NATIONAL ASSOCIATION OF REALTORS®

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TESTIMONY OF

RON PHIPPS,

2009 FIRST VICE PRESIDENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

U.S. SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

HEARING REGARDING

"STATE OF THE NATION'S HOUSING MARKET."

October 20, 2009

Introduction

Chairman Dodd, Ranking Member Shelby, and members of the committee, on behalf of more than 1.2 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry thank you for inviting me to testify today regarding the current state of the nation's housing market.

My name is Ron Phipps. I am a 3rd generation member of a 4 generation family tradition in the Rhode Island residential real estate industry. My passion is making the dream of homeownership available to all American families. As direct result of my passion, I have become very active within the NATIONAL ASSOCIATION OF REALTORS® (NAR); holding significant positions at both the state and national levels. Since 2000, I have been President of the Rhode Island Association, a NAR Regional Vice President, and a member of the NAR Executive Committee. Most recently, I was elected NAR First Vice President for 2009.

Current Housing Trends

A review of the latest data strongly suggests that the homebuyer tax credit has had its intended impact of significantly stimulating home sales. From about 4.5 million annualized home sales pace in the few months prior to the stimulus, sales have jumped to 5.1 million in recent months. That is a change of 600,000 additional existing home sales. New home sales have risen from mid 300,000 to low 400,000 over the similar period. The rise in sales has been concentrated in the lower-priced homes largely because first-time buyers are looking to stay, rightly, well within their budget.

Housing inventories, while still higher than a desired level, have been trimmed. The latest 8-month supply of existing-home inventory is much better than the double-digit figures of last year. Home values have likewise moved in an "improving" direction. Broadly speaking, they are down from one year ago, but the declines have been less steep in recent months compared to the pre-stimulus times. The median existing home price as of August was down 12.5 percent compared to a nearly 20 percent decline early in the year. In short, sales have risen and home prices are on the verge of stabilizing.

Housing's Impact on the Economy

At a cost of about $10 billion, should the first-time homebuyer tax credit be extended through the middle of next year, the housing market will likely have recovered nicely with the broader economy on track for a solid robust expansion. The $10 billion price tag is rather modest compared to the $700 billion in TARP funding and $800 billion of the broader economic stimulus package that was passed early in the year. Moreover, the $10 billion cost is a static measure that does not take into account job creation and increased tax revenue from rising economic activity. Actually, if all of the economic dynamic responses are taken into consideration, the home buyer tax credit can be argued as a net positive revenue generator for the federal government.

As an example, Arun Raha, the chief economist for the state of Washington, is quoted in the Seattle Times as indicating that, "the tax credit has prompted 7,000 purchases by first-time homebuyers [in the state of Washington] — purchases that otherwise would not have occurred. Every 1,000 home sales generate $112.4 million of economic activity with $71.9 million of it directly from home-sale preparation and the actual real-estate transaction. In addition, more than 700 new jobs are created. This is not a balance-sheet bailout, it's real help for our neighbors and communities. One reason for the tangible success and economic impact of the tax credit is that it focuses on first-time buyers, whose purchases spark a surge of home buying that ripples across the economy and into the future. Most of their purchases are homes that someone else has been waiting to sell so that they, in turn, can purchase another house. The Washington Center for Real Estate Research at Washington State University estimates that 65 percent of those who sell their home to first-time buyers subsequently buy another house in the state. The people from whom they bought their home also purchase a new residence, and so on."

There is nothing like economic growth to dent budget deficits. If the economy was already at full capacity, the housing stimulus would simply be moving dollars from one sector of the economy to another. But as is fully visible out on the street, we are nowhere near full capacity. Factory capacity utilization was 69.6 percent in August, compared to an 80 percent rate that should be the case in normal economic times. On the job market front, the country is facing a double-digit unemployment rate rather than the healthy 5 or 6 percent unemployment rate. Therefore, there is plenty of room for growth and a win-win situation for the housing market and other sectors of the economy.

Outlook

Despite these vast potential benefits to the economy from extending the homebuyer tax credit, valid questions should nonetheless be asked. Is there any pent-up demand remaining? Will the tax credit just go to the people who would have bought a home anyway and thereby will simply pocket the $8,000 check? Well, a compelling case for tapping the financially healthy renter population follows.

In 2000, before the housing market boom, there were 11.5 million renter households who had the necessary income to buy a median priced home at prevailing market conditions. Today, the pool of renters who can buy a median priced home is over 16 million. Just nudging even a small share – say 5 percent – of these financially healthy renters into buying via a tax credit check will mean 800,000 additional home sales. That number is sufficiently meaningful to get the inventory down to the level of home value stabilization. The housing market will then be on the path to a self-sustaining recovery.

The key to any future sustainable economic recovery lies in home values stabilizing or, better yet, a return to a historical home price appreciation rate of 3 to 5 percent each year.

The bubble prices crash landed, but all the excesses have already been removed. In fact, one could legitimately argue that home values have overshot downward. Price-to-income ratio is now below the historical average, and the monthly mortgage payment for a middle income person buying a middle priced home is well below its historical norm.

Housing Challenges

Although the future of the housing market looks bright, that future is extremely tenuous as a number of obstacles must be cleared to ensure a successful recovery. NAR believes that Congress and housing industry participants must adequately address jumbo mortgages, commercial mortgages, HVCC, the modernization of FHA, short sales, and the unwinding of the Federal Reserve's MBS program to guarantee a smooth economic recovery.

Jumbo Mortgage Issues

For residential borrowers seeking to purchase or refinance homes that are above the existing GSE loan limits, the lack of government participation has caused a situation similar to that faced by commercial mortgage market participants. A severely reduced amount of private capital in the jumbo market space has constricted the consumer's ability to get an affordable loan, if funding is available at all. For homeowners needing to refinance to a more reasonable mortgage product, the lack of liquidity is all but forcing many homeowners into foreclosure or short sale, which continues to place severe downward pressure on housing and the economy.

Commercial Mortgage Issues

Currently, banks and the CMBS market represent 75% of all outstanding commercial real estate loans. However, banks have tightened their credit standards and moved to reduce commercial real estate exposure, while the CMBS market has ceased to function - all of which points to systemic dysfunction. Hundreds of billions of dollars of commercial real estate loans from a variety of sources are expected to mature this year and over $1 trillion in the next few years. However, under current conditions, there is insufficient credit capacity to refinance this wave of loan maturities. With no liquidity, commercial borrowers face a growing challenge of refinancing maturing debt and the threat of rising delinquencies and foreclosures. Without the presence of a GSE to support liquidity and provide capital, the current crisis facing the commercial credit markets is even more profound.

Home Valuation Code of Conduct (HVCC)

The Home Valuation Code of Conduct (HVCC) has been in effect for over five months and REALTORS® report many adverse, unintended consequences since its implementation. According to a July 2009 survey of REALTORS®, 76 percent of respondents said the length of time to obtain a completed appraisal report increased after May 1, 2009. More than one third of REALTORS® have lost at least one sale because of a delay in the appraisal process. At the same time, respondents who identified themselves as appraisers said their time frame to submit an appraisal reports decreased and half of these respondents say this impacts the quality of the appraisal report. Finally, consumers are paying more for delayed appraisal reports that may have quality issues.

The Need for FHA Modernization

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.

Uniform Short Sales Policies

The number of short sales are increasing due to the current economic crisis. 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 may be aware, 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.

Unwinding of the Federal Reserve MBS Program

NAR believes that the manner in which the Federal Reserve unwinds the MBS program is critical to the housing and mortgage industries and to the economy as a whole. It will take considerable planning and effort to ensure that phasing out of this program does not lead to a significant spike in interest rates, disruptions to the flow of mortgage capital, and a halt to the fledgling recovery in the housing industry.

To ensure a smooth transition, NAR recommends the following steps:

- The Fed, Treasury, FHFA, and the GSEs should document that recently issued MBSs under the program are performing well and disseminate this information widely and publicly, in order to instill confidence among investors.
- The Fed, Treasury, FHFA, and the GSEs should work with banks and others in the financial industry to bring private investment back into the MBS market.
- The FHFA and/or the Treasury should signal that new agency MBS are, at least in effect, backed by the United States Government.
- If private investment does not return to the market in sufficient amounts to replace the current rate of Fed MBS investment, the Fed should increase the dollar size of the program and extend its term beyond the end of the first quarter of 2010.

Recommendations to Enhance Recovery and Spur Growth

REALTORS® believe that in order for the U.S. housing market and economy to thrive, the housing market requires strong consumer demand and the secondary mortgage market must be safe, sound and contain dependable participants in are economic situations, good or bad. NAR suggests that the following suggestions regarding the first-time homebuyer tax credit, the FHA / GSE loan limits, and "Principles for Ensuring a Robust Financing Environment for Homeownership" be considered as legislation is entertained to further stimulate and sustain the housing market.

<u>Extend the 1st Time Homebuyer Tax Credit</u>

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.

FHA / GSE Mortgage Loan Limits

NAR strongly supports making permanent the GSE and FHA mortgage loan limits that are currently in effect. The GSEs and FHA have 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.

Principles for Ensuring a Robust Financing Environment for Homeownership

NAR believes that these principles, which require a continuing role for the federal government in the mortgage market, should be used in the development of a model for secondary mortgage market going forward, in order to encourage a safe and sustainable housing market. According to the principles, the secondary mortgage market model must:

1. Ensure an active secondary mortgage market by facilitating the flow of capital into the mortgage market, in all market conditions.
2. Seek to ensure affordable mortgage rates for qualified borrowers.
3. Establish reasonable affordable housing goals so all qualified borrowers, including low- and moderate-income households, have an opportunity to realize the dream of homeownership. Affordable housing goals should not provide incentives for the institution that are inconsistent with sustainable homeownership.
4. Require the institution to pass on the advantage of its lower borrowing costs (and other costs of raising capital) by making mortgages with lower rates and fees available to qualified borrowers.

5. Ensure mortgage availability throughout the nation. NAR supports indexing conforming loan limits based on increases in median sales prices, including higher indexed limits for areas with high housing costs.

6. Require sound underwriting standards.

7. Require the highest standards of transparency and soundness with respect to disclosure and structuring of mortgage related securities.

8. Ensure there is sufficient capital to support mortgage lending in all types of markets. And,

9. Provide for rigorous oversight.

These principles espouse two major themes. First, the housing market must work in all markets, and at all times, no matter the existing economic condition. As we have mentioned in previous testimonies before Congressional Committees, the housing market has brought us out of nearly all of the major economic downturns, and will continue to do so if we as a nation protect the housing mission or the GSEs. Pure privatizing of the GSEs without any level of government support, which would incent them to act as current private investors and flee the market during an economic downturn, would create a major draft on future housing and U.S. economic recoveries.

Second, mortgage capital needs to be available to **ALL** potential, qualified housing consumers. NAR is not advocating going back to the excesses that we saw during the housing boom, where everyone, practically regardless of their ability to repay the loan, could get a mortgage. On the contrary, the housing goals that the government imposed on the GSES, when they were reasonable, fostered opportunity for many creditworthy consumers who were in the lower portion of the income spectrum to pursue and obtain the dream of homeownership. Removing the government's involvement in the secondary mortgage market will offer no incentive for market participants to reach out to lower income, creditworthy consumers which will ultimately deprive them of their ability to own a home, and build wealth that future generations can use to move up the economic ladder.

Retain Strength 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."

FHA has announced that their 2009 audit will demonstrate that their capital reserve fund has fallen below the Congressionally-mandated 2 percent ratio. 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. FHA actual total reserves are higher than they have ever been – with combined assets of $30.4 billion. 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. It is important to note that 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 **<u>not</u>** 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.

Conclusion

The National Association of REALTORS® sees a bright future for the housing market and the overall economy. However, our members are well aware that the future we see rests on the industry's ability to successfully navigate some very serious issues. Congress and the housing industry must maintain a positive, aggressive, forward looking partnership if **WE** are to ensure that a housing and national economic recovery are sustained.

I thank you for this opportunity to present our view of the state of the nation's housing market. As always, The National Association of REALTORS® is at the call of Congress, and our industry partners, to help facilitate a sustainable housing and national economic recovery.