Testimony Delivered to the Committee on Financial Services, Housing and Community Opportunity Subcommittee
By Jon Eberhardt
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Introduction:

My name is Jon Eberhardt and I am the President-elect for the California Association of Mortgage Brokers, a state affiliate of The National Association of Mortgage Brokers (NAMB). NAMB is the largest organization of individual loan originators in the country. NAMB has a membership of over 21,000 originators and affiliates and supports consumer education and a code of ethical conduct by its members. Like the NAMB membership, I originate loans for a living. I became licensed in 1991 and have originated loans since then. My organization, Prime Equity Management, is located in Torrance, California, a suburb located in Southern Los Angeles County. My company is a medium sized loan origination shop with approximately ten originators producing loans in any given month. We are certified to originate FHA insured loans as an FHA correspondent. I am here today to speak in support of HR4110.

The Problem:

As you may know, The Los Angeles Times recently reported that Los Angeles County's median home price has jumped twenty percent in the past twelve months and the new median home price is $379,000. The majority of growth is in areas traditionally considered desirable for first time homebuyers. Entry level houses that traditionally sold for $280,000 are now selling anywhere between $360,000 and $380,000. The FHA loan limit for Los Angeles County is $290,319, the highest permissible under current law. Twenty-three of California's fifty-eight counties are currently at this $290,319 ceiling with another six counties approaching the ceiling when factoring in the latest jump in home prices. These twenty-nine counties represent approximately eighty-five percent of California's population. California is not alone. High cost areas exist in states across the country. Maryland, for instance, has five of twenty-four counties currently at the $290,319 maximum with another seven counties approaching the limit. Again, these counties represent a great majority of the population for Maryland. States that currently feature counties at or approaching the maximum FHA loan limit include Pennsylvania, Connecticut, New York, and New Jersey among others.

Recognizing high cost areas with regard to FHA loan limits is not new to this legislative body. It should be pointed out that Congress already recognizes high cost areas in Hawaii, Alaska and various United States Territories. These areas feature an exception that takes their available loan limit to one hundred and fifty percent of the FHA loan limit.

This congress and this administration have made homeownership a priority in the country. June is Homeownership Month and I was honored to attend the breakfast and press conference held on June 2nd here in the Capital. That press conference featured statements highlighting the record percentage of homeownership in this country. The United States now boasts homeownership in excess of 60%. Minority homeownership is over 50%. Both of these numbers are the highest in history. While homeownership continues to increase in this country, the demand for homes continues to outstrip new development and sales of existing homes continuing an upward push in home prices. To facilitate the demand for homes, certain steps should be taken to accommodate buyers, particularly first time homebuyers.

The Federal Housing Authority (FHA) was created by the National Housing Act of 1934. It was created to increase homeownership and assist the building industry. FHA has a long history of assisting homeownership. Since its inception, FHA has insured over 33 million loans and is the largest insurer of mortgages in the world. FHA insured loans are the staple for first time homebuyers. FHA insured loans are more accommodating to first time homebuyers than other types of loan programs. The program is designed to include flexibility for debt-ratios, income and credit history not included in Fannie Mae and Freddie MAC guidelines.

FHA insured loan programs should serve as a permanent backstop for all first time homebuyer programs. By creating the ability for FHA loan limits to float up and down with 100% of the median home price, the legislation seeks a logical loan limit that will benefit both the housing industry and the consumer.

Why is this particular solution needed?

- By altering the FHA loan limit ceiling through HR4110, the FHA loan limit will float with the market. By tying the loan limit to the median home price for an individual county, the limit can float up and down, following home prices instead of some number evolved from a complicated formula. The limit will follow a true home market economy. Rather than restrict purchases of new homes through a legislatively mandated ceiling, the limit can automatically adjust under current guidelines established for increasing the FHA loan limit on a county-by-county basis.

- The median home price is monitored be many different sources to inform economists and government agencies about housing trends. The median home price is also an industry standard used to define luxury versus entry-level homes in a geographic area. By utilizing the median home price to define an FHA loan limit, consumers also can keep track of loan types by virtue of the median home price for a county. Essentially, the consumer can be better informed as to the type of financing available by keeping track of the median home price. This is much easier to understand than 95% of the median home limit or 85% of the Freddie Mac limit.

- Working families that live in areas that exceed the FHA ceiling yet need and qualify for an FHA loan should not be penalized because of their geographic location. Increasing the loan limits to the median home price of each county ends this unintended discrimination. For homebuyers in counties like Los Angeles the FHA insured loan programs do not work. My office services downtown Los Angeles and traditional entry-level home areas like Long Beach, Carson and Wilmington. The number of FHA insured loans on single-family residence purchases in these areas has dropped to a very few. I, personally, was doing between three and four FHA loans per month for new homebuyers over the past few years. The last FHA insured loan I did was in October of last year. This unintended discrimination is felt hardest by the minority first time homebuyers who predominantly buy in these areas.

- The type of loan that has replaced the FHA insured loan in areas like Los Angeles is a type of loan that has a higher incidence of default than an FHA insured loan. In Los Angeles FHA insured loans are replaced by interest only loans and sub-prime loans. These loans typically have a limited, two to three year, fixed period followed by an adjustable interest rate. Many also have prepayment penalties. The margins on the adjustable interest rate portion of the loan are prohibitive. Ultimately, the homebuyer must refinance the loan to maintain the payment that the home was purchased with. If property values go down, the homebuyer is stuck and becomes a candidate for default.

- Programs have varied significantly in the past ten years, while the FHA programs have remained steady. Those who remember the 1980's and early 90's in lending will recall high interest rates and extended amortization schedules to accommodate first time homebuyers. While the interest rates came down so did home values. During this period few lenders were willing to loan on homes at high loan to value due to an increased chance of default. As home values began to rise again in the mid 90's we saw 125% loans that assumed increased value of property. Now we are at another crossroads. Many economists are predicting a fall in home values should the interest rates go up. Simultaneously we continue to experience a very high demand for homes. In either scenario the FHA program will remain the same, establishing a constant for our industry.

- Some critics have wondered why this legislation is here now, and why it impacts the rest of the country. The answer is simple. Every county in every state will enjoy some benefits of this legislation. While many counties will not increase the way Los Angeles County has, increasing the ceiling to 100% rather than 95% of the median home price will have salutary impact on every county in the country. This increase in FHA insured loan availability will further stimulate homeownership in areas that will not exceed the $290,319 loan limit. The formula for determining the increase is the following: FHA LOAN LIMIT divided by .95 equals NEW FHA LOAN LIMIT.

- FHA is one of the only agencies in the government to exist solely on the fees that it generates from its programs. It is not a taxpayer subsidized entity.

Selective Answers to other questions posed by the Committee:

Question 2:

The National Association of Mortgage Brokers and the California Association of Mortgage Brokers are both on record in support of Zero Down Payment Act of 2004 (HR3755). However, one must ask this question: How many homebuyers are not going to have access to this program due to the ceiling on FHA insured loans?

Question 3:

As outlined in one of my points above, the FHA insured loan is more desirable than some of the high cost loans that have replaced it in high cost areas.

Question 8:

HR4110 would increase access to homeownership by many of the families that currently cannot obtain financing through any means. The FHA insured loan programs offer a means to obtain financing through underwriting flexibility and generous guidelines. Most of the loans that I have done through the FHA insured programs have been for minority homeowners. It is these same people who cannot obtain financing now. For example, it is important to understand that neither Fannie Mae nor Freddie Mac will allow a homebuyer to qualify with a credit score average below 600. Using compensating factors, the FHA insured program allows for this. If the same borrower tried to obtain financing using a subprime product, the approved loan to value would be lower than the FHA loan to value guidelines and the interest rate would be substantially higher. Most likely the subprime loan would include a prepayment penalty.

Question 9:

For the sake of simplicity and consumer awareness, permanently tying the FHA insured loan ceiling to the median home price will resolve many of the issues regarding definition of high cost and not high cost areas.

Question 10:

One only needs to look at the late 1980s to remember the type of support the private sector gave to homebuyers in a declining value market. Programs were eliminated and underwriting standards became unbearable. This was highlighted in some of the oil producing states. In a declining value market lenders will be reluctant to loan at high loan to values due to the increased risk factor. It is for this very purpose that the FHA program was created.

Thank you for allowing me to testify today.

Respectfully submitted:

Jon Eberhardt