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Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
U.S. House of Representatives

"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets, Part 2"

September 8, 2011

Chairwoman Biggert, Ranking Member Gutierrez and members of the subcommittee, thank you for the opportunity to provide this statement on behalf of the Mortgage Bankers Association (MBA)[1] on the occasion of this second hearing on the future roles of the Federal Housing Administration (FHA), Rural Housing Service (RHS), and the Government National Mortgage Association (Ginnie Mae) in the single- and multifamily mortgage markets.

FHA and Ginnie Mae are pioneers of America's housing finance market. When FHA was established during the Great Depression, it served as a source of stability and liquidity during a time of financial crisis. Ginnie Mae, established in 1968, created and guaranteed the very first mortgage backed security, an instrument that continues to create liquidity for the market today. Together, FHA's and Ginnie Mae's traditional role has been to assist those segments of the population who need a little extra help in securing safe, decent affordable housing – whether through homeownership or the financing of affordable rental housing. Of late, FHA and Ginnie Mae have buoyed the nation's housing finance system during these difficult economic times. With the contraction of the private sector, FHA's market share has grown to almost 30 percent of all loan originations and has reached as high as 50 percent in some geographic locations in 2010, and almost 50 percent of all purchase mortgages in the country. Ginnie Mae, which only securitizes FHA, VA and RHS loans, has grown in turn. FHA was also responsible for 21 percent of multifamily and healthcare mortgages originated in 2010.

FHA was not immune to the challenges of the economic downturn. When the November 2009 actuarial review showed that the FHA's Mutual Mortgage Insurance Fund (MMI) had fallen to 0.50 percent in FY2010, FHA took serious and deliberate steps to strengthen its risk profile. For example, FHA made a series of single family risk management, lender oversight and enforcement changes over the last two years designed to protect the financial stability of FHA. The MBA sincerely hopes that these efforts will continue under Acting Commissioner Carol Galante and we look forward to working with her to ensure FHA remains a resource for generations to come.

In April and May of this year, MBA testified at two subcommittee hearings on the topics of credit risk retention and the role of FHA and Ginnie Mae in the single family and multifamily mortgage markets. We are pleased to have the opportunity to discuss the important link between these two issues.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Credit Risk Retention and the Qualified Residential Mortgage Exemption in the Context of FHA

One of the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank) most significant provisions requires issuers of asset backed securities to retain an economic interest in a portion of the credit risk for any asset that the issuer securitizes. MBA supports the concept of risk retention and believes Congress' intent in crafting Dodd-Frank's risk retention requirements was to address errant securitizer and originator behavior inherent in the originate-to-sell model by better aligning the interests of borrowers, lenders and investors in the long-term performance of loans.

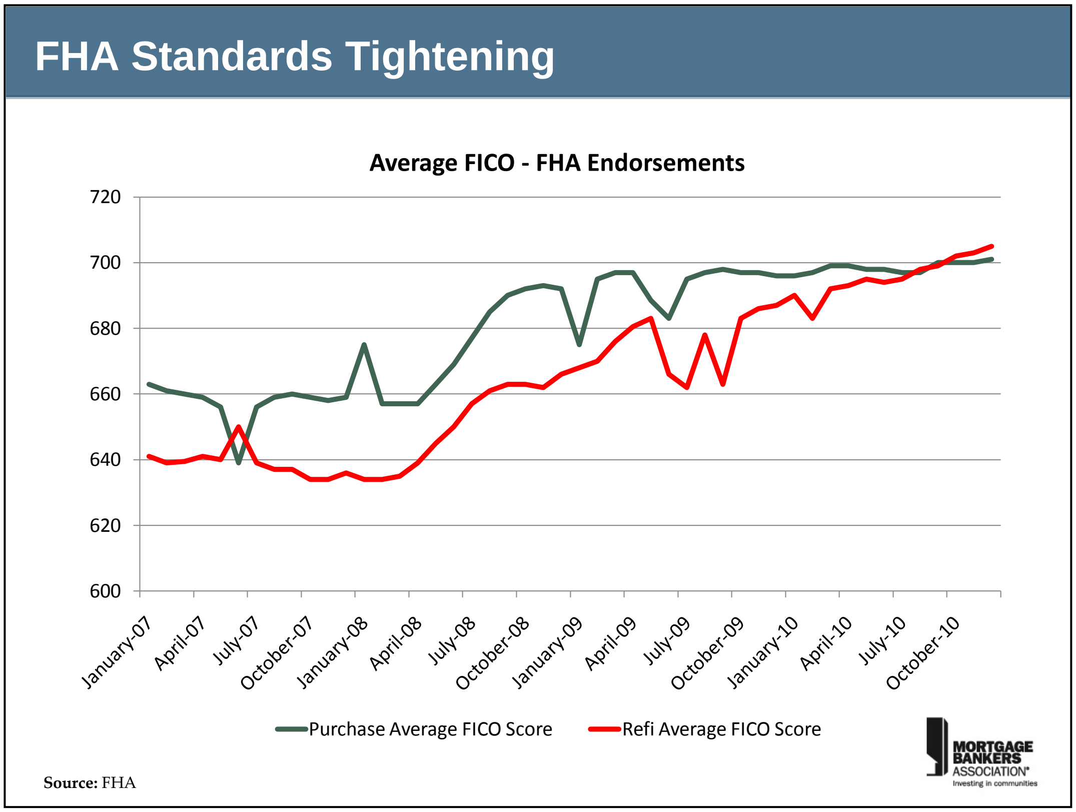
This "skin in the game" requirement, however, is not a cost-free policy option. Recognizing these costs, Dodd-Frank establishes an exemption from risk retention requirements for Qualified Residential Mortgages (QRMs). The QRM exemption was intended to recognize that traditional mortgage loans – standard products, properly underwritten and with appropriate documentation – were not the cause of the recent crisis, and securitization of these loans should remain unimpeded in order to return the U.S. mortgage securitization market to being among the most liquid in the world. By requiring a QRM exemption, the statute would keep consumer costs lower for QRMs, with higher costs for non-QRM loans. MBA believes the proposed regulations and structure of the QRM deviate significantly from what Congress intended and are likely to have a dramatic impact on the housing finance system unless they are substantially revised. MBA recommended several revisions to the proposed regulations in a comment letter submitted to federal regulators on August 1. MBA's statement today focuses on the impact of the proposed regulations on FHA.

It is not at all clear from the proposal whether the regulators reflected on the relationship between the proposed QRM definition and the FHA's eligibility requirements in light of FHA's statutory exemption from risk retention.

MBA shares the belief expressed by the Obama administration in its February 2011 report to Congress, *Reforming America's Housing Finance Market*, and countless others that the role of the government, including FHA, in the housing finance market must be rolled back. Yet, the proposed QRM definition produced by the six regulators appears to conflict directly with the administration's plan for reforming the housing finance system, as it would make it more difficult for private capital to re-enter the housing finance market.

We support FHA's role as a source of financing for first-time homebuyers and other underserved groups. However, because of the wide disparity between FHA's downpayment requirement of 3.5 percent and the currently proposed QRM requirement of 20 percent, MBA is concerned that the FHA programs will be over-utilized.

With the risk-management changes to FHA coupled with stricter underwriting standards by lenders, access to credit, even in the government-supported mortgage market, is tightening. Today, the average credit score for FHA borrowers is significantly higher than prior years, indicating lessening availability and affordability of sustainable mortgage credit for underserved and first-time homebuyers that FHA traditionally serves. We are seeing similar trends for conventional market loans backed by the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.



As the nation continues to work through the worst economic crisis in a generation, the MBA urges policy makers to allow the FHA to continue playing a countercyclical role by extending the higher conforming loan limits, which will be discussed later in this statement. In the long term, however, MBA firmly believes it is not in the public interest to allow government insurance programs like FHA to dominate the market, especially if private capital is available to finance and insure mortgages that exhibit a low risk of borrower default. We all share the belief that private capital must be given room to return to the market at the appropriate time and setting up a system where FHA logically becomes the primary source of mortgage financing will hinder the market recovery.

MBA also supports the FHA as a resource for low- and moderate-income buyers, including most first-time homeowners, and we urge policymakers to avoid taking steps that would eliminate access to FHA for those individuals – such as adopting a QRM definition with hard-wired characteristics that will make it more difficult to offer qualified consumers affordable mortgage products.

MBA suggests a better solution to meeting the requirements of Dodd-Frank is to allow the use of credit enhancements, such as private mortgage insurance, to offset part of the down payment requirement for QRMs to provide some of the financing for low down payment loans that FHA would provide.

Furthermore, MBA believes that the Qualified Mortgage (QM) proposal issued by the Federal Reserve is a better starting point for achieving Dodd-Frank's goal of ensuring that the market originates safe, sustainable mortgage products than the QRM proposal.

Section 1411 of Dodd-Frank prohibits making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated, that the consumer will have a reasonable ability to repay the loan, including any mortgage related obligations. Section 1412 provides that if the loan meets the QM definition, it is presumed to meet the ability to repay requirements. The CFPB is charged with prescribing rules to implement Section 1412.

By statute, FHA-insured mortgages – because of their stringent underwriting requirements and the statutory definition of points and fees – meet the definition of a QM.

MBA believes that because the QRM and QM constructs were intended to achieve the same purpose of ensuring better, more sustainable lending, both constructs should be essentially the same. If a QM definition is well structured as a bright line safe harbor, it will be the chosen means for lenders to comply and, therefore, the best way to incent the sound underwriting mandated by Dodd-Frank.

A QM safe harbor will increase the availability and affordability of credit for the largest number of qualified borrowers, without establishing hardwired numerical limits. The QRM proposal, on the other hand, would have the effect of excluding a large number of borrowers from the most affordable, sustainable mortgage products and directing them into FHA-insured mortgage products.

The Role of FHA in the Single and Multifamily Mortgage Markets

In May, Michael D. Berman, CMB, the Chairman of the MBA, had the opportunity to testify before this subcommittee on this important topic. Mr. Berman's testimony included an extensive discussion on the importance of FHA and Ginnie Mae and called on Congress to provide FHA the information technology and staffing resources it needs as it continues to play a countercyclical role in the nation's housing market, to restore housing counseling funding by fulfilling HUD's FY2012 budget request, and to revise the National Housing Act to allow table funding of FHA-insured mortgages by permitting former loan correspondents to close loans in their name rather than that of an FHA approved lender. In addition, Mr. Berman's testimony addressed several important topics: FHA's minimum downpayment requirement and FHA loan limits for both single and multifamily residences.

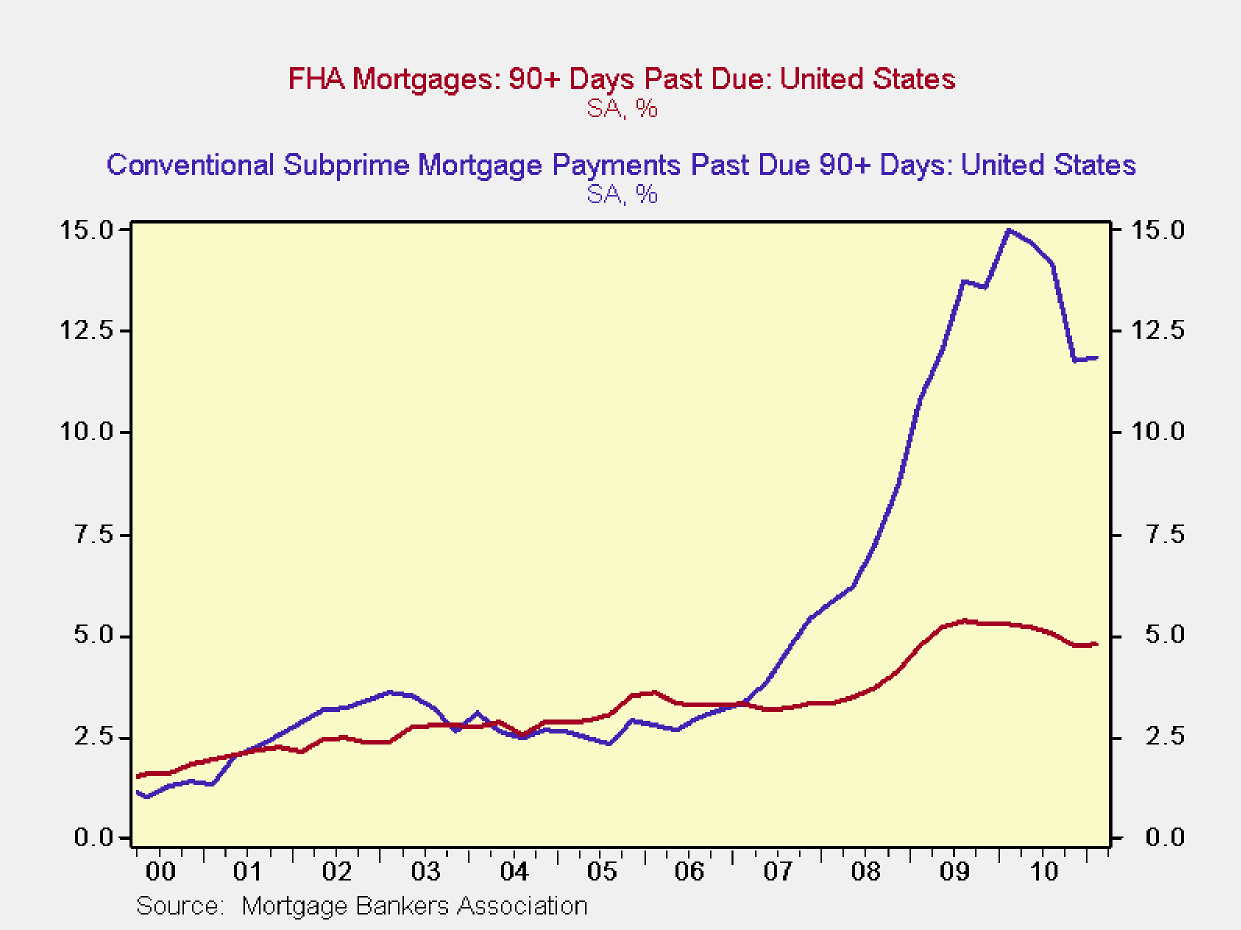
Maintain the Current Minimum Downpayment

A critical component of FHA's mission is to maintain the affordability of homeownership. The current minimum downpayment of 3.5 percent for borrowers with credit scores of 580 or above and 10 percent for borrowers with credit scores of 579 and below (a recent change to FHA policy) permits borrowers to have appropriate equity while providing credit-worthy homebuyers with an option for entering the purchase market. Maintaining the existing minimum downpayment requirements, while requiring strong underwriting standards, such as full documentation and income verification, allows borrowers to responsibly become, and stay, homeowners.

Recently, policymakers have focused on required minimum downpayments as a measure of what factors are necessary to create sound lending practices. MBA notes that data show that the principal determinant in the rate of default is the quality of underwriting standards, not the down payment. While loans with higher loan to value ratios may pose greater risks, these risks can be mitigated by compensating factors such as strong credit and appropriate documentation. Importantly, FHA's requirement of full documentation of all loans and limited loan product options helped insulate the MMI Fund from experiencing the devastating default rate during the height of the housing crisis. As the following chart below illustrates, for most of the past decade, FHA loans have performed better than subprime loans, with the exception being the years where FHA problems were dominated by the now defunct Seller-Funded Downpayment Assistance Program. Over the course of the crisis, delinquency rates on subprime loans have far exceeded rates on FHA loans.

FHA's traditional business has typically performed well and its product, credit, and documentation standards have been important contributors to this solid performance. And, even in the midst of this economic crisis, the quality of FHA borrowers has actually improved – with average borrower credit scores being the highest they have been in the history of the program.

MBA cautions policymakers to carefully weigh the socioeconomic costs of decreasing risk by raising the minimum down-payment versus the certain and dramatic negative impact on the availability of loans to low-to-moderate, first-time, and minority homebuyers.



Loan Limits

The discussion draft bill that is the topic of today's hearing would change the calculations of the FHA single-family loan limits to 125 percent of the area median home price of each county, not to exceed the GSE loan limit of the area.

Preliminary calculations indicate that the impact of this would be a decrease in consumer buying power in most areas across the nation. During this time of constriction in the credit markets, the MBA would urge the subcommittee to reconsider this proposal, which would severely limit access to mortgage credit to millions of borrowers.

The maximum loan limits for Fannie Mae, Freddie Mac, and FHA are currently $417,000 with a temporary limit of up to $729,750 for one-unit properties in high-cost areas. The temporary high-cost area limit was first set in the Economic Stimulus Act of 2008, and was extended in subsequent legislation. These limits expire on September 30, 2011. Without an extension, the high-cost loan limit ceiling would revert back to the limits established under the Housing and Economic Reform Act of 2008 (HERA), a maximum of $625,500 in high-cost areas. This would mean that FHA-insured loans would be available to fewer individuals seeking to buy or refinance homes in certain parts of the country.

The Obama administration stated in its housing finance reform white paper that it will not support another extension of the higher loan limits and MBA understands that many in Congress agree with this position. At the time that document was authored, however, the expectation was that the economy had reached bottom and that the nation was poised for economic growth. Unfortunately, that has not been the case.

While in the long term the MBA would like to see a reduction in the conforming loan limits so that the federal government's footprint in the housing finance market can be reduced, in the short term a reduction in the loan limits will ultimately result in less access to mortgage credit across America. Therefore, MBA believes the higher limits should be maintained until the housing market stabilizes and the private market shows more signs that it has returned and is willing to lend to a full range of credit worthy borrowers in communities across the nation.

Importantly, if Congress elects to provide another temporary extension to the higher loan limits, MBA would urge that legislation be enacted quickly to avoid further market disruption. Due to the uncertainty surrounding this issue, many lenders have already curtailed originations in an effort to ensure timely closings.

Increase Multifamily Loan Limits

FHA's statutory limits for multifamily financing, while sufficiently high in most markets, are severely restricting the ability of rental property owners in high-cost urban markets to use FHA insurance programs. In the prior Congress, MBA worked with the House to pass H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act of 2009, on September 15, 2009, and as an amendment to H.R. 5072, the FHA Reform Act of 2009, on June 10, 2010. These bills, along with S. 3700, which was introduced in the Senate on August 4, 2010, would have increased the FHA loan limits for elevator properties in extremely high-cost areas. Because many MBA members originate loans in markets with higher labor, material, regulatory and land costs, there is a gap between the mortgageable amount needed to finance construction or substantial rehabilitation of units in the nation's major cities and HUD's statutory loan limits for multifamily properties. High-rise elevator buildings also serve the senior population, especially in older urban markets. MBA strongly supports providing the HUD Secretary additional discretion to be used in extremely high-cost areas (similar to that provided in Alaska and Hawaii today).

Conclusion

We urge Congress to remain vigilant in its regulatory oversight to make sure that efforts to provide a safe and sound housing market do not lead to an overreaction that risks making sustainable mortgage credit unnecessarily costly and unavailable to far too many families.

MBA believes the proposed risk retention and ability to pay regulations would lessen competition, increase the cost of credit, and harm the very people they were designed to protect. We believe significant adjustments must be made in concert with, or at least conducive to, comprehensive reform of the government's role in the housing finance system in order to facilitate the provision of sustainable mortgage credit to the widest array of qualified borrowers at the most affordable costs.

We respectfully urge Congress to carefully monitor these and other regulations implementing Dodd-Frank to make certain they do not unwittingly harm American families, the mortgage market or the nation's economic recovery. These factors are particularly important as this subcommittee continues its examination of potential changes to the FHA, RHS, and Ginnie Mae program areas.