Testimony of

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On Behalf Of:

The National Association of Home Builders

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Hearing on

The Present Condition and Future Status of Fannie Mae and Freddie Mac

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Introduction

On behalf of the more than 200,000 members of the National Association of Home Builders (NAHB), thank you for the opportunity to submit this statement for the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises' hearing on "The Present Condition and Future Status of Fannie Mae and Freddie Mac." My name is Joe Robson, and I am a builder and developer from Tulsa, Oklahoma, and the 2009 NAHB Chairman of the Board.

The housing government-sponsored enterprises (GSEs) – Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks) – are charged with providing liquidity to the mortgage markets and supporting the flow of credit to meet affordable housing needs. In pursuing this mission, these institutions have become valuable and critical components of the housing finance system. Fannie Mae and Freddie Mac (the Enterprises) have encountered severe problems and are currently operating in conservatorship under the direction of their new regulator, the Federal Housing Finance Agency (FHFA). The FHLBank System has also experienced stresses which, while considerably less intense, have affected its capacity for mission pursuit.

These developments have raised important questions on the future structure and operation of Fannie Mae and Freddie Mac, as well as on the prospective configuration and roles of the FHLBanks. NAHB commends the Subcommittee for holding this hearing to discuss and explore these issues. An effective solution requires intensive review and thoughtful assessment of what has become an extremely complex system.

NAHB believes that the housing benefits that the GSEs have provided in the past and their significant roles in programs that have been instituted to deal with the current unprecedented turmoil in the financial system clearly demonstrate the need for federal government support for the secondary mortgage markets. There is broad agreement that Fannie Mae and Freddie Mac will not be able to emerge from conservatorship without alteration in their previous public mission/private ownership structure. While NAHB believes the liquidity and affordable housing mission must continue with federal government backing, the primary objective is a system that assures the continued availability of affordable housing credit that facilitates healthy housing markets and consistency in satisfying community housing needs. Therefore, NAHB is open to discussing different models for achieving that objective.

Present Condition of Fannie Mae and Freddie Mac

Since being placed into conservatorship, the financial conditions of the Enterprises have deteriorated as government has taken firmer control over the operations of the two companies. As the credit crisis has worsened, both firms have tightened underwriting standards and increased loan delivery fees which have made it more difficult for borrowers (both single family and multifamily) to obtain credit. At the same time, Fannie Mae's and Freddie Mac's combined market share has increased and now represents nearly seventy-five percent of the single family market and they are the primary source of credit in the multifamily market.

Recent Financial Statements

Over the last four quarters ending on March 31, 2009, Fannie Mae and Freddie Mac have reported a staggering $140 billion in net losses combined, a situation that would have been considered unimaginable a few short years ago. Just over half of this combined loss is attributable to credit losses on loans guaranteed by the two Enterprises. The Enterprises have also suffered billions of dollars of fair value losses related to derivatives transactions, the deteriorating private label mortgage-backed securities portfolio, and to wider credit spreads on assets held in trading accounts. In addition, the Enterprises' level of seriously delinquent loans continues to grow, which portends additional credit related losses in future reporting periods. Relative to the first quarter of 2008, Fannie Mae's first quarter 2009 seriously delinquent loan rate increased from 1.15 percent of guaranty assets to 3.15 percent. Freddie Mac's seriously delinquent loan rate increased from 0.77percent to 2.76 percent over the same period.

On May 6, 2009, the Treasury and FHFA, acting in its capacity as conservator, amended the Senior Preferred Stock Purchase Agreements (Agreements) whereby Treasury increased its total Enterprise funding commitment from $200 billion to $400 billion. Due to the aforementioned first quarter losses, the Director of FHFA has requested additional monies from Treasury under the terms of the respective Enterprise Agreements to eliminate the net worth deficit as of March 31, 2009, which would avoid a trigger of mandatory receivership under the *Federal Housing Finance Regulatory Reform Act of 2008*. Once this draw request is executed, the Treasury will have funded approximately $87 billion in Enterprise net worth deficits under the Agreements. Due to current trends in the housing and financial markets, it is expected that the Enterprises will continue to report losses in future periods and will therefore be required to obtain additional funding from the Treasury pursuant to the Agreements.

Tighter Underwriting Requirements and Delivery Fees

As the credit crisis has worsened, both Enterprises have lowered the maximum loan-to-value (LTV) ratio and raised the minimum FICO score requirements for eligible loan purchases. The maximum LTV is now 95 percent (97 percent for certain affordable mortgage products) and the minimum FICO score is 620. In addition, each has implemented risk based delivery fees, which they have continued to increase since August 2007, with higher fees for lower FICO, higher LTV loans. These fees have made it more expensive for eligible borrowers to buy a home or refinance into a more affordable mortgage.

For example, under the latest round of fee increases which became effective April 1st, the fee on a loan with a 620 FICO and a 20 percent downpayment rose to 300 basis points (including the 25 basis point adverse market delivery charge) on a loan sold to Freddie Mac, and 325 basis points on the same loan if it were sold to Fannie Mae. This translates into an increase in the borrower's mortgage rate of at least 75 basis points, which could significantly impair the ability of such a borrower to obtain credit. In addition, a new 75 basis point delivery fee was instituted for condominium purchases with loan-to-value ratios greater than 75 percent. This will add almost 20 basis points to the interest rate on the purchase of a condo, which in many communities is the most affordable form of homeownership.

The continual ratcheting up of delivery fees and tightening of underwriting standards by the Enterprises are significant factors restricting credit, particularly for low- and moderate-income homebuyers, but these factors are within the control of the Enterprises. We believe that the actions of the Enterprises have forced the pendulum to swing too far, and, as a result, viable buyers are being denied credit. While the Enterprises must operate in a safe and sound manner, beyond a point, such self-selecting measures become too restrictive.

The cumulative impact of these recent actions in combination with all previous risk-based fee increases could prove to be a significant counterweight to the benefits being achieved through the initiatives of the Treasury and Federal Reserve to drive mortgage rates down. With the Treasury now directly funding the Enterprises' ongoing net worth deficits, it is futile for these entities to attempt to increase their revenues at the expense of desperately needed mortgage credit. In the face of the Enterprises' dismal financial situation and the conservatorship actions, it can no longer be argued that risk-based fees are necessary to meet the demands of private equity or debt holders. Losses have overwhelmed incremental increases in revenues attributable to risk-based pricing, and will probably continue to do so into the future. These fees, however, do great harm to consumers by increasing the cost of mortgage credit, and they frustrate policymaker's attempts to reduce foreclosures.

NAHB has been rebuffed by FHFA and the Enterprises in response to several requests to roll back these fees. Therefore, as we discuss the future role and structure of the Enterprises, we urge the Committee to direct FHFA and the Enterprises to take the interim step of eliminating the risk-based delivery fees for their mortgage purchase programs introduced since August 2007. Elimination of these fees will directly increase mortgage affordability, enhance policymakers' attempts to reduce foreclosures, and help the country get back on the road to economic recovery.

Fannie Mae Condominium Requirements

Earlier this year, Fannie Mae implemented changes to its condominium project approval standards that have raised the presale requirement to 70 percent, without exception, for projects that lenders review and warrant to Fannie Mae. This increase represents a change from the customary 50 percent presale requirement that had existed for many years and it comes at a time when condominium developers and homebuyers need every financing tool available to consummate sales.

This change in Fannie Mae's condo presale requirement, which was effective on January 15, follows a year of review by Fannie Mae after it suddenly stopped conducting in-house condominium project reviews in late 2007. Prior to this action, Fannie Mae's internal condo project review process was long considered the "gold standard" and was widely accepted by investors and the Federal Housing Administration (FHA).

Following the shutdown of its internal review process, Fannie Mae only offered a web-based Condo Project Manager (CPM) system that lacked the flexibility to handle some condo projects because of the manner in which these projects are constructed and marketed in phases. While lenders may still use the CPM system, under the new condo approval guidelines, the presale requirement that will be determined by this system varies between 50 and 70 percent and

is not known by the lender until a final, irrevocable determination has been made. Fannie Mae also has reinstituted a direct review process similar to that which existed in 2007. This process may, however, result in a presale requirement greater than 50 percent.

In contrast, Freddie Mac does not appear to have firm rules or written policy regarding condo presale requirements, opting instead to set this requirement in a 50 to 60 percent range depending on the lender and the area where the project is located.

NAHB believes that a 50 percent presale requirement based on marketing phases adequately balances the interests of lenders, investors and mortgage insurers with those of the builder/developer and with the need for condominium purchasers to be able to finalize their purchases in a timely manner. This requirement also conforms to the presale requirement for projects containing loans insured by the FHA.

NAHB is greatly concerned that Fannie Mae and Freddie Mac may move toward an irrevocable, non-negotiable 70 percent presale requirement for all condominium projects, regardless of the projects' locations or conditions. Such a gross overreaction would result in the denial of homeownership opportunities for thousands of prospective condominium purchasers and would lead to financial ruin for innumerable condominium projects and the projects' developers.

NAHB urges Congress to direct FHFA, the regulator and Conservator of Fannie Mae and Freddie Mac, to bring the Enterprises' condominium presale requirements into line with FHA's 50 percent pre-sale requirements.

Multifamily Financing

Fannie Mae and Freddie Mac have been key sources of multifamily financing over the past two years. Fannie Mae, Freddie Mac and the FHA Multifamily mortgage insurance programs have kept the multifamily market afloat. However, the Enterprises' underwriting requirements have tightened considerably, making it more difficult for borrowers to obtain needed financing. Equity requirements of 35 to 40 percent have become the norm. Debt service coverage (DSC) ratios have increased considerably, from 1.10 to 1.25 depending on the market and type of loan. Fees and interest rates are rising. Last week, two NAHB members reported that they secured a forward commitment for a permanent loan takeout on a Low Income Housing Tax Credit (LIHTC) project from Fannie Mae at a rate of 9.32 percent – 550 basis points over the 10-year Treasury. This rate is up 100 basis points from rates just above 8 percent in early March. Neither firm is providing construction financing for multifamily projects.

In early January 2009, Freddie Mac announced revisions to its underwriting standards for all of its multifamily loans, including conventional and targeted affordable housing loans. The revisions included increasing the minimum DSC to take into account the potential impact of declining cash flow from weaker market fundamentals and reducing the maximum loan-to-value limit for loan terms less than ten years. Freddie Mac is also making further adjustments to LTV and DCR limits across all product lines based on the risk associated with specific transaction characteristics such as financing options and/or type of asset. Freddie Mac continues to provide

credit enhancement for tax-exempt bonds, but at a steep price to the borrower, as fees were increased in early 2009 and underwriting requirements also tightened.

Multifamily lenders and borrowers also continue to be concerned about the portfolio limits placed on Fannie Mae and Freddie Mac, which could negatively affect liquidity for multifamily mortgage credit. Although the Administration recently increased the portfolio limits, the expectation is that single family loans will be a significant portion of the GSEs' purchases. As the credit crisis worsened and other multifamily lenders left the market, Fannie Mae and Freddie Mac increased their market share of multifamily loans substantially. These loans have gone into their respective portfolios.

Both Fannie Mae and Freddie Mac are returning to securitization of their multifamily loans. This shift will affect the types of mortgages that can be offered to multifamily developers, because securitization will require more standardized loan structures. Although customized loans no longer will be possible, it is expected that securitization will lower interest rates. Fannie Mae once had an active securitization program, which was halted as it became more difficult for Fannie to compete with conduit lenders who were packaging multifamily, office, hotel and retail loans into Commercial Backed Mortgage Securities (CMBS). Freddie Mac has always relied more heavily on its portfolio lending. The Enterprises have been planning for this strategy, looking ahead to how they can remain competitive in all types of market environments and under more restrictive portfolio constraints.

Future Status of Fannie Mae and Freddie Mac

NAHB believes it is essential for the federal government to continue to provide a sound underpinning for the U.S. housing finance system. As demonstrated in the current financial crisis, the private sector cannot be counted on to provide and maintain a consistent and reliable flow of affordable housing credit. NAHB supports changes to the structure and operations of Fannie Mae and Freddie Mac to enable them to support mortgage market liquidity and address affordable housing finance needs without creating excessive taxpayer risk.

Continued Need for GSE Support of the Housing Finance System

NAHB believes it is critical for the federal government to provide a backstop to the housing finance system to ensure a reliable and adequate flow of affordable housing credit. In the secondary mortgage markets, the need for such support, which has been demonstrated historically, is heavily underscored by the current state of the system, where Fannie Mae, Freddie Mac, the FHLBanks and Ginnie Mae are the only conduits for home mortgage credit. NAHB believes that the federal backstop must be a permanent fixture in order to ensure a consistent supply of mortgage liquidity, as well as to allow rapid and effective responses to market dislocations and crises. It has been clearly demonstrated that the private sector, unaided, is not capable of consistently fulfilling this role.

Alternative Approaches to GSE Status

The conservatorship of Fannie Mae and Freddie Mac has raised fundamental questions regarding their future status and structure in the U.S. housing finance system. Former Treasury Secretary Henry Paulson has stated that the current public mission/private stockholder business model is unworkable and that Fannie Mae and Freddie Mac cannot continue to exist in their current form. The firms should be either government entities or entirely private companies. While this view is extremely black and white, there is a significant probability that the structure and function of Fannie Mae and Freddie Mac will undergo significant change and that such a shift could also bring changes to the Federal Home Loan Bank (FHLBank) System.

A number of alternate structures for carrying out the functions and mission of Fannie Mae and Freddie Mac are listed below.

1. Status Quo: Following conservatorship, Fannie Mae and Freddie Mac would resume operating with private stockholders, a public mission charter and an implicit federal government backing.

2. Full Government Ownership and Control: Fannie Mae and Freddie Mac are converted to government agencies (essentially a conventional market version of Ginnie Mae).

3. Completely Private Operations: Fannie Mae and Freddie Mac are converted to fully private companies with no public mission or government backing.

4. Private Utility Model: Fannie Mae and Freddie Mac are converted to private companies and granted monopoly powers over selected housing finance functions, with prices, fees and profits regulated by the government.

5. Government Sponsored with Private Stockholders and Reduced Operations: Fannie Mae and Freddie Mac would emerge from conservatorship as privately held corporations, retaining their public charter and implicit or explicit government backing. The key difference is that their scope of operations would be narrowed to primarily guaranteeing mortgage-backed securities and purchasing limited housing-related instruments that do not currently have a secondary market outlet.

6. Government Sponsored with Customer Stockholders and Limited Operations: Fannie Mae and Freddie Mac would emerge from conservatorship as privately held corporations, retaining their public charter and implicit or explicit government backing. Stockholders would be limited to financial institution customers of Fannie Mae and Freddie Mac, similar to the ownership model for the Federal Home Loan Banks. In addition, the scope of Fannie's and Freddie's operations would be narrowed to primarily guaranteeing mortgage-backed securities and purchasing limited housing-related instruments that do not currently have a secondary market outlet.

Last year, a NAHB Housing Finance Task Force reviewed the pros and cons of these alternative structures[1] and concluded that neither the status quo nor either extreme on the spectrum of possibilities is acceptable. Fannie Mae and Freddie Mac should not return to operating with a public charter while their stock is traded publicly, because the friction between housing mission and the interests of private stockholders would inevitably result in activities that are not in the best interests of housing or American taxpayers. Fannie Mae and Freddie Mac (and the FHLBanks) should also not be transformed into fully private companies because such companies could not be counted on to provide liquidity in times of crisis or to consistently address affordable housing needs. And Fannie Mae and Freddie Mac (and the FHLBanks) should not be converted to federal government agencies because such entities would be burdened by government red tape and would lack the resources and agility to respond effectively to market developments and housing finance needs.

The Task Force concluded that the public-private conflict in the Fannie/Freddie model must be eliminated and recommended that Fannie Mae and Freddie Mac be recast, retaining federal backing but limited primarily to providing credit enhancement of mortgage-backed securities. Limited portfolio capacity should be permitted to accommodate mortgages and housing-related investments that do not have a secondary market outlet. The Task Force concluded that a significant portion of credit and interest risk should be shared by the private sector institutions that benefit from the government's secondary market support.

The Task Force recommended several principles for federal government support and structure of the housing finance system. These recommendations were ratified by NAHB's Board of Directors at our annual Convention in January. The principles outlined below suggest a cooperative structure where the mortgage originators that sell loans to government sponsored secondary market housing finance entities would be required to purchase stock in the entities in proportion to the their mortgage sales volume. This model is similar to that currently utilized by the FHLBanks; thus, the FHLBanks' structure would not require significant modification. Further, it is not necessary to preserve the current institutional structures of Fannie Mae and Freddie Mac as there are a number of different ways to achieve the stated principles. At this time, however, NAHB does not have a position on a specific structure, such as whether the Enterprises should be merged into one operation or left as separate (or several) entities.

NAHB Principles for Federal Government Support of the Housing Finance System

- The Federal government must provide a permanent backstop to the housing finance system in order to ensure available and affordable mortgage credit in all geographic areas and under all economic circumstances.

- Secondary market entities (Fannie Mae, Freddie Mac and the Federal Home Loan Banks) should retain sufficient federal backing to allow them to reduce mortgage rates and fees.

- Fannie Mae and Freddie Mac should focus on the core business of securitizing mortgages and limited portfolio capacity should be permitted to accommodate mortgage and

[1] The Task Force's analysis of the pros and cons of each approach is provided in the appendix to this statement.

housing-related investments that do not have a secondary market outlet, including acquisition, development and construction (AD&C) loans.

- Fannie Mae and Freddie Mac must have the authority and ability to provide reliable liquidity to the mortgage markets during times of stress, which requires flexibility in terms of portfolio composition and size over the mortgage credit cycle, or with changing conditions in the secondary mortgage markets.

- Secondary market entities must be adequately capitalized.

- The secondary market must have a private sector component with risk shared by participants/shareholders, with governance by a board that includes public interest, housing industry and shareholder representatives.

- The Federal Home Loan Banks should be authorized to securitize housing-related loans (mortgage and AD&C).

- The regulator of secondary market entities should be an independent agency and have a strong housing focus (advocate for meeting housing finance needs).

- Flexibility in pursuing new mortgage programs and products should be balanced with accountability and safety and soundness.

NAHB also reaffirms its support for the affordable housing requirements mandated by the *Housing and Economic Recovery Act of 2008* (HERA), including affordable housing goals and the establishment of an Affordable Housing Fund (AHF). NAHB regrets that the conservatorship of the Enterprises has delayed implementation of the AHF. NAHB urges that the Fund be established as soon as the Enterprises emerge from conservatorship, regardless of their operation structure.

In addition, NAHB strongly recommends that the temporary loan purchase limit framework, enacted earlier this year under the *American Recovery and Reinvestment Act of 2009* (ARRA), be made permanent. ARRA restored the 2008 ceilings and local area loan limits for loans that can be purchased by the Enterprises, up to a maximum of $729,750. ARRA also authorizes the Director of the Federal Housing Finance Agency (FHFA) to establish separate conforming loan limits in subareas where home prices are significantly higher than the median home price for the county or MSA in which they are located. Congress enacted this provision to address areas of the country where the conforming loan limit is depressed due to a concentration of older homes and/or foreclosed properties which makes it difficult to purchase homes with conforming loans in higher-priced subareas of the county or MSA. To date, FHFA Director Lockhart has indicated that he does not intend to exercise this authority. NAHB urges Congress to require FHFA to establish subarea limits to address such situations.

Time Frame for Structural Reforms

While NAHB welcomes Congressional consideration of possible approaches to restructure the status and role of the Enterprises in the housing finance system, we urge caution in implementing any changes until the market returns to more normal conditions. It would be extremely difficult, if not impossible, to restructure the Enterprises when they are inextricably involved in ongoing efforts to address the deepening financial morass.

NAHB is particularly concerned about the winding down of the Enterprises' portfolios which pursuant to HERA must be reduced by 10 percent per year after December 31, 2009. We urge the Committee to direct FHFA to review the Stock Purchase Agreements, the basis for this requirement, and to adjust the criteria for reductions in the portfolios as warranted by market conditions. While portfolio restrictions may be prudent, now is not the time to wind down the portfolios as there is no apparent end in sight to the ongoing financial turmoil. During these times, the Enterprises' portfolios must be available to support market liquidity and to maintain the supply and low cost of mortgages. As the markets function in a more normal fashion, the Enterprises should be allowed to reduce their portfolios in an orderly manner to avoid unnecessary volatility.

Conclusion

The mission of providing mortgage market liquidity and meeting affordable housing needs must continue with federal government support. Fannie Mae's and Freddie Mac's structure must change when they emerge from conservatorship but the companies should not be either fully private or entirely public firms. There are several options of achieving the appropriate balance of public and private elements and NAHB would like to actively participate in deliberations on the best possible approach. Changes of this nature should not be undertaken amidst the current severe financial market turmoil as it is too difficult to implement effective changes while the Enterprises are enmeshed in a wide range of financial market rescue efforts. At the present time, Fannie Mae and Freddie Mac should roll back changes in single family and multifamily underwriting requirements that are resulting in the denial of credit to viable borrowers and projects and impeding economic recovery.

Thank you for the opportunity to participate in this important and timely hearing. NAHB looks forward to working with all stakeholders to develop an effective as well as safe and sound means to provide a reliable flow of housing credit under all economic and financial market conditions.