homebuyers, many of whom were eligible for the credit. Of those first-time buyer transactions, about 355,000 to 400,000 transactions were directly attributable to the credit.

The buyers who qualified for the $8000 credit entered the market at a time when housing was more affordable than it's been in decades. That's been a good thing for buyers and for our national economy. The credit has provided a huge indirect benefit to local governments, as well. Home purchases have shored up the property tax bases for particularly hard-hit areas. In these hard times, that's good for everyone.

When NAR's members embraced the idea of a first-time homebuyer credit, they anticipated that it would provide the most direct incentive to generate purchasing activity. In early 2008, many communities were paralyzed as home prices kept dropping. The credit was viewed as a tool that would generate activity that could help stabilize prices while at the same time taking some of the fear out of the marketplace. The credit has met those objectives.

During 2007 and 2008, the inventory of houses available for sale skyrocketed. Early in the housing crisis, those increases in inventory were a direct result of the subprime mortgage fiasco. While in most respects the subprime crisis is behind us, there remain a significant number of adjustable rate mortgages that will reset this quarter. These resets will impose hardship on many owners.

Another ominous threat lies ahead. In some states, lenders were subject to either formal or self-imposed moratoria on foreclosures. In most states that imposed formal moratoria, those mandatory forbearance periods will soon expire and financial institutions will bring their inventories of foreclosed properties to market. Similarly, the financial institutions had self-imposed moratoria may see that prices in their communities have stabilized and they, too, will bring more properties to market.

Finally, many prudent homeowners who followed the rules and paid their mortgages will lose their homes because of job loss during these times of increasing unemployment. If foreclosure rates do spike again, inventories could become bloated again. Thus, incentives are still needed to keep the market moving.

We remain fearful that another wave of foreclosures looms. This, in turn, will send inventories up to the high rates of the recent past. In a "normal" market, the optimal inventory is about six to seven months. That is, it would take six to seven months to sell all the houses that are available. In an unsustainable boom market such as we had in 2003 – 2006, inventories are three months or less.

In August 2008, a ten-month supply of inventory was available. By November 2008, the inventory peaked at 10.6 months supply. When the current $8000 tax credit was enacted in February, the inventory of homes for sale was 9.1 months. By April, it was up to 9.5 months. Since April, however, the inventory has declined each month. The most recent data (August 2009) shows an inventory level of 8.2 months: closer to "normal" than at any time since 2007.

To sustain these improvements in a still-fragile market, it is essential that Congress extend the $8000 tax credit. The threats of more foreclosed property coming to market, combined with the mortgage rate resets and growing unemployment are simply too great to take a wait and see approach.

The best available tool for sustaining the gains that have been made will soon expire as of December 1, 2009. In reality, the credit will be out of reach for most people in our market well before its expiration date. The reason: between now and November 30, a purchaser must find a home, enter into a contract, satisfy any

conditions of that contract, secure financing and get to closing. In most markets, that process is taking 45 – 60 days, even for the most straightforward deals. October has already arrived, so not much time is left.

In a friendlier world, we could not only extend the credit but also expand its application through some combination of increasing the amount of the credit, increasing the income limits and/or making the credit available for all purchases of a principal residence. We recognize that today's fiscal environment would make all those changes difficult. We do not doubt, however, that the more robust the credit and the greater its duration, the greater the chance that the housing market can perform its traditional role of helping the economy move out of a recession.

APPRAISAL: THE HOME VALUATION CODE OF CONDUCT

The tax credit is a good thing, but a major stumbling block for consumers and for practitioners is the current operation of the property appraisal process. In fact, current appraisal practices threaten to undermine the efficacy of the tax credit.

NAR supports the independence of appraisers and the integrity of the appraisal process. We commend Attorney General Cuomo and both government sponsored enterprises (GSE), Fannie Mae and Freddie Mac, for their efforts to address appraisal fraud in the mortgage industry. We wish, however, to express concerns about the Home Valuation Code of Conduct (HVCC or the Code) they have issued. We support its intent to address appraisal fraud, but we have serious concerns about the implementation and adverse unintended consequences it has had on the real estate industry.

The HVCC has been in effect for five months. The Code is causing delays in closings and even canceled sales, which lead to artificially low existing home sales. While our monthly index of pending home sales shown steady growth in potential home sales for seven straight months, NAR's Chief Economist, Lawrence Yun, notes that not all of these contracts are turning into closed sales. He notes that "The rise in pending home sales shows buyers are returning to the market and signing contracts, but deals are not necessarily closing because of long delays related to short sales, and issues regarding complex new appraisal rules.

In response to a recent survey, our members report that appraisal problems are hampering the housing market's recovery. Almost 40 percent of Realtors® have lost at least one sale since May 1, 2009.[1]

[1] NAR's Research Department conducted the random sample survey in June 2009. Results were made available in July 2009. More information can be found at http://www.realtors.org/research.

Twenty percent of respondents report losing more than one sale. Each sale that is not completed costs the economy $63,000 in related sales and goods. Lost sales also mean a delay in the housing recovery, which will cause a further decline in home prices. Declining home prices in turn, will hamper the overall economic recovery and lead to a greater number of foreclosures. Problems arising from the implementation of HVCC may reverse positive momentum at a time when the real estate industry is just starting to show signs of a rebound in many markets.

We have previously raised our concerns about HVCC with the Federal Housing Finance Administration (FHFA), the NY Attorney General's Office, Fannie Mae and Freddie Mac. NAR President Charles McMillan has met with these stakeholders requesting a moratorium to address the unintended consequences of the HVCC. At the request of Mr. McMillan, the GSEs updated their frequently asked questions documents and FHFA put out some additional guidance. We believe this is a positive first step but more must be done.

HVCC May be Increasing Costs to Consumers

The HVCC agreement reached between the Attorney General Cuomo and the GSEs, and approved by Director Lockhart, does not address the costs of the real estate transaction. Appraisers now must consider their obligations under the Uniform Standards of Professional Appraisal Practice (USPAP) and the Appraisal Foundation and the additional burden of complying with the HVCC. Higher costs may also be an issue for lenders. The creation of a new set of standards to follow and a new oversight organization may lead to increasing the cost of the real estate transaction. ***According to NAR survey data, the cost of the appraisal has increased by as much as $100 for consumers.***

Maintain a Single Frequently Asked Question Standard

Both Fannie Mae and Freddie Mac have issued separate frequently asked questions (FAQ) documents. NAR appreciates this guidance but we believe there should be one FAQ document for both GSEs and the Federal Housing Administration (FHA). This document must be codified and incorporated into existing appraisal policy to ensure proper information is available to the real estate industry. FHA Commissioner David H. Stevens has asked his staff to begin discussions with the GSEs to further explore this recommendation.

AMC Regulation Improving at State Level

Because the HVCC requires mortgage brokers to arrange for appraisals through third party organizations, AMCs now have an increased role in the real estate appraisal process. In fact, the number of our appraiser members obtaining more than half of their assignments from AMCs increased from 13 percent

to 40 percent after May 1, 2009. These AMCs are giving appraisers assignments in areas where they lack geographic competency. For a variety of reasons, appraisers may feel compelled to take these assignments. More than 70 percent of REALTORS® responding to our June survey report appraisers lacking geographic competency for their assignments. Recently, Fannie Mae, Freddie Mac, the FHFA, and FHA have all reaffirmed the existing geographic competency rule found in the Uniform Standards of Professional Appraisal Practice (USPAP). While the geographic competence problem existed prior to the implementation of the HVCC, the problem is exacerbated by the increasing prominence of AMCs since May 1, 2009.

NAR believes there is a critical need for regulation at the state level. Aside from geographic competency, our survey found that appraisers have less time to complete an appraisal report and the quality of appraisals is deteriorating. Perhaps most importantly, both REALTORS® and appraisers report that overall fees to appraisers are declining, so the cost of an appraisal is increasing for the consumer.

Many state legislatures are in the process of enacting laws to regulate AMCs. In 2009 at least 10 states introduced measures to regulate AMCs. Other states are considering measures in their upcoming legislative sessions. Since AMCs now have a larger role in the real estate transaction, a moratorium on HVCC will give states more time to enact legislation and promulgate regulations on the AMC industry.

Lender-Owned AMCs Cause Conflicts of Interest

The proposed HVCC would have barred lenders and affiliates of lenders from relying on an appraisal report obtained by, or through, an appraisal management company (AMC) that is more than 20 percent owned by the lender or affiliate of the lender. The final Code does not limit lender ownership of AMCs. We disagree with this result. NAR believes that lenders should be *prohibited* from using an appraisal report from an AMC where the lender or the lender's affiliate maintains *any* ownership stake. Allowing lenders to obtain appraisal reports from AMCs where the lender has a stake in ownership does not meet the goal of the HVCC to assure the independence of the appraisal process.

Implement the Independent Valuation Protection Institute

The Independent Valuation Protection Institute (IVPI) was announced as an integral part of the HVCC. The purpose of the IVPI is to receive complaints from appraisers and users of appraisal services on the improper influence or attempted improper influence of appraisers. To date, the IVPI has not been implemented. FHFA recently stated that the IVPI will be implemented by year's end – a full eight months after the HVCC went into effect. No interim process has been announced by the GSEs or FHFA. A moratorium will give FHFA and the GSEs more time to implement this critical element of the HVCC.

Enhancing Appraisal Policy Without Causing Harm to the Industry

On September 18, 2009, FHA Commissioner Stevens announced plans to implement credit policy changes that will enhance the agency's risk management functions. The announcement reaffirms existing appraisal policy and enhances appraisals in many ways. Further, it implements components of the HVCC while taking into consideration the unintended consequences that burdened the GSEs. FHA was able to address these consequences by consulting with the real estate industry, including REALTORS® and lenders, prior to implementing the new rules.

As a part of these changes, FHA issued two mortgagee letters focusing on appraisals. Commissioner Stevens said "given the size and scope of the FHA and its importance to today's market, these risk management and credit policy changes are important steps in strengthening the FHA fund, by ensuring that lenders have proper and sufficient protections." The new policies will be effective January 1, 2010. FHA reaffirms existing policy on appraiser independence and geographic competence. Mortgage brokers and commission based lender staff will be prohibited from ordering appraisals. FHA's appraisal validity period will be reduced from six months to four.

In a statement by President Charles McMillan, NAR applauds the recommended policy changes. Mr. McMillan said "The Federal Housing Administration is very important to the housing market". With this announcement, "FHA has taken some timely steps to protect taxpayer money." The following is a summary of FHA Mortgagee Letters released subsequent to the Credit Risk Policy announcement.

Appraisal Management Companies (ML 2009-28)

FHA does not endorse or oppose the use of appraisal management companies (AMC). If the lender orders an appraisal through an AMC or another third party organization the lender must ensure that:

- FHA appraisers are not prohibited from recording the fee paid to the appraiser in the appraisal report;
- FHA appraisers are compensated at a rate that is customary and reasonable for the market where the property is being appraised;
- The Fee for the completion of the appraisal may not include a fee for the management of the appraisal process or any activity other than the completion of the appraisal;
- Management or other fees charged by an AMC or other third party must be for actual services related to ordering, processing, or reviewing appraisals for FHA financing; and
- AMC or other third party fees may not exceed what is customary and reasonable for the market area where the property is being appraised.

Portability (ML 2009-29)

This ML provides guidance when a borrower switches from one FHA-approved lender to another after the appraisal was ordered by the first lender. A second appraisal may be ordered by the second lender in the following circumstances: 1) the first appraisal contains material deficiencies, 2) the appraiser from the firs lender is on the second lender's exclusionary list of appraisers, and 3) failure of the first lender to provide a copy of the appraisal report to the second lender in a timely manner that would result in a delay in closing or other potential harm to the borrower. In cases where the borrower switches lenders, FHA does not require that the client name be changed on the appraisal. The lender is not permitted to request that the appraiser change the name of the client unless it is a new assignment.

Affirming Existing Policy - Improper Influence on Appraisers (ML 2009-28)

Consistent with ML 1996-26, no members of a lender's loan production staff or any person (i) who is compensated on a commission basis upon the successful completion of a loan or (ii) who reports, ultimately, to any officer of the lender not independent of the loan production staff and process, shall have substantive communications with an appraiser relating to or having an impact on valuation, including ordering or managing an appraisal assignment. Prudent safeguards must be in place who cannot achieve absolute lines of independence because of small or limited staff size.

Affirming Existing Policy - Appraiser Independence Safeguards (ML 2009-28)

Consistent with ML 1994-54, ML 1996-26, and ML 1997-45, FHA reaffirms requirements of appraiser independence. Mortgagees are prohibited from:

- Withholding or threatening to withhold timely payment or partial payment for an appraisal report;
- Withholding or threatening to withhold future business for an appraiser, or demoting or terminating or threatening to demote or terminate an appraiser;
- Expressly or impliedly promising future business, promotions or increased compensation for an appraiser;
- Conditioning the ordering of an appraisal report or the payment of an appraisal fee or salary or bonus on the opinion, conclusion or valuation to be reached, or on a preliminary value estimate requested from an appraiser;
- Requesting that an appraiser provide an estimated, predetermined or desired valuation in an appraisal report prior to the completion of the appraisal report, or requesting that an appraiser provide estimated values or comparable sales at any time prior to the appraiser's completion of an appraisal report;

- Providing to the appraiser an anticipated, estimated, encouraged or desired value for a subject property or a proposed or target amount to be loaned to the borrower, except that a copy of the sales contract for purchase must be provided;
- Providing to the appraiser, appraisal company, appraisal management company or any entity or person related to the appraiser, appraisal company or management company, stock or other financial or non-financial benefits;
- Allowing the removal of an appraiser from a list of qualified appraisers or the addition of an appraiser to an exclusionary list of qualified appraisers, used by any entity, without prompt written notice to such appraiser, which notice shall include written evidence of the appraiser's illegal conduct, a violation of the Uniform Standards of Professional Appraisal Practice (USPAP) or state licensing standards, improper or unprofessional behavior or other substantive reason for removal;
- Ordering, obtaining, using, or paying for a second or subsequent appraisal or automated valuation model(AVM) in connection with a mortgage financing transaction unless: (i) there is a reasonable basis to believe that the initial appraisal was flawed or tainted and such appraisal is clearly and appropriately noted in the loan file, or (ii) unless such appraisal or automated valuation model is done pursuant to written, pre-established bona fide pre- or post-funding appraisal review or quality control process or underwriting guidelines, and so long as the lender adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value; or
- Any other act or practice that impairs or attempts to impair an appraiser's independence, objectivity or impartiality or violates law or regulation, including, but not limited to: the Truth in Lending Act (TILA) and Regulation Z and USPAP.

Affirming Existing Policy - Geographic Competency (ML 2009-28)

The lender is responsible for determining whether an appraiser's qualifications are sufficient to enable the appraiser to competently perform appraisals before assigning an appraisal to them. Appraisers are reminded that USPAP applies to all appraisals performed for properties that are security for FHA, including the Competency Rule. Lenders and appraisers are both responsible for the quality and accuracy of the appraisal if the lender knew or should have known there were problems with the integrity, accuracy, or thoroughness of an appraisal report.

<u>FHA Strength/Solvency</u>

FHA has announced that their 2009 audit will demonstrate that their capital reserve fund has fallen below the Congressionally-mandated 2 percent ratio. The capital reserve ratio reflects the reserves available (after paying expected claims and expenses) as a percentage of the current portfolio, to address unexpected losses. This is not FHA's only reserve fund – FHA also has a cash reserve's account separate from the capital

reserves. FHA actual total reserves are higher than they have ever been – with combined assets of $30.4 billion. In fact, the audit is also expected to confirm that FHA has "positive" reserves – meaning they have adequate resources to cover all claims and expenses from their portfolio. In addition, the audit will show that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years.

The reason the cap reserves have fallen below 2 percent actually has nothing to do with FHA's current business activities. It simply is a reflection of falling housing values in their portfolio. The economic forecaster that FHA uses to conduct their audit dramatically revised their projection of home prices (from an expected increase of 2.4 percent to a loss of 10.2 percent). This significant change in home price values and depreciation directly impacts the economic value of the fund. There has not been a significant increase in defaults on the part of borrowers, or underwriting problems on behalf of FHA and its lenders. Instead, the decrease in the capital reserve account is a direct effect of the state of our economy and our housing markets.

Given the devastating impact home price declines have had on banks, lenders, and even the government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae, FHA has performed remarkably through this crisis. Why? FHA has never strayed from the sound underwriting and appropriate appraisals that have traditionally backed up their loans. FHA meets it mission of serving low and moderate income homebuyers, but has never resorted to abusive loans, improper or nonexistent underwriting, or other bad practices. As a participant in the home mortgage process, FHA cannot be immune to the pitfalls of the housing crisis. But solid policies and practices have protected them from the biggest failures.

Today, FHA borrowers have never been stronger. The Federal Reserve report shows that *FHA is not the new subprime. FICO scores have increased, and its LTVs decreased.* The average credit score for FHA's current customer has grown to 693, and only 7.5 percent of their purchase borrowers this year had FICO scores below 620. Borrowers have more equity, as the percentage of FHA's Loan-to-Value (LTV) ratios above 95% fell from 72 percent in 2007 to 62 percent in 2008. FHA's cash reserves are strong, and sufficient to pay claims. We believe FHA is taking the necessary steps to assure it remains a critical source of mortgage insurance for America's homebuyers at all times – good and bad.

FHA's New and Proposed Changes

FHA is not required to do anything when the reserves fall below 2 percent, other than work to get them above 2 percent. The audit will show the even if FHA does nothing, the reserves are expected to rise back to that level within a few years. But FHA is appropriately taking some steps to improve their position. First, they are hiring a Chief Risk Officer to oversee FHA's efforts to mitigate risk. We applaud the leadership

of FHA Commissioner Dave Stevens for making this decision so quickly after taking office. A Chief Risk Officer will have the primary responsibility for overseeing risk management across all FHA programs. We believe FHA has taken strong measures to mitigate risk, but assigning one senior staff member with the responsibility for coordinating FHA's risk management activities makes good sense.

FHA has also announced that it will modify its procedures for streamlined refinancing. For those borrowers who apply for a simple refinance loan, with no cash out, FHA will now require a short seasoning period for the original loan (6 payments), the lender to demonstrate a net benefit to the consumer, and the borrower to exhibit an acceptable payment history. We do not think any of these changes are onerous on consumers, and strongly admire FHA for including the "net benefit" requirement to assure consumers aren't bearing the costs of refinancing, without receiving any benefit. In addition, lenders must verify that the borrower is employed and has income at the time of the refinance. While we understand the logic of this requirement, we question what will occur in the case where a borrower has lost employment, is still making their mortgage payments, and the refinance would make it easier for them to make those payments (net tangible benefit). Would those borrowers – whose risk is already borne by FHA – be ineligible for a refinance? Where the borrower will take cash out of the transaction, we support FHA's changes to require additional underwriting and property appraisals.

Conclusion

We urge Congress to extend the first-time homebuyer tax credit through 2010 and look forward to working with members to assure that happens. In the interim, we are pleased with the progress that has been made so far in sorting out appropriate appraisal requirements and practices. We are particularly pleased that the FHA has clarified its intent in coordinating the application of myriad new rules as we move forward in strengthening FHA, assuring that all parties to a transaction have clear ethical responsibilities that are also practical and easily accommodated.

We look forward to the time that the housing market can again lead the economy out of recession. Extending the tax credit and standardizing rational appraisal and FHA rules will contribute substantially to that goal.