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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

THE UNITED STATES HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING & INSURANCE

HEARING TITLED

"SUSTAINABLE HOUSING FINANCE: PRIVATE SECTOR PERSPECTIVES ON HOUSING FINANCE REFORM, PART II"

NOVEMBER 2, 2017

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Introduction

Chairman Duffy, Ranking Member Cleaver and members of the Subcommittee; my name is Kevin Brown. I am the broker of Better Homes Realty, Rockridge. I have over 39 years of experience servicing the cities of Oakland, Berkeley, Albany, El Cerrito, and Sacramento in California, and the city of Portland in Oregon. I am currently the Chairman of the National Association of REALTORS® (NAR) Conventional Financing and Policy Committee and served as the President of the California Association of REALTORS® in 2014.

I am here to testify on behalf of the nearly 1.3 million members of NAR, who thank you for the opportunity to present our views on "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform, Part II."

REALTORS® Perspective

While the housing industry has generally improved since the financial crisis, REALTORS® recognize that the current conservatorship of Fannie Mae and Freddie Mac (Enterprises) is unsustainable. REALTORS® also strongly believe that policymakers need to address the mounting risks and challenges facing the secondary mortgage market and overall housing market which could have a severe impact on taxpayers and American households' ability to access affordable mortgage credit.

The main risks to the housing industry include, but are not limited to, inadequate housing inventory, low levels of single-family construction, rising interest rates, declining affordability, tight mortgage credit conditions, stagnate job and wage growth, increased student loan debt levels, and low levels of home purchases by the Millennial generation.

These risks are accompanied by the substantial challenges facing the secondary mortgage market. These include declining capital reserves at the Enterprises, volatile profits at the Enterprises, the need for a steady flow of capital, standardization of mortgage-backed securities (MBS), liquidity over the economic cycle, limited private label securities (PLS) participation, narrow participation in credit risk transfers (CRTs) or equity capital, and the impact of the Federal Reserve's wind down of its reinvestment position and long-term decline in demand for Agency MBS.

In order to minimize the effects of these threats, NAR urges Congress to enact comprehensive housing finance reform legislation. As part of comprehensive reform of the secondary mortgage market, NAR urges policymakers to prioritize the establishment of capital reserves to prevent disruptions from losses during market fluctuations and economic downturns until comprehensive reform is completed.

Protect & Preserve FHA

In addition to the important role that the Enterprises play, NAR believes that the Federal Housing Administration (FHA) is a critical component of our nation's housing finance system. The Great Recession demonstrated the significant counter cyclical role of FHA. Mark Zandi of Moody's

Analytics reported that "if FHA lending had not expanded after private mortgage lending collapsed, the housing market would have cratered, taking the economy with it."[1] Moody's has estimated that without FHA, housing prices would have dropped an additional 25 percent, and American families would have lost more than $3 trillion of home wealth. The Enterprises benefited from the symbiotic relationship with the FHA, as the FHA helped stabilize home prices as private capital fled the market. As President Trump's nominee to lead the FHA, Brian Montgomery said in his testimony before the U.S. Senate Banking Committee: "FHA played no role in the housing boom or collapse, but it was FHA that stepped in and provided more than $1 trillion in mortgage liquidity that helped more than 8 million families purchase or retain their homes between 2008 and 2012.[2]"

Proposals that would limit eligible borrowers, increase premiums, or reduce the loan limits will disenfranchise millions of qualified families from purchasing a home, with equally significant ramifications for local communities. Converting to a partial guarantee could make credit less available and more costly, as found by a recent CBO study. That same study illustrated that lowering the loan limits could hurt the taxpayers, because it would "exclude many low risk, high income borrowers" from the Mutual Mortgage Insurance Fund (MMIF).[3] It would also unfairly penalize those American who happen to live in high cost areas. Narrowing the eligibility of FHA to first time homebuyers or those below a certain income would also affect the MMIF. Repeat buyers are generally lower risk, as are higher income borrowers. Eliminating those borrowers from the pool would add risk to the MMIF.

NAR believes that small reforms can protect taxpayers and retain access to affordable, safe credit for American families. Separating the FHA Home Equity Conversion Mortgage (HECM) program from the MMIF would give Congress a more accurate picture of FHA's financial state, which has continued to be strong following the aftermath of the housing crisis. NAR also supports allowing FHA to utilize their own receipts to upgrade their technology. Many HUD systems continue to operate on obsolete hardware and software. Nominee Montgomery said that improving technology would be his highest priority for FHA, and that "doing so will help reduce the financial risk to taxpayers and ensure that FHA can operate on a stable platform for years to come."[4]

The only way that FHA can be available to play its counter-cyclical role, is for it to be available to all qualified buyers in all markets at all times. Any policy changes that diminish that ability could have dire consequences for our nation when the next economic crisis hits.

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[1] Zandi, Mark, Obama Policies Ended Housing Free Fall, *The Washington Post*, September 28, 2012.
[2] Testimony of Brian D. Montgomery, Nominee, HUD Assistant Secretary for Housing-Federal Housing Commission, Senate Committee on Banking, Housing, and Urban Affairs, Thursday, October 26, 2017, https://www.banking.senate.gov/public/?a=Files.Serve&File_id=F3169219-FF5B-45D0-9FD2-9D6A80C74502.
[3] Congressional Budget Office, *Options to Manage FHA's Exposure to Risk From Guaranteeing Single-Family Mortgages,* September 2017.
[4] Ibid.

NAR's Comprehensive Housing Finance Reform Recommendation

There were two primary issues that REALTORS® believe must be addressed if the U.S. housing finance sector is to improve. First, REALTORS® want to ensure that in all markets affordable mortgage capital will always remain available for creditworthy Americans. Second, REALTORS® believe that taxpayer dollars should be protected. These are the driving forces behind our organization's updated housing finance reform principles (see Appendix A) which are the drivers behind the recommendations that the Association puts forward today.

In order to ensure a steady flow of capital into the mortgage market in both good times and bad, NAR believes the Enterprises should be converted into **government-chartered, non-shareholder owned authorities that are subject to tighter regulations on products, profitability, and minimal retained portfolio practices in a way that ensures the protection of taxpayer monies.**

The new government-chartered non-shareholder owned authorities must ensure that there is liquidity in the marketplace for those standard mortgage products (e.g. long-term fixed-rate mortgages along with traditional adjustable rate mortgages with reasonable annual and lifetime caps) that are the foundation of our housing finance market. Additionally, the establishment of no less than two authorities will create the competition needed to continue to foster innovative mortgage products that can expand consumer choice for safe and reliable mortgages. With the new authorities offering standard and innovative products, private capital will be free to compete and pursue opportunities to offer products in addition to those offered by the new authorities. With the full recovery of the market, the conversion of the Enterprises into these new authorities, and a return of private capital, the nation will see the appropriate balance of government, government-hybrid, and private activity in the secondary mortgage market.

Key Elements of NAR's Recommendation

REALTORS® believe that any entity with private profits that is implicitly backed by public losses, as the Enterprises were structured before conservatorship, is flawed and problematic. NAR proposes a structure that is not driven by shareholders' desire to maximize profits. Instead, the authorities' mission is clarified and their federal backing is made explicit.

NAR believes a "government-chartered" structure with clearly defined roles and enhanced safeguards is the best model for the new authorities because this structure establishes a separate legal identity from the federal government, while serving a public purpose (e.g. the Export-Import Bank of the United States). Unlike a federal agency, government-chartered organizations are established to be politically independent and often are self-sustaining—not requiring appropriations from Congress. The ability of the authorities to focus on their mission (providing affordable liquidity to the housing market), without the need to chase risky profit-driven opportunities, is an important criteria for REALTORS®.

Moreover, a government-chartered authority should remove any ambiguity regarding the government's backing of these secondary market authorities. REALTORS® believe that explicit government backing of new authorities is required in order to instill confidence in potential investors of the authorities' mortgage-backed securities (MBS). Without the confidence of these investors, the ability of the authorities to raise capital for the purpose of providing liquidity to the secondary mortgage market will be limited.

However, REALTORS® also believe that the authorities should not be operated as if the government/taxpayers are in the first loss position. The authorities should be self-sufficient (need no appropriations) and price risk effectively to cover potential losses. Most importantly, the new authorities must utilize any profits to establish capital reserves to alleviate losses that occur during market fluctuations and economic downturns.

Lastly, REALTORS® believe that the conversion of the existing government-sponsored enterprises (Fannie Mae and Freddie Mac) into government-chartered authorities will pose the least amount of market disruption, and ensure a continuous flow of capital to the secondary mortgage market during the transition period. Because of their existing capabilities and infrastructure, the current Enterprises are best positioned to be government-chartered authorities. With this in mind, REALTORS® also suggest that the new authorities import the best components from the current Enterprises such as their ability to create MBS and their automated underwriting systems.

Why not Full Privatization or Nationalization?

Privatization

NAR considered a number of different models for the future structure of the Enterprises. Our members first considered fully private and fully federal systems. REALTORS® believe that neither would effectively solve the two issues deemed necessary to address the challenge of restructuring the secondary mortgage market.

REALTORS® believe that full privatization, even a private utility, is not the most effective option for the secondary market because a private firm's business strategy will inevitably focus on optimizing its revenue/profit generation or dividend distribution. This model would foster mortgage products that are more in line with the business's goals (e.g. higher profits and inconsistent risk-taking) than in the best interest of the nation's housing policy, the economy, or consumers. The situation would likely lead to a decline in access to long-term, fixed-rate mortgage products like the 30-year fixed-rate mortgage, an increase in the costs of these products to consumers, or both. Or worse, the market could experience a surge in risk taking by private players akin to 2001 through 2006.

Additionally, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without a strong federal backstop. Some other developed countries have encouraged the use of fully amortized long-term fixed-rate loans. However, in all instances save for

Denmark, loans typically have adjustable rates and reset frequently. The United States is unique in supporting a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable. Americans have come to view this product as critical to sustainable ownership and a hedge against unforeseen life events. Lastly, it is important to note that in early 2000, when former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he quickly abandoned that position.

Second, the size of the U.S. residential mortgage market must be considered. Currently, the U.S. residential mortgage market stands at $9.8 trillion, with the Enterprises owning or guaranteeing $4.8 trillion of mortgage debt outstanding and providing capital that supports roughly 47 percent of new first-lien mortgage originations. REALTORS® believe that it is extremely unlikely that enough purely private capital could be attracted to support existing mortgage funding and continue to make mortgage lending available in all types of markets.

Finally, REALTORS® fear that in times of economic upheaval, a fully private secondary mortgage market will severely contract. This contraction occurred during the financial crisis in the markets for private label securities (PLS), commercial mortgages, and manufactured housing mortgages. When the economy turns down, private capital rightfully flees the marketplace. Should that happen in the residential mortgage market, the results for the entire economy would be catastrophic.

Nationalization

In contrast to privatization, full nationalization places the government/taxpayer in the first loss position should the housing market turn down and these institutions run into financial trouble. A priority of NAR is to reduce the taxpayer exposure to losses of these authorities. Converting the Enterprises to federal agencies, or merging them with the FHA, conflicts with this goal of REALTORS®.

Moreover, nationalization would yield a number of undesirable consequences. First, establishing one public secondary mortgage market entity may remove competition and incentives for innovation in the secondary mortgage market. Though REALTORS® favor more vigorous regulation of the products that the new authorities will purchase, they also recognize that innovation is required in order to foster more efficient and less costly products for consumers.

In addition, a single entity that dominates the secondary mortgage market could lose focus on specific housing missions. For example, an entity that combines the FHA with the Enterprises could lose focus on either low- and moderate-income housing mission or ensuring that the middle market has access to affordable mortgage capital.

Protecting Excess Revenue

REALTORS® believe that it is prudent to have the new authorities invest excess revenue earned in strong markets into a capital reserve fund so that they can pursue countercyclical activities in weaker

markets, as well as store capital to prevent the need for taxpayer funds during economic downturns. Again, a primary goal of NAR is to ensure that the government and taxpayers are not immediately on the hook even if a serious downturn occurs.

Utilization of Retained Portfolio

NAR believes that the authorities should maintain a portfolio for the purpose of funding their daily operations to use in a countercyclical fashion when the market turns down and private capital inevitably leaves the market place. It could also be used to test innovative products and house mortgages on products that are not easily securitized (e.g. multi-family housing loans and rural mortgages). The use of the portfolio will ensure that there is a continual flow of capital into the secondary mortgage market during downturns thus preventing a crisis within the housing market, as well as provide much needed capital to those portions of the housing market that don't traditionally have access to large amounts of private capital.

REALTORS® do not recommend a specific size for the portfolio. They do believe that the portfolio should be large enough to support the authorities' business needs, the products that lack private capital, and when necessary ensure a stable supply of capital consistent with market conditions. REALTORS® insist that the portfolio size should not be driven by profit motives.

Increased Sustainable Homeownership & Assumability

As first-time homebuyers continue to sit on the sideline and the housing market experiences inconsistent growth, NAR believes that the authorities should focus their mission on encouraging increased sustainable homeownership by providing safe and affordable mortgage financing and refinancing, especially if lenders, capital sources and other mortgage product providers benefit from an explicit government guarantee.

Moreover, NAR believes that any new secondary mortgage market must allow for mortgages that are syndicated through explicitly government-guaranteed MBS to be assumable. REALTORS® believe that when interest rates rise, especially in high cost areas, the ability to assume a lower-rate mortgage on a property may become the most affordable source of financing for a qualified buyer.

Addressing the Enterprises' Declining Capital Reserves

Under the terms of their agreements with the U.S. Treasury, the Enterprises' capital reserves will decline to zero by January 1, 2018. NAR believes that, as Congress contemplates reforming the secondary mortgage market, the amount of capital reserves needed in the system will be an important question that will not only have immediate implications for taxpayers but ultimately Americans' access to credit and homeownership.

While there is less concern that a draw on the Enterprises' line of credit at the U.S. Treasury due to accounting rules would disrupt mortgage markets, it is important to have a buffer between any losses and the taxpayer. This is especially the case if comprehensive housing finance reform

legislation has not yet been adopted. It makes sense to build that buffer now while the Enterprises have positive cash flows.

To address this concern, a prudent intermediate step would be to establish a Mortgage Market Liquidity Fund (MMLF) through legislation or under existing regulatory authority. A portion of the Enterprises' profits could be deposited into the fund, controlled by the Federal Housing Finance Agency (FHFA) Director, which would cover future losses due to market fluctuation as described above. The FHFA Director could release funds from this account to buffer against further U.S. Treasury involvement. As a result, some capital will be in place to avoid significant market disruptions and to continue to ensure that Americans have access to affordable mortgages.

The MMLF would protect taxpayers by reducing the need for the Enterprises to draw additional funding from the U.S. Treasury. Finally, the fund would provide Congress the necessary time to enact comprehensive housing finance reform.

Conclusion

The stakes have never been higher for the housing market and the broader economy. Yet, there are sizeable challenges and risks associated with the ongoing conservatorships of the Enterprises. Comprehensive housing finance reform enacted by Congress will help address many of these issues. However, any misstep in the implementation of a new housing finance system could cause serious harm to our housing market and economy. In the balance hang many potential homebuyers with the desire and ability to purchase a home. Any disruption to the housing finance system could injure these aspiring new homeowners, as well as existing homeowners.

REALTORS® support a secondary mortgage market model that includes an explicit government guarantee. That guarantee protects the taxpayer while ensuring that all creditworthy consumers have reasonable access to affordable mortgage capital so that they too can attain the American Dream – homeownership. REALTORS® recognize that this is an extensive and important conversation regarding how we mend, and improve, a housing finance system that has served us well for many years.

Furthermore, if Congress is unable to enact reasonable and comprehensive housing finance reform in the near term, NAR strongly urges policymakers to consider addressing the declining capital reserves at the Enterprises through the creation of a MMLF. This will ensure hardworking Americans have continued access to affordable mortgage credit while protecting taxpayers from unnecessary threats.

NAR's recommendations will help Congress and our industry partners design a secondary mortgage model that will be in all of our nation's best interest today, and in the future.

Appendix A

Updated: May 2017

NAR Principles for Housing Finance Reform

NAR supports restructuring the secondary mortgage market to ensure a reliable and affordable source of mortgage capital for consumers, in all types of markets, to avoid a major disruption to the nation's economy that would result from the total collapse of the housing finance sector. Restructuring is required in response to the failure of Fannie Mae and Freddie Mac, which has been under government control since entering conservatorship in September 2008.

- **An efficient and adequately regulated secondary market is essential to providing affordable mortgages to consumers.** The secondary market, where mortgages are securitized, is an important and reliable source of capital for lenders and therefore for consumers. Without a secondary market, mortgage interest rates would be unnecessarily higher and unaffordable for many Americans. In addition, a poorly functioning secondary market will impede both recovery in housing sector and the overall economy.

- **The old GSE system with private profits and taxpayer loss must be replaced.** The current GSEs (Fannie Mae and Freddie Mac) should be replaced with government-chartered, non-shareholder owned authorities that are subject to sufficient regulations on product, revenue generation and usage, and retained portfolio practices in a way that ensures they can accomplish their mission to support long-term mortgage financing and protect the taxpayer.

- **Reforms should ensure a strong, efficient financing environment for homeownership and rental housing.** The mission of the new authorities must include increasing sustainable homeownership, providing access to mortgage financing and refinancing for consumers who have demonstrated the ability to sustain homeownership. Creditworthy consumers require a steady flow of mortgage funding that, even during economic downturns, will continue to be available as insured by an explicit government guarantee.

- **The government must clearly, and explicitly, offer a guarantee of mortgage instruments facilitated by the authorities that meet the Qualified Mortgage (QM) standards.** This is essential to ensure qualified, creditworthy borrowers have access to affordable mortgage credit. Without government backing, consumers will pay much higher mortgage interest rates and mortgages may at times not be readily available at all-as happened in jumbo and commercial real estate loans. Taxpayer risk would be mitigated through the use of mortgage insurance on loan products with a loan-to-value ratio higher than 80 percent, or through other fees paid to the government.

- **The new authorities should guarantee or insure a wide range of safe, reliable mortgage products.** These mortgage products include 15-year and 30-year fixed rate loans, traditional adjustable-rate mortgages (ARMs), and other products that have stood the test of time and for which American homeowners have demonstrated a strong "ability to repay."

- **Provide a self-sufficient mechanism whereby safe, sound, transparent, and insured Mortgage Backed Securities (MBS) may be packaged and sold.** There must be an option for an explicit government guarantee or insurance for all offered MBS within the secondary mortgage market. The creation of a not-for-profit "utility" facility is needed to receive, package, sell and guarantee MBS.

The authorities should operate with similar insurance and enforcement components as the FDIC. This option must minimize taxpayer exposure.

- **Sound and sensible underwriting standards must be established.** Establish standardized, sound underwriting principles and products that provide the foundation for responsible, credit worthy borrowers to be able to achieve homeownership goals. For additional safety, these standards must also be applied to securities (MBSs), purchased for portfolio (to a limited extent).

- **The authorities should price loan products or guarantees based on risk.** In addition, the new authorities must set standards for the MBS they guarantee that establish transparency and verifiability for loans within the MBSs.

- **Ensure solid, verifiable, current loan level data is available to investors that empowers and enables them to conduct their own risk analysis.** There is a strong consensus among multiple market participants that solid loan level data is the essential foundation from which to rebuild the private mortgage security industry. Investors want to be empowered and enabled to conduct their own analysis. With properly structured loan level data the mortgage collateral supporting a regulated, securitized instrument will lead to a verifiable, current predictable instrument of cash flow and thus will attracting private capital.

- **The reformed authorities must have a separate legal identity from the federal government but serve a public purpose.** Unlike a federal agency, the authorities will have considerable political independence and be self-sustaining given the appropriate structure.

- **The GSEs should remain politically independent.** Political independence of the authorities is mandatory for successful operation. CEOs should have fixed terms so they cannot be fired without cause, and they should not be allowed to lobby. Additionally, the authorities should be self-funded instead of receiving ongoing appropriations.

- **There must be strong oversight of the authorities**. The new authorities should be overseen by the Federal Housing Finance Agency (FHFA) or a successor agency that would make timely reports to allow for continual evaluation of the authorities' performance.

- **Restore investor confidence and trust in the Representations and Warranties via the standardization of pooling and servicing contracts.** Standardization of Representations and Warranties is imperative. Pooling and Servicing Agreements (PSAs) must be simple with clear terms and definitions so they are easily understood by investors. They must have clear disclosures of any deviations from "Federal Best Practice Standards", clearly define "buy back" rules, and servicer operational policies must be consistent with their fiduciary duties to the investor.

- **The new system must allow for mortgages that are syndicated through explicitly government guaranteed mortgage-backed securities (MBS) to be assumable.** When interest rates rise, especially in high cost areas, the availability of an assumable low rate mortgage on a property may become the most affordable source of financing for a qualified assuming buyer.