NATIONAL ASSOCIATION OF REALTORS®

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HEARING BEFORE THE

UNITED STATE HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"THE FUTURE OF THE FEDERAL HOUSING ADMINISTRATION'S CAPITAL RESERVES: ASSUMPTIONS, PREDICTIONS AND IMPLICATIONS FOR HOMEBUYERS"

WRITTEN TESTIMONY OF

BOYD J. CAMPBELL DSC, GRI, CBR, E-PRO

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

OCTOBER 8, 2009

Madam Chairwoman, Ranking Member Capito, and members of the Subcommittee; my name is Boyd Campbell, and I am a Managing Partner and Associate Broker for CENTURY 21 in Lanham, Maryland. I serve as a member of the Maryland Association of REALTORS® Executive Committee, and as a member of the National Association of REALTORS® GSE Presidential Advisory Board.

I am here to testify on behalf of 1.2 million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on the importance of FHA mortgage insurance. 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.

Importance of FHA

With the collapse of the private mortgage market, the importance of the Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, FHA is one of the primary sources of mortgage financing available to families today. Without FHA, families would be unable to purchase homes and communities would suffer from continued foreclosure and blight. On September 30, the Federal Reserve published its draft explanation of the 2008 Home Mortgage Disclosure Act (HMDA) data. That report shows the critical role FHA is playing in the market. According to the Federal

Reserve, by the end of 2008, nearly one half of home purchase loans and one quarter of refinancing loans were backed by either FHA or the VA. In addition, minority borrowers rely heavily on FHA. According to the Federal Reserve, "In 2008, more than 60 percent of home purchase loans and almost 40 percent of refinance loans to blacks were from either the FHA or VA. For Hispanic-white borrowers, nearly 50 percent of their 2008 home-purchase loans and 21 percent of their refinance loans were from the FHA or VA."[1]

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 hallmark feature of a 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 Strength/Solvency

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 account separate from the capital reserve. 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

[1] *The 2008 HMDA Data: The Mortgage Market during a Turbulent Year ,* http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft.pdf

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 capital 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 assumed 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 it from the biggest failures.

Today, FHA borrowers have never been stronger. The Federal Reserve report shows that FHA is not the new subprime lender - its 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

While FHA is not required to do anything when the reserves fall below 2 percent 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 for 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.

FHA has also released mortgagee letters on appraiser independence, effective January 1, 2010. We support FHA's language related to geographic competence, especially as it relates to the use of Appraisal Management Companies (AMCs). FHA does not require lenders to utilize AMCs, and reinforces the importance of geographic competence. Consumers and REALTORS® have encountered significant problems with appraisals when the appraiser is not familiar with the community in which the home is located. FHA's mortgagee letter states that lenders and appraisers are both responsible for the quality and accuracy of the appraisal. FHA states that the lender is responsible for determining whether an appraiser's qualifications are sufficient prior to assigning an appraisal. Appraisers are reminded that USPAP applies to all appraisals performed for properties that are security for FHA. In addition, FHA's letter states that if the lender orders an appraisal through an AMC or another third party organization the lender must ensure that specific guidelines are followed to ensure the FHA appraiser is compensated appropriately and that the fee charged to the consumer for the appraisal report is consistent with the market rate for appraisals.

The letter also provides guidance on the subject of appraisal portability. NAR believes it is important for borrowers to have complete flexibility in choosing a lender, and should not be hampered by having to repeat an appraisal simply because they switched lenders. NAR feels strongly that consumers should not be required to pay excessive fees for appraisals, nor be subject to appraisals conducted by appraisers who are not familiar with their market. Mortgage brokers and lenders underwriting staff will be prohibited from ordering the appraisal. This will create a firewall between lending staff and the appraiser and enhance the independence of the appraisal process. To further support the independence of appraisers and to ensure uniformity in the real estate industry we have called on FHA to work with the GSEs to established a combined frequently asked questions (FAQ) document that will be codified in existing appraisal policies. In a recent meeting, FHA Commissioner David H. Stevens has asked his staff to begin discussions with the GSEs to further explore this recommendation. We support these changes by FHA.

FHA will also begin rulemaking dealing with mortgage lenders and brokers. They will propose to increase the net-worth requirements for mortgagees to $1 million (from $250,000) and will place liability for mortgage brokers' actions on the lender. NAR does not have data or policy on these specific lender issues. However, such actions would put FHA in-line with industry standards, and do not appear to be particularly onerous for lenders. Assuming FHA has data to show that these changes are needed to help retain the safety and soundness of the FHA fund, we would support these proposals.

NAR Additional Recommendations for FHA

NAR does support some additional changes for FHA to ensure its continued strength and availability to homeowners.

Technology and Staffing

NAR strongly supports increased funding for FHA to upgrade their technology. FHA operates with technology that is an average of 18 years old. 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. Legislation has recently passed the House, H.R. 3146, the "21st Century FHA Housing Act of 2009," which would provide this authorization. This bill, introduced by Representatives Adler (D-NJ) and Lee (R-NY), will provide a number of reforms to modernize FHA. We also understand funding has been included in the Appropriations bill for HUD, and we urge that funding to be included in the final version of the FY2010 Appropriation for HUD.

We also believe HUD should have the ability to hire the professional staff they need to run what is now such a large and critical component of our housing finance system. H.R. 3146 provides HUD flexibility to hire appropriate staff using the compensation guidelines of similar agencies, such as the Federal Housing Finance Agency or the Federal Deposit Insurance Corporation. The legislation would also permit the hiring of expert consultants to work on specific program areas within FHA's operations. We think these changes are necessary to ensure the FHA is able to work efficiently and effectively with qualified, experienced staff.

Condominium Rules

NAR has also been working closely with FHA on their new condominium approval process. As originally published in Mortgagee Letter 2009-19, we have concerns that some components of the new policy may lengthen the real estate crisis, just as some markets are seeing positive growth. We applaud the Department for delaying implementation of this letter, and believe they are making some changes to their policies.

NAR recommends elimination of the owner-occupancy requirement for FHA condo mortgages. The GSEs do not have an occupancy ratio for condominium projects if the borrower is going to occupy the unit, which of course would be the case for all FHA borrowers. Eliminating this requirement will allow more buyers to purchase condominiums (which are often more affordable), raise occupancy levels, and will stabilize these developments and the community. If FHA retains the occupancy ratio, NAR recommends amending the rules so that all bank-owned REOs are not counted for the purposes of the occupancy ratio. Again, this will align FHA with the industry practices in this area.

Condominiums are often the only affordable option for first time home buyers or borrowers with good credit, but small downpayments. NAR recommends amending the FHA concentration requirement. Currently, no more than 30 percent of the total units in a project may have an FHA mortgage. Increasing this limit, or temporarily suspending it, will result in a greater owner-occupied ratio in the project because more borrowers will be able to use FHA to purchase.

Many condominiums remain largely vacant because of our real estate crisis. But FHA requires that at least 50 percent of the units be sold prior to FHA's endorsement on a unit. This eliminates condominiums as an option for many FHA borrowers. Reducing or eliminating this requirement grants greater choice for the borrower but also helps reduce the number of vacant units on the market.

NAR urges FHA to clarify the condominium reserve study requirements. Currently the reserve study requirement can be financially costly for small condominium associations and can cause delays in completing sales. We urge FHA to clearly state what has to be included in the study and who should conduct and bear the costs of the study.

Lastly, NAR recommends FHA reconsider the elimination of the Spot Loan Approval Process. Spot loans can be critical for borrowers who wish to use FHA to purchase a condominium in a project that is not FHA approved. Elimination of the Spot Loan Approval Process effectively reduces consumer choice in condominiums as there will likely be many projects not approved by FHA but a logical choice for potential homeowners.

<u>Mortgage Loan Limits</u>

We also strongly support making permanent the FHA mortgage loan limits that are currently in effect. FHA has played a critical role in providing mortgage liquidity as private financing has dried up. The current loan limits are set to expire in just a few months, on December 31, 2009. Last year, when the limits temporarily expired, many communities saw dramatic declines in mortgage liquidity. More than 612 counties in 40 states and the District of Columbia saw their limits fall. The average decline in the loan limits was more than $51,000.

In today's real estate market, lowering the loan limits further restricts liquidity and makes mortgages more expensive for households nationwide. FHA and GSE mortgages together continue to constitute the vast majority of home financing availability today, which makes it particularly critical to extend the current limits. Without the additional liquidity created by maintaining these loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

We strongly support the legislation introduced by Committee members Brad Sherman (D-CA) and Gary Miller (R-CA), H.R. 2483, the "Increasing Homeownership Opportunities Act" to make the current loan limits permanent. We urge the Subcommittee quickly consider this important legislation to ensure that liquidity in this tenuous market is not put at risk.

<u>Other Needs for a Housing Recovery</u>

NAR would also like to take this opportunity to suggest some other necessary changes that Congress can implement to aid in our housing recovery. Most economists agree that our housing markets are slowly coming back. Some areas are starting to see price stability and even revival. But a number of federal actions have lead to this and need to be continued and additional steps needs to be taken to get our country back on its feet.

Extend the 1st Time Homebuyer Tax Credit

The $8000 first-time homebuyer tax credit expires as of December 1, 2009. But the usefulness of the credit diminishes daily if the credit is not extended well before that date. A homebuyer is eligible for the tax credit only if the home is “purchased” before December 1, 2009. That means that buyers have to find a house, complete a contract, satisfy any contingencies, secure financing and go to closing by November 30. Accomplishing those tasks by November 30 will become more difficult with every passing day. In today’s market, it generally takes between 45 and 60 days to go from contract to closing. Without Congressional action now, the market may freeze again – possibly as soon as this month. NAR’s research suggests that as many as 350,000 sales this year can be directly attributed to the availability of the credit. The tax credit stimulated market activity. The volume of housing sales has improved steadily every month since the credit was enacted. The credit pulled people from the sidelines and created some momentum that had been absent.

The housing market remains fragile. The market has improved and prices have stabilized in many areas, but the market has not fully corrected. Retaining the tax credit sustains that recovery. Inventory may remain unusually high. The waves of foreclosures attributable to subprime and other improper lending practices are working themselves through the system. Presently, high unemployment rates pose a threat to homeowners and could set another round of foreclosures in motion. If foreclosure rates were to spike again, inventories could become bloated again. Incentives are still needed to keep the market moving.

Home sales continue to stimulate economic activity. The economy will never fully recover until housing markets fully recover. Thus, the stimulus the credit provides is still needed. NAR estimates that every sale generates approximately $60,000 of additional economic activity. And expanding the credit beyond first-time homebuyers would give the economy a much needed kick. We continue to need the homebuyer credit. Congress must act now to be sure that the credit is available through 2010.

Uniform Short Sales Policies

Due to the recent economic crisis, including rising unemployment, and drops in home prices in communities across the nation, the number of short sales is increasing. Since a short sale generally costs the lender less than a foreclosure, it can be a viable way for a lender to minimize its losses. A short sale can also be the best option for homeowners who are "upside down" on mortgages because a short sale may not hurt their credit history as much as a foreclosure. As a result, homeowners may qualify for another mortgage sooner once they get back on their feet financially.

However, too often, a short sale is a story of delay, unrealistic expectations of the value of the home, lost documents, full voicemail boxes, and insufficient or untrained staff. NAR has been working with lenders and servicers to try and ease the closing of short sales. As you know, the vast majority of short sales never close – even after the offer has been accepted. On May 14, 2009, the Administration announced incentives and uniform procedures for short sales under a new Foreclosure Alternative Program. These guidelines and forms are in the process of being completed, and are expected to be released later this month. NAR was extremely pleased that the Administration heard the concerns of our members that short sales reform is crucial to helping families, who are unable to keep their homes, nevertheless avoid foreclosure.

The new program offers the hope of uniformity, transparency, and speed. But those goals will only be achieved if a large majority of servicers agree to participate and if they apply it uniformly to all eligible families. Completed short sales are not only good for the seller and the buyer, but saves the lender tens of thousands of dollars and benefits the community by keeping the home occupied and maintained. REALTORS® anxiously await implementation of the program and continue to report, every day, problems getting short sales to closing resulting in unnecessary foreclosures.

Conclusion

The National Association of REALTORS® believes in the importance of FHA and thinks it has shown tremendous leadership and strength during the current crisis. FHA remains fiscally safe and sound. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the rest of the real estate finance industry. We applaud FHA for continuing to serve the needs of hardworking American families who wish to purchase a home.

We believe Congress and the Administration are taking the right steps to facilitate the economic recovery. We urge them not to stop now. Additional resources are needed to ensure the housing markets and our national economy continues to improve. We thank you for this opportunity to testify, and stand ready to work with you to accomplish our recommended proposals.