Testimony of Jerry Howard

On Behalf of the

National Association of Home Builders

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"Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform – Part II"

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Chairman Duffy, Ranking Member Cleaver and members of the Subcommittee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on housing finance reform. My name is Jerry Howard and I am NAHB's Chief Executive Officer.

NAHB represents over 140,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's members construct approximately 80 percent of all new housing in America each year. Our builders rely on both government and private programs to help provide decent, safe, and affordable single family and multifamily housing to many of our fellow citizens.

We believe an effective housing finance system must address liquidity as well as affordability and that those two elements are very closely related. Therefore, while it is important the system provide housing credit at affordable terms as well as address specific housing needs, it also is essential that credit is consistently available on those terms regardless of domestic and international economic and financial conditions.

NAHB remains a staunch supporter of comprehensive housing finance system reform. To NAHB this means effective reform of the conventional mortgage finance market, including Fannie Mae and Freddie Mac (the Enterprises), private capital sources and federal mortgage finance programs, in particular the U.S. Department of Housing and Urban Development (HUD), (most involving the Federal Housing Administration, FHA), the U.S. Department of Agriculture's Rural Housing Service (RHS) and the U.S. Department of Veteran's Affairs (VA). NAHB believes comprehensive reform must come through Congress and focus on fixing the structural flaws that led to the breakdown of the housing finance system. Comprehensive legislation is the only way to ensure a stable housing finance system, preserve access to credit and protect taxpayers.

Need for Comprehensive Housing Finance System Reform

In September, Fannie Mae and Freddie Mac completed their ninth year in conservatorship under the control of their regulator, the Federal Housing Finance Agency (FHFA). NAHB believes strongly that having the Enterprises continue in conservatorship, with no end in sight, is undesirable and unsustainable.

Under the terms of their conservatorships, the Senior Preferred Stock Purchase Agreements (PSPAs), the Enterprises are required to remit all their profits, above a small capital buffer, to the U.S. Department of the Treasury (Treasury) on a quarterly basis and reduce their capital buffer to zero by January 1, 2018. Since being placed in conservatorship, the Enterprises have paid Treasury a combined $270.9 billion. Significantly, this does not count as repayment for the $189.4 billion (including the initial $2 billion) of the capital support provided by Treasury. The Treasury has a remaining outstanding commitment of $258.1 billion available to the Enterprises to draw down. It is this commitment from Treasury that is supporting investor confidence in the Enterprises' mortgage-backed securities (MBS) and keeping the housing market liquid and operational.

While Fannie Mae and Freddie Mac are not granted an explicit government guarantee by their charters, Treasury's backing has turned the Enterprises' historical implicit guarantee into an explicit government guarantee. The Enterprises currently back over $5 trillion in mortgages. Combined with Ginnie Mae securities, which are backed by loans insured by FHA, RHS and mortgages guaranteed by VA, outstanding securities in the agency market totaled $6.29 trillion in September 2017, a significant percentage of the entire U.S. economy. These loans all have a federal government backstop, which means taxpayers are at risk of loss due to a failure of the underlying mortgage loans. FHFA has taken steps to reduce taxpayer risk on Fannie Mae- and Freddie Mac-backed loans through Credit Risk Transfer (CRT) programs that transfer a meaningful portion of credit risk to private investors on at least 90 percent of their targeted fixed-rate single family mortgage acquisitions.

As 2018 approaches, many industry participants, including FHFA Director Mel Watt, are expressing concerns about the impact the reduction and eventual elimination of capital reserves could have on the Enterprises and the mortgage and financial markets broadly. While Director Watt has steadfastly maintained it is the role of Congress, not FHFA, to make housing finance reform decisions, he believes it is irresponsible for the Enterprises to have such a limited capital buffer because a loss in any quarter could result in an additional draw of taxpayer support and a corresponding reduction in the fixed dollar commitment Treasury has pledged to support the Enterprises.

While some have called on FHFA to allow Fannie Mae and Freddie Mac to recapitalize in an effort to avert the need for further draws from Treasury, NAHB believes this constitutes a piecemeal approach to reform and would be counterproductive to long-term sustainability. Allowing the Enterprises to recapitalize would encourage their release from conservatorship prior to meaningful reform and would reestablish the “failed GSE model” that allows private gains and public losses.

Congressional action on comprehensive housing finance reform is the <u>only</u> way to achieve an effective and sustainable solution. To ensure a stable housing finance system that will support the future of homeownership and affordable multifamily housing in America, Congress must fix the structural flaws inherent in Fannie Mae’s and Freddie Mac’s government charters that contributed to the housing finance crisis. Short-term regulatory solutions or piecemeal legislative steps are not adequate.

As talk of a possible draw from Treasury continues, NAHB calls on Congress to make comprehensive housing finance reform a top priority and pass legislation to ensure the federal government continues to provide a backstop for a reliable and adequate flow of affordable housing credit in all economic and financial conditions.

NAHB's Key Elements for a Reformed Housing Finance System

NAHB believes the U.S. housing finance system should be multifaceted with both competing and complementary components, including private, federal and state sources of housing capital. Key elements of NAHB’s specific policy proposals covering both single family and multifamily housing are summarized below. The full details of NAHB’s housing finance system recommendations are contained in NAHB's white paper, *"Why Housing Matters: A Comprehensive Framework for Housing Finance System Reform."* [1]

Importance of Federal Government Backstop and the 30-year Fixed-Rate Mortgage

As stated earlier, NAHB's priority in housing finance system reform is ensuring liquidity for the housing sector in all markets throughout the economic cycle. This is only possible if market participants know there is a federal government backstop that will maintain stability in catastrophic circumstances. While NAHB agrees that the current degree of government intervention is unsustainable, an ongoing, though more limited, government role must be maintained to avoid future interruptions in the flow of credit to mortgage borrowers.

While NAHB agrees that private capital must be the dominant source of mortgage credit, the future of the housing finance system cannot be left entirely to the private sector. The historical track record clearly shows that the private sector is not capable of providing a consistent and adequate supply of housing credit without a federal backstop.

NAHB believes federal support is particularly important in continuing the availability of the affordable 30-year fixed-rate mortgage (FRM), which has been a staple of the U.S. housing finance system since the 1930s. These loans are geared toward affordability; 30-year terms lock in low monthly payments, allowing households with average incomes to comfortably budget for their home loan. Knowing their monthly housing costs will remain the same year in and year out regardless of whether interest rates rise provides households with a sense of financial security and also acts as a hedge against inflation. Many young buyers know that as their incomes rise, their housing costs will stay constant and become less of a burden, enabling them to prepare for other long-term obligations, such as college tuitions and retirement savings. In most instances, all of the interest and property taxes borrowers pay in a given year can be fully deducted from their gross income to reduce taxable income. These deductions can result in thousands of dollars of tax savings, especially in the early years of a 30-year mortgage when interest makes up most of the payment.

The key to the sustainability of the 30-year FRM is a securitization outlet because originators (banks and thrifts) do not have the capacity to hold such long-term assets which are funded with short-term deposits. Currently, Fannie Mae and Freddie Mac provide the securities vehicle along with a government guarantee for investors. There are serious doubts on whether a private housing finance system would be capable of supporting this type of product without some government backing. At a minimum, the cost and terms of 30-year FRMs would be significantly less favorable under a totally private system.

A government role is also essential for multifamily mortgage programs that also play a critical role in the overall health of the U.S. housing finance system. More than one-third of Americans live in rental housing and demand for rental housing in the future is expected to increase. As discussed further below, the multifamily sector performed much better than the single family housing market during the recent downturn. Multifamily loans held or guaranteed by Fannie Mae and Freddie Mac have very low default rates and the multifamily segments of both

[1] *"Why Housing Matters: A Comprehensive Framework for Housing Finance System Reform"*, published by NAHB in September 2015.

Enterprises are profitable. FHA also provides support to the multifamily market through the FHA multifamily mortgage insurance programs. Private market financing is not readily available for all segments of the multifamily market. Thus, there is a need to maintain a viable, liquid and efficient secondary market for multifamily rental financing where the federal government continues to play a role.

Reformed Secondary Market System for Conventional Mortgages

NAHB believes it is essential to have an efficient and stable secondary market where conventional single family and multifamily mortgages are aggregated and placed into diversified pools for securitization and sale to investors worldwide. The securities would have an explicit federal government guarantee. However, the federal support to the conventional mortgage market of the future should be limited to catastrophic situations where carefully calibrated levels of private capital and insurance reserves are depleted before any taxpayer funds are employed to shore up the mortgage market. This would be done by creating a privately funded insurance pool for conventional MBS that would be similar to the insurance fund that secures savings deposits through the Federal Deposit Insurance Corporation (FDIC).

Under this approach, private Housing Finance Entities (HFEs) would be authorized to purchase mortgages from loan originators and to package the loans into securities. Only mortgages with reasonable and well understood risk characteristics would be eligible to serve as collateral. The originators and HFEs would be required to maintain capital to cover a portion of the credit risk on the pooled mortgages, with private mortgage insurance required on higher loan-to-value mortgages. The HFEs and originators also would pay premiums into the insurance fund that would provide additional protection to MBS investors. The federal government would ensure that the fund is actuarially sound and would stand behind the insurance fund in a catastrophic last tier position. This would provide securities investors a guarantee similar to the successful Government National Mortgage Association (Ginnie Mae) model.

<u>The Enterprises could be recast as HFEs</u>

Fannie Mae and Freddie Mac could be brought out of conservatorship and restructured as HFEs alone or with other participants. The Enterprises would be subject to the same rules, including safety and soundness and capital requirements, as all HFEs, and would be provided the protection and opportunities of the federal catastrophic backstop. Most important, the Enterprises' infrastructure should be utilized one way or another regardless of the ultimate future of Fannie Mae and/or Freddie Mac. During the more than four decades of their existence prior to conservatorship, the Enterprises developed sophisticated infrastructures of products, programs, and processes, including underwriting and servicing requirements, which should be used to form the foundation of a new system. The Enterprises recent risk-sharing initiatives in the single family market also should be retained and enhanced. This would ensure less market disruption in the transition to the new system.

The HFE conventional mortgage securitization system should operate under the oversight of a strong independent regulatory agency to ensure all aspects of safety and soundness. The agency also would oversee the federal conventional MBS insurance fund. The regulatory agency should be governed by a board, similar to the body governing the FDIC, with extensive expertise in the housing capital markets and housing finance needs.

Any changes to the housing finance system should be undertaken with extreme care and with sufficient time to ensure that U.S. home buyers, owners, and renters are not placed in harm's way and that the mortgage funding and delivery system operates efficiently and effectively as the old system is wound down and a reformed system is put in place. Every effort should be made to reassure borrowers and markets that credit will continue to flow to creditworthy borrowers and that mortgage investors will not experience adverse consequences as a result of changes in process.

Restart a Carefully Regulated Fully Private Mortgage-Backed Securities System

The HFE conventional MBS would operate in tandem with a fully private MBS system. A robust market for private label MBS will be critical to the availability of mortgage products that do not conform to the underwriting and credit guidelines of mortgage loans that will be eligible for purchase by HFEs or insured or guaranteed by FHA, USDA and VA. The government guaranteed and non-guaranteed market segments can and should complement each other by specializing in distinct market niches while also competing on price and product for overlapping market segments.

During the housing recession, private-label securities (PLS) investors experienced significant losses, and an unprecedented level of mortgage defaults exposed problems with the agreements governing PLS. As a result, PLS issuances dropped significantly after 2006 and continue to be very small today. The PLS share of all residential mortgage-backed securities (RMBS) was 2.9 percent in the first nine months of 2017.

Private capital must be encouraged to reenter the mortgage market. However, without reforms, private capital is not incented to compete in today's market where the federal government backstop and bank portfolios provide a pricing advantage, and where structural and policy uncertainties exist.

Key prerequisites to restarting the private-label MBS market include: increasing transparency and disclosure around the collateral and structure of private label securities; clarifying servicing roles and responsibilities; and, ensuring that all participants operate under adequate regulation and have a stake in the performance of the mortgages that are originated and sold. The credit ratings process must be reformed to address conflicts of interest and provide investors assurance that their interests and rights are protected.

Continue the Roles of the Federal Government Housing Agencies

The housing finance support roles of HUD, FHA, VA, RHS and Ginnie Mae should be preserved. These agencies provide crucial counter-cyclical support to the housing market, expanding in downturns and contracting when the market improves. During the recent mortgage crisis, FHA demonstrated how invaluable its counter-cyclical support was in providing access to homeownership for underserved communities, primarily first-time home buyers, minorities and those with limited downpayment capabilities. As other sources of mortgage credit disappeared, FHA's share of the single family mortgage market jumped from 3 percent during the housing boom to a high of almost 30 percent early in the crisis before receding to around 15 percent of today's purchase housing market. FHA should have the ability to temporarily expand its support in cyclical downturns by loan limit and other programmatic changes as was done in the recent housing crisis.

Efforts should continue to make the operations of these agencies more efficient and effective. FHA's operations, in particular, must be modernized to allow the agency to operate more efficiently and effectively. Too many constraints have been placed upon FHA, by Congress and internally via HUD, which inhibit FHA's ability to operate in a manner that recognizes, complements and evolves with developments by the private sector. To continue its vital role in the housing finance arena, FHA must be afforded greater freedom from external micromanagement and political influence while developing a professional, responsive, results-oriented culture and remaining accountable for achievement of its mission.

FHA should have the authority, without further Congressional action, to create or alter specific insurance programs in order to have the flexibility to react promptly to changes in market and other conditions. Hiring, salaries, personnel management, and procurement would be freed from current, confining federal government constraints in order to be more consistent and competitive with the private sector. FHA would be operated in a manner that does not require a federal subsidy and would allow FHA to retain revenues generated in excess of expenses to be used for mission purposes.

Further, NAHB urges Congress and policymakers to evaluate any changes to FHA or other government housing agencies within the context of other changes that have occurred, or may occur, within the agency and in the broader housing finance system. Changes must be assessed in terms of the cumulative impact on all components of the housing finance system, including the interplay among housing finance sectors.

Finally, NAHB encourages greater coordination between FHA and RHS on issues related to risk management and streamlining of administrative practices and procedures in some program areas, such as FHA multifamily mortgage insurance and rental housing assistance. However, NAHB does not support the transfer of RHS programs to FHA. The RHS programs are uniquely structured to address the housing credit needs of low and moderate income persons in rural areas, which are very different than those found in urban and suburban areas.

Enhance Roles of State and Local Housing Finance Agencies

State and local housing finance agencies have proved critical in helping communities continue to meet the needs of consumers who have faced hardships in the face of less credit availability. State and local housing finance agencies utilize tax-exempt bonds and taxable securities as well as state and federal resources to offer a range of single family and multifamily funding programs.

The recent economic crisis significantly diminished investor interest in mortgage revenue bonds (MRBs) and therefore severely limited the amount of funds available to finance affordable home mortgages and multifamily loans. The stress in the economy pressed HFAs to consider new ways of doing business, such as alternative bond financing programs. In addition, HFAs have increasingly turned to MBS execution through Ginnie Mae as an alternative funding source. Efforts to address problems in the tax-exempt MRB market and to facilitate new HFA financing products should be encouraged.

HFAs are uniquely positioned to assess community housing needs and should play an even more prominent housing finance role through the development of new programs for new, for-sale housing and multifamily rental homes. This should include partnering with federal and private providers of housing capital.

Expand Role of the Federal Home Loan Banks in the Housing Finance System

The Federal Home Loan Banks (FHLBanks) should continue their current activities to serve as an ongoing key liquidity source for institutions providing housing credit. The eleven FHLBanks currently operate by making collateralized loans to, and mortgage purchases from, member financial institutions, funded by debt offerings. Each FHLBank is a cooperative enterprise, which is owned by the commercial banks, thrift institutions, credit unions and insurance companies that utilize the FHLBank as a source of funds.

The principal business of the FHLBanks is extending to their members loans, called advances, which are collateralized by mortgages and other eligible assets in the portfolios of borrowing institutions. Most FHLBanks also have operated or participated in mortgage purchase programs, where the FHLBanks buy mortgages from member institutions to hold in portfolio. FHLBank advances and mortgage purchase activities are funded by debt offerings for which all eleven FHLBanks are responsible on a joint and several basis and which are managed by an Office of Finance.

Existing programs, such as the FHLBanks' mortgage purchase programs, should be enhanced by allowing the FHLBanks to have greater options for managing their balance sheets, consistent with safety and soundness. Further, the FHLBanks should develop additional programs to leverage their strong understanding of regional housing conditions and needs. Specifically, the FHLBanks should be authorized to engage in additional activities, including purchase of multifamily mortgages, and services to support a full range of housing-related lending by their members.

The FHLBanks also have been cautiously expanding their role in the housing finance system through pilot programs developed to help their members sell mortgage loans in the secondary mortgage market. FHLBanks could expand their mortgage programs by aggregating loans for sale to HFEs. Alternatively, one or more FHLBanks could be restructured as HFEs, subject to the same requirements and protections of all HFEs.

Reform of the housing finance system must carve out a role for the FHLBanks. NAHB could support an expanded role as long as any new lines of business, new mortgage programs or statutory changes to the FHLBank charters are considered carefully in order to avoid unintended consequences that might conflict with the FHLBanks' existing authorities and primary activity of providing advances to members. Further, changes to the housing finance system must be undertaken in a manner that will not diminish the favorable cost of funds for the FHLBanks or impair the role of the FHLBanks in supplying liquidity to institutions providing mortgage and housing production credit, support for community and economic development, and resources to address affordable housing needs.

Access to Affordable Credit

In a future housing finance system, where several layers of private capital stand in front of a government backstop for catastrophic circumstances, the relative cost of housing credit would increase from current levels as home buyers ultimately bear the charges needed to attract the private capital and cover the cost of the government guarantee. However, NAHB believes that such a system would entail lower housing credit costs than one that relied exclusively on private players. Also, as mentioned previously, a completely private system likely would be subject to inconsistent credit availability.

With the prospect of higher mortgage borrowing costs, NAHB believes it is extremely important to make every effort to ensure that mortgage interest rates and fees do not increase more than is absolutely necessary to safely sustain the new system. It is important to base federal guarantee/insurance charges on the universe of mortgage products and underwriting requirements that will be in place in the future rather than on products and protocols that are no longer in existence. Careful study should be undertaken to determine the level of private capital and federal guarantee/insurance charges that are needed for a safe, sound and sustainable future housing finance system.

Equal Playing Field for Small Lenders

To ensure the future housing finance system serves all markets, broad market participation should be encouraged. Barriers to entry to the secondary market should be a low as possible while balancing safety to the system. Compliance with regulatory requirements should not be more burdensome for smaller lenders – recognizing the unique role many small lenders have carved out for their communities.

As the name implies, community banks offer financial services designed to meet the specific needs of their unique local markets. They are known particularly for serving rural areas and traditionally underserved markets. In the current environment of increased regulatory compliance requirements, tighter underwriting standards, and overall less availability of mortgage credit, it is important to be vigilant about the impact of housing finance reform on community banks and the mortgage borrowers they serve. Meeting the needs of their communities can mean these institutions are not originating standard products that can be sold in the secondary markets. This inability or difficulty to sell their loans to the secondary market can restrict their primary market activity.

While not having the dominant share of mortgage originations, community financial institutions originate a significant volume of mortgage loans. Over the years, community banks have sold their loans to large aggregators, including Fannie Mae and Freddie Mac, and have paid higher fees based on smaller volumes. In a reformed housing finance system, access and pricing should not be based on the volume of business or size or geographic location of the selling institution.

Preserve the Successful Multifamily Housing Finance Framework

It is important to understand that not all private market sources of capital for multifamily financing are available for all segments of the multifamily market. Each has strength in specific niches and markets and thus moves in and out of the market as economic conditions and their investment goals change. Life insurance companies typically target low-leverage, high-quality deals in the strongest markets (usually urban) and typically serve the highest income households. Once they meet their own portfolio investment targets, life insurance companies retract their lending. Banks do not provide long-term financing and are subject to significant restrictions in terms of capital requirements. Banks also have significant exposure to regulatory pressure that influences their lending decisions, including obligations under the Community Reinvestment Act (CRA). While the commercial mortgage-backed securities (CMBS) market was significant at one time, it has not recovered from the financial crisis and is not expected to resume its past levels of volume.

These facts point to the need to maintain a viable, liquid and efficient secondary market for multifamily rental financing where the federal government continues to play a role. In addition, the secondary market must be structured to ensure that the appropriate range of products is available to provide the capital needed to develop new and to preserve existing rental housing, as well as to refinance and acquire properties. An adequate flow of capital will ensure that demand for rental housing is met and that affordable options are available for a range of households and communities.

NAHB cautions against over-reaching in regard to reforming the multifamily finance system. This component of the nation’s housing finance system has performed, and continues to perform, very well. Housing finance reform should preserve the successful framework of the current system—including the federal backstop for conventional and federally insured multifamily mortgages. Taking draconian steps to “fix” an unbroken system is unwise and unnecessary. Again, NAHB believes that the critical consideration in a new system is broad and continued liquidity during all economic cycles and for all geographic areas.

Preserve Successful Infrastructure and Programs from the Conventional Market

It is absolutely critical that the Enterprises, or successor entities, provide broad liquidity to the market during all economic cycles. To achieve this mission, the Enterprises must continue to offer a diversified line of products and retain the ability to address financing for a large range of multifamily property types.

As noted earlier, in spite of the crisis that affected single family housing, the multifamily sector has performed well. Multifamily loans held or guaranteed by Fannie Mae and Freddie Mac have very low default rates, and both businesses are profitable. Both of the Enterprises’ multifamily businesses involve risk-sharing with private capital, and both businesses have practiced disciplined underwriting. In addition, because of the range of products and business lines employed by the Enterprises, a wide range of multifamily rental properties that provide housing for very-low to middle income households can be financed in the conventional market. NAHB strongly supports retention of the successful infrastructure, products and programs that have been built over the years by the Enterprises and which are used as the core of most of the major financial institutions providing multifamily debt financing.

In the unlikely event that Fannie Mae and Freddie Mac are wound down, NAHB does not believe it would be practical for the regulator to absorb and run the Enterprises' multifamily businesses. A more practical option would be to transition the Enterprises' multifamily businesses to private entities, which would then be allowed access to the federal government guarantee.

Federal Multifamily Housing Programs

NAHB's members utilize a number of federal programs administered by federal agencies. The multifamily housing finance support roles of federal agencies, such as HUD, FHA, RHS and Ginnie Mae should be preserved. These agencies have been an important support for multifamily housing for many years. They continue to play an essential counter cyclical role in meeting America's affordable housing needs by expanding in downturns and contracting when the market improves.

Of particular importance to NAHB's multifamily members are the FHA multifamily housing mortgage insurance programs. FHA provides an explicit federal government guarantee on multifamily loans for which borrowers pay a mortgage insurance premium set by HUD. The largest of these programs are the Section 221(d)(4) program, which insures mortgages for new construction and substantial rehabilitation projects, and the 223(f) program, which insures refinanced mortgages. FHA multifamily loans have performed well with low default rates. The multifamily mortgage insurance programs generate significant revenue to the federal government in the form of a negative credit subsidy, generating positive cash flow to the U.S. Treasury.

Any reforms to FHA must build on the positive characteristics of this government entity. NAHB strongly supports FHA's mission to support liquidity, innovation and continuity in the housing finance markets by providing mortgage insurance backed by the full faith and credit of the U.S. government, as well as its counter-cyclical role to promote stability in the housing market. Further, NAHB supports prudent underwriting criteria that consider the availability of FHA-insured mortgages and protections for taxpayers. Moreover, we support the continued funding of FHA through borrower-paid mortgage insurance premiums and the fiscally responsible operation of FHA in a manner that does not require a federal subsidy.

Considering the important role FHA plays in providing liquidity to the multifamily mortgage market, NAHB cautions against imposing new mandates on FHA that would unintentionally inhibit the Agency's mission. For example, NAHB does not support setting occupancy and rent restrictions based on area median income (AMI) for the FHA multifamily mortgage insurance programs. These programs are a key source of liquidity, so the imposition of income limits would impede that portion of FHA's mission, particularly in higher-cost markets. The FHA multifamily mortgage insurance programs are subject to statutory mortgage loan limits, which effectively serve to focus the provision of FHA multifamily mortgage insurance on affordable and workforce rental housing. Imposing burdensome provisions that require developers, lenders and property managers to track and document incomes and rents on unsubsidized properties is costly and unnecessary, given that the proposed targeted population is already being served by the programs.

Affordable Housing

For far too many Americans, the housing affordability crisis is all too real. This is particularly true for very-low income renters, or, those renters whose incomes do not exceed 50 percent of the area median income. HUD's recent report to Congress entitled *Worst Case Housing Needs 2017*[2] found that 8.3 million households had "worst-case housing needs" in 2015, meaning they were very low-income renters who did not receive government housing assistance and paid more than half their income for rent, lived in severely inadequate conditions, or both. This latest figure is the second-highest number of households recorded. The highest number of renters with worse case housing needs was 8.5 million in 2011. While incomes rose between 2013 and 2015, rents also increased nearly as fast. For the poorest renters, growth in rental costs outpaced income gains.

Federal Government Role in Addressing Affordable Housing

The federal government has an important role to play in addressing this crisis. NAHB calls on Congress and the Administration prioritize enactment of policies that will promote the construction of sorely needed rental apartments. Access to capital is a key component of this production strategy. To assist the poorest of the poor, a rental subsidy is necessary.

Specifically, NAHB is urging Congress and the administration to:

- Approve the Affordable Housing Credit Improvement Act to strengthen the Low Income Housing Tax Credit Program (Senate bill S.548 and House bill H.R. 1661).
- Provide a strong fiscal 2018 budget for HUD, which funds the HOME Investment Partnerships (HOME) Program, the largest federal block grant to state and local governments designed exclusively to create affordable housing for low-income households and the Community Development Block Grant (CDBG) Program.
- Provide full funding to renew contracts for crucial rental assistance programs such as the Housing Choice Voucher Program, Project-Based Rental Assistance and Rural Rental Assistance.

Each of these programs serves an important purpose. They are not interchangeable, but are complementary. Different strategies are necessary to meet the housing needs of households with different income levels and in different parts of America. The array of federal government programs that have been developed over the years in response to identified needs are essential elements in ensuring that there are affordable options for providing housing. Steps should be taken to make the operations of these agencies more efficient and effective.

Fannie Mae and Freddie Mac Support for Affordable Housing

In the conventional market, the Enterprises are also required to support affordable housing. Under the current regulatory framework, Fannie Mae and Freddie Mac provide liquidity to support affordable housing through their affordable housing goals, their Duty to Serve

[2] Worst Case Housing Needs 2017, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, Preface. (August 9, 2017)

Underserved Markets, and incentives provided under the exclusions from the multifamily volume caps.

Pursuant to the Housing and Economic Recovery Act of 2008 (HERA) and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act), FHFA must establish, monitor and enforce annual housing goals for the Enterprises. These goals include separate categories for purchases of single-family and multifamily mortgages on housing that is affordable to low-income and very low-income families, among other categories. If FHFA determines that the housing goals cannot be met consistent with HERA's requirements, it may suspend the goals until they can be achieved.

Because FHFA has historically taken a conservative approach to setting the multifamily goals, NAHB urged the Agency to consider more aggressive targets. It is important that the Enterprises' goals are challenging, but reasonably so. Both Enterprises' multifamily businesses have done very well financially, and meeting these goals has not negatively affected safety and soundness. We believe our request is reasonable when weighed against the strong need for affordable housing, the Enterprises' performance over the last five years and the incentives Fannie Mae and Freddie Mac receive to support affordable housing.

The Enterprises' Duty to Serve Underserved Markets (Duty to Serve), was mandated by HERA and the Safety and Soundness Act. The Duty to Serve calls for Fannie Mae and Freddie Mac to increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing for very low-, low-, and moderate-income families in the manufactured housing, affordable housing preservation and rural markets. The Enterprises must serve these markets in a safe and sound manner. The Enterprises must explain their plans for serving these markets and populations in Underserved Market Plans, which are subject to public comment and FHFA approval.

In their Plans, the Enterprises proposed many positive initiatives they, or their successors, should be free to pursue. For example, NAHB supports the Enterprises' proposals to reenter the Low Income Housing Tax Credit (LIHTC) equity investment markets. Likewise, NAHB applauds the Enterprises' initiatives to support small multifamily properties with 5 to 50 units, as well as programs to support small financial institutions having assets of $304 million or less. Small, multifamily rental properties would benefit from sale to the secondary market. Targeting purchases from smaller local and regional banks and community-based lenders who are attempting to meet the financing needs of small multifamily property owners could provide a boost to the liquidity of loans on small multifamily properties and increase affordability of the units. Incenting the Enterprises to purchase small multifamily rental properties from this niche group of small financial institutions also serves as a way to encourage the Enterprises to engage with these small institutions and may lead to additional support for mortgage and small business lending by these institutions. We also support the Enterprises' securitization proposals for small multifamily properties.

Finally, FHFA regulates the Enterprises' multifamily market share by capping dollar volume originations, and quarterly review based on market share. NAHB would prefer the volume caps to be lifted altogether. If they must be continued, however, the current exclusions should be retained for loans on targeted affordable, small multifamily (5-50 units), rural, energy efficient, senior housing / assisted living properties and manufactured housing rental community blanket loans.

Going forward, Fannie Mae and Freddie Mac (or successor entities) must continue to meet an affordable housing mission. The Enterprises' support to these market segments is critical, perhaps even more so as access to mortgage credit continues to be tight. NAHB's economic forecasts, like FHFA's, predict mortgage interest rates will rise through 2019, which will have a negative impact on affordable housing opportunities for low-income and very low-income households.

The Enterprises, or their successors, should demonstrate leadership in affordable multifamily housing by providing liquidity and supporting housing for tenants at different income levels in various geographic markets and in various market segments. In addition to serving families at 80 percent and 50 percent of area median income, NAHB believes it is crucial to ensure the Enterprises have the flexibility and incentives to provide greater support to workforce housing that serves moderate-income families as well.

Further, Congress and regulators should resist the temptation to impose income or rent restrictions on loans or requirements to use inflexible standardized products as a condition of access to a federal government backstop. Loans should be financed to ensure long-term financial and physical viability of the property, and loan products should be available to both non-profit and for-profit providers on an equal basis.

Appraisal System Reform

The process to evaluate the collateral supporting real estate transactions is an important component of the overall housing finance system and improving the appraisal process should be considered in housing finance reform discussions. Today's residential appraisal system remains in a state of uncertainty. The current patchwork system cannot continue indefinitely. A key consideration must be to establish stability and restore confidence in the system that determines the value of mortgage collateral.

The current residential appraisal system is impaired due to inconsistent and conflicting standards and guidance; inadequate and uneven oversight and enforcement; a shortage of qualified and experienced residential appraisers; and the absence of a robust and standardized data system. NAHB believes these problems must be addressed in order to restore confidence in the residential real estate market and to establish a foundation for sustainable growth of the U.S. economy. This can only be accomplished through sound valuation practices, policy, and procedures that produce more credible valuations under all economic circumstances.

NAHB is a strong proponent of a sound and effective appraisal system. NAHB has been a leading advocate for improving the valuation process and has undertaken a number of actions to raise awareness and address the adverse impacts from inaccurate appraisals on the housing sector, and has engaged with appraisal and financial industry stakeholders in identifying areas in need of improvement. NAHB believes that fundamental appraisal system reform must be a principal element of efforts to rebuild the nation's housing finance system. Coordination and accountability currently are lacking and there are major gaps in the system.

NAHB Activities

NAHB has been significantly engaged on this issue since the financial crisis. NAHB conducted five Appraisal Summits to provide opportunities for the agencies and organizations that establish appraisal standards and guidelines to join housing stakeholders in a constructive dialogue on major appraisal topics of concern. The goal of the Appraisal Summits was to bring all the interested parties together to identify recommendations and solutions that participants could jointly pursue to improve the appraisal process. In addition, NAHB formed an Appraisal Working Group, consisting of home builders and representatives from the financial and appraisal sectors, to analyze the appraisal process and develop recommendations for improvement. As a result of these efforts, NAHB developed a "Comprehensive Blueprint for Appraisal Reform" which outlines recommendations for improving the appraisal system by streamlining regulations and devoting adequate resources to ensure effective oversight and enforcement.

NAHB Recommendations

NAHB believes that the regulatory framework for real estate valuation should be reformed to more effectively oversee standards, guidance and enforcement. The goal is to better integrate and streamline the jumble of existing entities to ensure the valuation of collateral in housing finance transactions occurs in a coordinated and effective manner. This would contribute to uniform and consistent standards and avoid the current multitude of conflicting and confusing requirements.

Efforts should be made to standardize appraisal requirements throughout the housing finance system so all parties are operating under the same set of rules. In the meantime, NAHB continues to work with all stakeholders to improve the current appraisal system by expanding the availability of data needed for appraisal analysis, ensuring open lines of communication and sharing of information between all parties in the real estate transaction and providing educational opportunities for appraisers. NAHB remains committed to residential appraisal reform and looks forward to working with industry stakeholders to address the problems and implement solutions to the current U.S. residential appraisal system.

Strengthened Regulatory Oversight

Oversight of appraiser qualifications and appraisal practices falls to the individual states, and many jurisdictions have inadequate resources to adequately perform this function. Many State Appraisal Boards are responsible for the enforcement of a number of other professional services, which reduces their capacity for appraisal oversight and enforcement. In many cases personnel are shared and funds are swept from appraisal activities into the state's general fund.

Standardization of state oversight practices within and across the states would provide numerous efficiencies and improve reciprocity between the states. State appraisal boards should be fair, transparent and representative of the real estate community and there should be an effective federal regulatory system for appraisal oversight.

Streamlined Rules

NAHB urges the establishment of a single, consistent set of rules and guidelines for appraisers and appraisals and set standards to ensure the engagement of an appraiser who has the training and experience necessary for the assignment. The establishment of a single set of rules and appraisal forms should be incorporated as a high priority as part of housing finance system reform.

Currently, Fannie Mae and Freddie Mac impose de facto appraisal authority through the guidelines they have established for appraisals on the mortgages they purchase and the forms they use to collect appraisal information. These Enterprise appraisal rules tend to restrict appraisers' ability to pursue approaches that could result in more accurate valuation. In addition, confusion arises in how to interpret the Enterprise appraisal guidelines in relation to the rules established by The Appraisal Foundation (TAF) in the Uniform Standards of Professional Appraisal Practice (USPAP) and the appraisal regulations of the banking regulators. This has prompted industry participants to impose overlays that further impede the ability of appraisers to produce accurate valuations.

A Collateral Valuation Oversight Committee should be established in the reformed housing finance system. This oversight committee would consist of a broad group of housing market stakeholders, including home builders, and, in consultation with federal regulatory agencies, would be responsible for establishing and maintaining guidelines for the secondary mortgage market, appraisal reporting formats, and a repository for valuation reports.

Workable Appeals Process

Finally, NAHB encourages the development of a workable process for appealing inaccurate or faulty appraisals. It is extremely important to establish a timely value appeals process that is fair, balanced and appropriate to allow all parties of the transaction to appeal appraisals that do not meet USPAP standards or are based on inaccurate data or assumptions. NAHB has been a proponent of the VA's "Tidewater Initiative" which encourages open communications and the sharing of information that assists appraisers' in their analysis. NAHB is also encouraged by The Appraisal Foundation's interest in developing best practices and guidelines for an efficient and effective Reconsideration of Value process.

Regulatory Reforms by FHFA

We believe many regulatory reforms undertaken at the Enterprises under the direction of Director Watt have begun the process of housing finance reform, but ultimately need the authenticity of legislation. Pending resolution of the conservatorships, FHFA has directed the Enterprises to implement changes to their securitization process that should ease the transition to a new securitization system for conventional mortgages. Additionally, the Enterprises are experimenting with increased use of private capital to reduce credit risk to taxpayers on the MBS they issue. Both developments generally have been accepted as beneficial to the industry and taxpayers. NAHB believes they should be retained as important components of a reformed housing finance system.

The increased use of private capital for risk management by the Enterprises is a major component of FHFA's plan for reducing taxpayer risk in the mortgage market. Credit Risk Transfer (CRT) structures utilized to date have proved extremely successful and CRTs have become a core business practice for the Enterprises. In FHFA's *2017 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions*, the agency directs the Enterprises to transfer a meaningful portion of credit risk on at least 90 percent of the unpaid principal balance (UPB) of newly acquired single-family mortgages in loan categories targeted for risk transfer. For 2017, targeted single-family loan categories include: non-HARP and non-high LTV refinance, fixed-rate mortgages with terms greater than 20 years and loan to value ratios above 60 percent. The Enterprises also are required to explore ways to transfer credit risk on categories not included in the targeted loan categories, develop additional transaction structures, refine structures already offered and propose ways to expand the base of investors interested in participating in credit risk transfer transactions.

Since 2012, the Enterprises have worked together, and with FHFA, to design and construct a single securitization platform to support the Enterprises' single family mortgage securitization activities, including the issuance by both Enterprises of a single MBS (Single Security). The objective of a Single Security is to reduce the trading value disparities between Fannie Mae and Freddie Mac securities and improve the overall liquidity of the Enterprises' securities and the nation's housing finance markets. Progress on the Common Securitization Platform (CSP) and the Single Security has moved steadily forward. Full implementation of the CSP is expected in 2019.

Current Reform Proposals Begin to Demonstrate Areas of Consensus

Since 2008, numerous lawmakers, housing and consumer advocates, academics, and industry stakeholders have proposed plans for a reformed housing finance system. Many of the early reform proposals called for a complete restructuring of the secondary market system and several proposed the full dismantling of both Enterprises. These plans were untested, often complex, and would have required a transition that could have been considerably disruptive to the housing finance market. Over the past nine years, in light of regulatory and policy changes throughout the industry and the continued functioning of the mortgage market, there has been a gradual moderating of the approach to reform and consensus is forming around broad principles. Recent proposals call for legislation that preserves areas of the market that are working, including the significant infrastructure and resources of Fannie Mae and Freddie Mac.

Recent proposals include the following common elements that are consistent with NAHB's vision of reform for the conventional secondary mortgage market:

- An insurance fund capitalized by market participants will stand in front of the federal government's explicit backstop. The federal government and taxpayers will be at risk only in the case of catastrophic losses.
- The system will rely primarily on private capital.
- The federal government backstop will apply to mortgage-backed securities, but not to private companies.
- There will be a level playing field for lenders of all sizes.
- The Enterprises, or their successors, must have appropriate capital requirements.
- The federal government guarantee applies only to single family loans that meet qualified mortgage (QM) requirements.

- The system continues federal government support for the multifamily mortgage market.
- The system will utilize the infrastructure and other resources of the Enterprises.
- There will be a careful transition to avoid market disruptions.

NAHB Still Opposes the PATH Act

NAHB commends the Subcommittee for once again starting the dialogue in the House of Representatives on reforms to the housing finance system. As this debate resumes however, NAHB must reiterate our strong opposition to the reform bill passed previously by the full House Financial Services Committee on July 24, 2013, the *Protecting American Taxpayers and Homeowners Act of 2013 (*PATH Act)[3]. While the PATH Act included some constructive legislative proposals supported by NAHB, we strongly believe that it would have diminished housing as a major policy priority for this nation. Rather than reform and restructure the basic housing finance system, the PATH Act would have dismantled Fannie Mae and Freddie Mac and diminished FHA's vital liquidity mission.

The PATH Act would have implemented steps to wind-down Fannie Mae and Freddie Mac within five years while encouraging the return of the private market without a federal government guarantee. NAHB believes strongly that the federal government should continue to provide an explicit guarantee to ensure a reliable and adequate flow of affordable housing credit in all economic and financial conditions. Absent an explicit guarantee, there would not be sufficient private capital to fund mortgages for the broad range of middle-class home buyers with good credit, steady jobs and an eager interest in homeownership. Lacking federal protections against unpredictable and massive federal financial collapses like the one the nation experienced in 2008, the private sector would cherry-pick the best loans and leave many potential home owners with no options or only very high-priced mortgages. In short, the PATH Act did not provide the federal support necessary to ensure a strong and liquid housing finance system.

The PATH Act also included reforms for the FHA that would have severely restricted credit-worthy borrowers' access to FHA-insured loans. In the single family area, the PATH Act would have allowed the FHA to provide mortgage insurance and other credit enhancements only for first-time homebuyers, low-and moderate-income (LMI) homebuyers, homebuyers in counter-cyclical markets and disaster areas. While NAHB agrees that FHA should continue to support these homebuyers, we oppose these limitations in FHA's assistance. FHA currently serves a broader group of potential homeowners and is available during all economic cycles, and NAHB believes the agency should continue to do so. By severely shrinking the scope of the FHA, the bill would have undermined the agency's core function of facilitating the flow of mortgage credit to home buyers. In other words, countless creditworthy American families who otherwise would have had an opportunity to own a home and join the middle class would have been left out in the cold.

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[3] On July 18, 2013, Jerry Howard testified on behalf of NAHB before the Committee on Financial Services and outlined the association's concerns with the PATH Act. NAHB Testimony on PATH Act

While NAHB hopes to restart this debate with a clean slate, should the PATH Act serve as the starting point for the subcommittee's reform efforts, we will strongly oppose the legislation unless significant changes are made from the 2013 committee-passed legislation.

Conclusion

NAHB thanks the Subcommittee for the opportunity to submit our perspectives on housing finance system reform. We look forward to working with the House Committee on Financial Services and others to develop legislation consistent with NAHB's recommendations and the consensus elements that have emerged over the last serval years of the Enterprises' conservatorship.

Whether they rent or own, Americans want to choose where they live and the type of home that best meets their needs. Given the significant role that housing plays in the economy, we urge Congress to take a long-term, holistic approach to housing finance system reform. NAHB also urges Congress to carefully consider the differences between the single family and multifamily market and not apply solutions to one piece of the market that are not appropriate for the other. NAHB thanks the Subcommittee for its leadership on this important issue, and stands ready to work with you to achieve such reforms and provide much-needed stability for this critical sector of the economy.