Testimony of
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On Behalf of the
National Association of Home Builders

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Subcommittee on Housing and Community Opportunity

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<u>Transforming the Federal Housing Administration for the 21st Century</u>

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Introduction

Chairman Ney, Ranking Member Waters, members of the Housing and Community Opportunity Subcommittee, on behalf of the more than 225,000 members of the National Association of Home Builders, thank you for the opportunity to testify today on the important subject of revitalization of the Federal Housing Administration's single family mortgage insurance programs. My name is Jerry Howard and I am the Executive Vice President and Chief Executive Officer of the National Association of Home Builders (NAHB).

The Importance of the Federal Housing Administration

Since its creation in 1934, and for much of its existence, the Federal Housing Administration (FHA) has been viewed as a housing finance innovator by insuring millions of mortgage loans that have made it possible for home buyers to achieve homeownership. Without FHA, many of these buyers either would have had to delay their purchase, been unable to purchase a home, or would have done so at an unnecessarily high cost.

FHA matters for a lot of reasons, not the least of which is that throughout its more than 70- year history, FHA's single family mortgage insurance programs have served home buyers in all parts of the country during all types of economic conditions. Moreover, FHA has done this without any cost to America's taxpayers. NAHB's support for FHA's single- and multifamily mortgage insurance programs has been steadfast through the years.

FHA’s Growing Irrelevancy

Over the past two decades, the popularity and relevance of FHA’s single family mortgage insurance programs has waned as FHA’s programs have failed to keep pace with competing conventional mortgage loan programs. In many respects, this is due to statutory and regulatory constraints that have limited FHA’s ability to respond to the needs of borrowers who might have otherwise chosen FHA.

All too often, the differences between FHA’s requirements and those for conventional mortgages have been viewed by lenders, appraisers and others as a disincentive to use FHA programs. Likewise, FHA’s unique and often burdensome requirements have caused many home builders to avoid using FHA’s programs to build homes - including condominiums – that otherwise would have been well-suited to borrowers who planned to use FHA-insured mortgage loans.

Furthermore, FHA’s lack of responsiveness to market needs has created opportunities for predatory lenders to charge unreasonably high fees and interest rates to borrowers who, despite limited cash resources and/or tarnished credit, could have qualified for market-rate FHA-insured loans.

The recent decline in FHA mortgage insurance activity, both in real terms and when measured against conventional loans programs, is bothersome in other respects as well. For example, FHA-insured loans serve as collateral for mortgage-backed securities issued by the Government National Mortgage Corporation (Ginnie Mae), which, like the FHA, is part of the U.S. Department of Housing and Urban Development (HUD). Ginnie

Mae serves a vital role in America's housing finance system by providing liquidity for lenders to offer mortgages that are insured or guaranteed by FHA and other government agencies. Because the bulk of Ginnie Mae securities are backed by FHA-insured loans, the declining trend in FHA-insured loan originations, if unabated, could call into question the viability of the Ginnie Mae program.

FHA's Revitalization Bodes Well for Its Future

Important strides have been made to revitalize FHA under the leadership of Assistant Secretary for Housing / FHA Commissioner Brian Montgomery with the support of HUD Secretary Alphonso Jackson. NAHB was gratified to learn that, upon taking office in June 2005, Commissioner Montgomery challenged his staff to identify obstacles that stood in the way of more widespread use of FHA's single family programs. The Commissioner, furthermore, charged his staff with the task of finding ways to overcome those obstacles.

The benefits of Commissioner Montgomery's efforts are already being realized as FHA has aligned its appraisal requirements with market practices by eliminating some bothersome paperwork requirements that needlessly created extra work for lenders, appraisers and home builders simply because a home buyer chose to use an FHA-insured loan to finance the purchase of a home. Other steps that have made the program more user friendly are FHA's new policies that increase the allowable loan-to-value (LTV) ratio for cash-out refinancing transactions and revisions to the 203(k) rehabilitation program.

Congress Should Quickly Act to Empower FHA

Despite these positive moves, FHA's loan limit structure and downpayment requirements, which are established by Congress, seriously constrain FHA's ability to deliver the range of mortgage products that are needed for FHA to fulfill its mission. FHA has proven through the years that it can serve some of the riskiest segments of the borrowing population, and do so in an actuarially sound manner. Accordingly, NAHB believes that Congress should grant FHA the broader authority outlined in the Administration's FY 2007 budget proposal and detailed in draft authorizing legislation. We believe strongly that this proposal will increase FHA's flexibility to mold its mortgage insurance programs in ways that meet the borrowing needs of unserved, underserved and improperly served families and others who desire to purchase a home. These are people who, for a variety of reasons, either cannot get a mortgage loan or who needlessly pay extraordinarily high costs for mortgage credit.

Mortgage Limits

The limit for FHA-insured mortgages is established in statute as 95 percent of the median home price of an area, within the bounds of a national ceiling and floor. FHA's single family loan limit for the 48 contiguous states is currently capped at $362,790, which is 87 percent of the Fannie Mae / Freddie Mac conforming loan limit. This limit is too low to enable deserving potential home buyers to purchase a home in many high-cost areas. Likewise, the FHA "floor" of $200,160, which is indexed at 48 percent of the conforming loan limit, is too low.

The artificially low FHA loan limits restrict choices for home buyers who use FHA-insured mortgage loans to the lowest echelon of available homes throughout much of the country. In many areas, FHA borrowers are precluded from considering the purchase of a new or recently-constructed home. NAHB does not believe that Congress created the FHA in 1934 with the intent of constraining borrowers to homes priced at the lower end of the market. In fact, NAHB's Board of Directors adopted specific policy in 2005 in support of increasing the FHA loan limit up to the conforming loan limit. NAHB also supports the Administration's proposals to recalibrate local loan limits to 100 percent of the area median from the current 95 percent and to increase the national floor for FHA loan limits.

Downpayments

One of the most common factors preventing potential home buyers from achieving their dream of homeownership is the lack of financial resources to pay the downpayment and closing costs. FHA's current statutory requirement for a cash contribution of 3 percent by a home buyer was innovative when downpayments of 10 percent or more were the norm for conventional loans. Recent strides in credit modeling, such as FHA's TOTAL Mortgage Scorecard, have made it possible to predict with a reasonable certainty the likelihood that a borrower will default on their loan and, therefore, have rendered the downpayment a less critical variable in the underwriting process.

NAHB believes that Congress should grant FHA the flexibility to establish downpayment requirements for its single family programs as long as the programs are operated on an actuarially sound basis. In 2005, NAHB's President David Wilson testified before this subcommittee in support of "The Zero Downpayment Pilot Program Act of 2005" (H.R. 3043), which was subsequently reported out of the subcommittee by a favorable vote. NAHB continues to support H.R. 3043. NAHB also believes it is important for FHA to have the flexibility to establish other reduced-downpayment mortgage options to more fully address market needs.

Mortgage Insurance Premiums

Likewise, NAHB believes FHA should have the authority to set mortgage insurance premiums at whatever levels deemed necessary to maintain actuarial soundness while striving to serve borrowers who have a wide variety of risk profiles. NAHB was pleased that the President's FY 2007 budget request included an initiative for a risk-based mortgage insurance premium. Such a premium pricing structure would temper the current structure where better-performing loans are cross-subsidizing weaker loans in the FHA insurance fund. NAHB looks forward to learning more about this new premium structure.

Loan Maturities

One underlying theme of FHA's revitalization is based upon the need to increase the affordability of the home financing process for prospective home buyers. By extending the maximum loan maturity to 40 years, FHA will enable borrowers' monthly loan payments to be reduced. Unlike the interest-only loans that are currently popular, an FHA-insured mortgage loan with a 40-year maturity will ensure that some part of the borrower's monthly payment is used to reduce the outstanding loan balance. NAHB believes that 40-year maturities will become commonplace in the not-to-distant future and that FHA should be well-positioned to meet emerging market needs.

Condominium Loans

In many communities, condominiums represent the most affordable path to home ownership. Unfortunately, FHA's requirements for condominium loans are burdensome and differ significantly from the requirements for mortgage loans that are secured by detached single family homes. For a condominium unit to be eligible to be sold to a purchaser who uses an FHA-insured loan, FHA requires the condominium developer to provide documentation related to historical and environmental reviews for the entire project. In contrast, on conventionally-financed condominiums, requirements of this nature are commonly dealt with at the state or local level. Moreover, it is common to have townhomes that are sold as part of a condominium located near townhomes that are part of a planned unit development (PUD). In early 2003, FHA found that its PUD approval process was redundant with local governmental review practices and subsequently dropped its PUD approval requirement. FHA's condominium approval processes are similarly redundant; however, FHA has been forced to retain these because of statutory requirements.

These different requirements exist because condominiums and detached single family homes are authorized under different sections of the National Housing Act and insurance for these loans is backed by different insurance funds. NAHB has heard from its members who develop condominiums that the burden of the additional and unnecessary requirements, and the delays encountered in attempting to comply with FHA's requirements, have caused these builders to price units that were once intended to serve the FHA market out of the range FHA borrowers could afford. On more than one occasion NAHB has urged HUD to move condominium unit financing under FHA's single family mortgage insurance program. We are very pleased that HUD has agreed to our recommendation and plans to ask Congress to unify all of the single family mortgage insurance programs under one section of the National Housing Act.

Conclusion

In closing, I would like to reiterate NAHB's strong support for FHA and its revitalization under the leadership of Secretary Jackson and Commissioner Montgomery. This leadership team at HUD is working hard at re-establishing FHA's relevance while keeping the program financially sound. With Congress' help, FHA will continue its long record of serving America's home buyers. Thank you once again for this opportunity. Mr. Chairman, I would welcome any questions you may have for me.