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BEFORE THE SUBCOMMITTEE ON

HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Good afternoon Chairman Ney, Congresswoman Waters and Members of the Subcommittee. It is a pleasure to be here. My name is Craig Nickerson. I am Vice President of Community Development Lending at Freddie Mac.

Freddie Mac's Mission

Freddie Mac is a shareholder-owned corporation chartered by Congress to create a stable flow of funds to mortgage lenders in support of homeownership and rental housing. Since our inception in 1970, Freddie Mac has purchased more than $2 trillion in residential mortgages, financing homes for more than 30 million families.

To achieve our mission, Freddie Mac attracts capital from around the world to finance housing in America, and we constantly innovate to deliver it as effectively as possible. Mortgage funds are available whenever and wherever they are needed. Mortgage rates are lower, saving homeowners thousands of dollars in interest payments. Thirty-year fixed-rate mortgages are plentiful, protecting families against unexpected interest-rate increases. In addition, the availability of low-down payment loans has helped open the door of homeownership to millions of low- and moderate-income families.

The high level of support provided by Freddie Mac and the secondary mortgage market has produced the best housing finance system in the world. The nation's homeownership rate has reached a record high, with more families of all racial and ethnic backgrounds owning homes than ever before. Still, less than half of America's minority households have achieved the dream of homeownership.

To accelerate the growth in minority homeownership, in 2002 Freddie Mac launched an innovative and comprehensive program called *Catch the Dream.* Many families face significant barriers to homeownership, including a lack of information about the homebuying process, impaired credit, insufficient funds for down payment and a shortage of affordable housing. Our 25 *Catch the Dream* initiatives seek to dismantle these and other barriers. The initiatives range from best-in-class homebuyer outreach and education to new technologies and mortgage products designed to put families into homes they can afford and keep. Representing a team effort with mortgage lenders, nonprofit housing and community organizations, and other industry leaders, *Catch the Dream* is Freddie Mac's contribution to making the dream of homeownership a reality for 5.5 million more minority households by the decade's end.

Given our focus on dismantling barriers to homeownership, Freddie Mac welcomes the legislation put forth by Representatives Harris and Rogers. By providing $200 million of down payment assistance in 2004 and 2005, H.R. 1276 will allow thousands of additional underserved families to share in the American dream of homeownership. More than 500 states and local jurisdictions would be eligible to receive the $200 million in grant funding. The program will be administered under the Department of Housing and Urban Development's (HUD) Home Investment Partnerships Program (HOME), an existing grant program that benefits communities nationwide by increasing the availability of affordable housing.

Building Wealth Through Homeownership

An enduring symbol of core American values, homeownership provides significant benefit to families, neighborhoods and to the nation. Owning a home provides a sense of security and contributes to safer, stronger communities. Homeownership also enhances the educational attainment of children and contributes to a family's ability to create wealth. For low- and moderate-income homeowners, in particular, home equity represents a significant share of household net worth.

Paradoxically, in order to build wealth through homeownership, borrowers must first accumulate some amount of wealth for a down payment. This contribution of borrower funds is a significant factor in virtually every lending decision. For years, mortgage research has shown that a borrower with a financial stake in the property is less likely to default. Until the mid-1990s, down payments on low-cost conventional mortgages averaged around 20 percent of the loan balance. Many families had to postpone homeownership for years while they worked to accumulate such a sizeable down payment.

Growing understanding of the default risk associated with mortgages – combined with greater ability to assess and manage it – has significantly reduced down payment requirements. Much of the credit goes to automated underwriting systems, such as Freddie Mac's Loan Prospector service, which is able to analyze a multitude of risk factors simultaneously. Today, many home purchase loans carry down payments of 5 percent or less, depending on the borrower's credit standing and other factors. Targeted programs, such as Freddie Mac's suite of affordable mortgage products require down payments ranging from zero to 3 percent. Many of Freddie Mac's affordable products offer borrowers greater flexibility on payment ratios, reserve requirements and credit history. In addition, most permit a variety of down payment sources, including loans from relatives, grants, gifts and lender financing

Freddie Mac's experience with innovative financing arrangements such as these indicates that the *size* of the down payment is more important to the long-term success of the loan than the actual *source* of the down payment funds. That is, whether a down payment is from a gift or grant or borrower savings, the probability of default is largely the same. Borrowers are far more likely to stay current with their mortgages when real money is at stake. Our experience also tells us that "a little goes a long way." Many borrowers simply need a boost of confidence to pursue homeownership – a boost that comes from having a few extra thousand dollars for unforeseen costs and expenses.

Down Payment Remains a Key Barrier

Despite the dramatic reduction in down payment requirements – and the growing use of alternative funds – out-of-pocket costs remain a major deterrent to homeownership, according to a recent study by Susan Wachter, Wharton School professor and former Assistant Secretary of Policy Development and Research at HUD. The study found that compared to the monthly mortgage payment, the down payment is three times more constraining on borrowers' ability to purchase a home.[1] In addition to the down payment, families must have adequate funds for closing costs, which often average between 2 percent and 4 percent of the loan balance. Finally, families must demonstrate adequate reserves to cover the inevitable upkeep and repair associated with homeownership.

The out-of-pocket costs associated with homeownership can be particularly daunting for lower-income and minority families who have limited savings and receive little or no assistance from their parents. According to the Federal Reserve Board's Survey of Consumer Finances, the median wealth of African-American and Hispanic households is less than one-fifth the median wealth of white households. The combination of low wealth, a lack of awareness of low down payment financing opportunities, and anxiety arising from a thin financial safety net causes many families to delay homeownership or give up the dream of owning a home altogether.

H.R. 1276 Will Help More Underserved Families Achieve Homeownership

The American Dream Downpayment Act represents a substantial commitment to address these issues. Assuming an average subsidy of $5,000, the American Dream Down Payment Fund would enable up to 40,000 families to become new homeowners each year. H.R. 1276 would particularly benefit low-income and minority families. Based on the Wachter analysis, Freddie Mac estimates that the provision of a 3 percent down payment would increase the share of rental households otherwise qualified to become homeowners by as much as 5 percentage points. Among African American and Hispanic renters, however, it would increase homeownership potential by 8.4 percentage points and 9.0 percentage points respectively. Increases such as these will play an important role in helping boost the number of minority homeowners by 5.5 million by the end of the decade.

H.R. 1276 establishes the American Dream Downpayment Fund as part of HUD's HOME Investment Partnerships Program, a successful entitlement grant program that helps communities expand the supply of standard, affordable housing for low- and moderate-income households. The HOME Program is widely recognized by leaders in the housing and mortgage finance industries as an efficient, flexible means by which state and local governments can design and implement affordable housing initiatives tailored to a community's specific needs.

Placement of the $200 million American Dream Downpayment Fund in the HOME Program would permit participating jurisdictions to use the new resources quickly and effectively. Requirements for undertaking a homeownership initiative with HOME Program funding are already well understood by participating jurisdictions. These

[1] "The Impact of Affordable Lending Efforts on Homeownership Rates." Roberto G. Quercia, George McCarthy, Susan Wachter, 2002.

requirements include property eligibility, borrower income, post-assistance owner residency, minimum property code standards, property values, and resale or recapture provisions. Since the inception of the HOME Program over a decade ago, a number of statutory and administrative improvements have made this affordable homeownership program increasingly workable.

In addition to providing enhanced HOME program funds, a provision of H.R. 1276 will ensure greater effectiveness of down payment assistance programs going forward. The Uniform Relocation Act, which protects tenants being displaced from properties being renovated or demolished with federal funds, currently applies to all affordable housing activities undertaken under the HOME Program. This requirement is appropriate when federal funds are being used by participating jurisdictions for rental housing development or for construction or renovation of single-family housing. However, the applicability of the Uniform Relocation Act to down payment assistance is less clear and has deterred many jurisdictions from undertaking a down payment assistance program. The American Dream Downpayment Fund clarifies that the Uniform Relocation Act does not apply to down payment assistance under this title.

Every effort should be made to ensure that the $200 million made available under this bill reaches the participating jurisdictions that are most focused on expanding affordable homeownership. H.R. 1276 accomplishes this goal by requiring HUD to allocate the resources using a formula based on community need and the past homebuyer assistance efforts of the participating jurisdiction. In this way, localities that have devoted HOME and Community Development Block Grant resources to ownership programs and have a strong track record of assisting first-time homebuyers would receive proportionately more of the proposed down payment assistance.

Perhaps the most important element of the proposed American Dream Downpayment Fund is the inherent flexibility in the use of the assistance. Localities can determine the amount of assistance for participating households, and determine whether it is used solely for the down payment or also for closing costs.

In summary, enhanced funding for down payment assistance will help many underserved families surmount a key barrier to homeownership. Used creatively at the local level, these funds can overcome a key barrier to owning a home – a lack of sufficient cash for down payment and closing costs. When coupled with flexible mortgage products from Freddie Mac and mortgage lenders and quality homebuyer counseling, the American Dream Downpayment Program will expand first-time homeownership opportunities for thousands of underserved families in a responsible and sustainable manner. In reducing the homeownership gap, H.R. 1276 will help address the wealth gap as new homeowning families are able to build equity for themselves, their children and their future.