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TESTIMONY OF

RON PHIPPS, ABR, CRS, GRI, GREEN, E-PRO, SFR
2011 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

HEARING REGARDING

LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS AND GNMA IN THE SINGLE-AND MULTI-FAMILY MORTGAGE MARKETS

MAY 25, 2011

Madam Chairwoman, Ranking Member Guittierez, and members of the Subcommittee, my name is Ron Phipps, and I am the 2011 President of the National Association of REALTORS®. I am proud to be part of a four-generation, family-owned residential real estate business in Rhode Island. My passion is making the dream of home ownership available to American families. I am proud to testify today on behalf of the more than 1.1 million REALTORS® who share that passion, and the 75 million Americans who own homes and the 310 million Americans who require shelter.

We thank you for the opportunity to present our views on the importance of the Federal Housing Administration (FHA) mortgage insurance program. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

Comments on Discussion Draft

Madam Chair, we appreciate your attention to the importance of FHA, especially during these difficult times and thank you for attempting to provide FHA with all the tools it needs to remain an important part of our housing finance system.

The Discussion Draft being considered today provides for a number of valuable enhancements that will help FHA remain fiscally strong. The National Association of REALTORS® strongly supports

Sections 6-12 of the bill, which will allow FHA to better monitor risk, increase enforcement tools, and strengthen protections for taxpayers. We also thank you for your attention to Section 13, proposing to move the Rural Housing Service out of the Department of Agriculture and into the Department of Housing and Urban Development. We appreciate your consideration of the critical impact rural housing programs have on tens of thousands of rural communities. NAR is still evaluating the impact of moving these entities to HUD on important programs like the 502 single-family loan programs and the 515 rural rental housing program. These programs are especially important to rural families, as private sector lending will be even slower to return to these communities.

As is discussed later in this testimony, NAR strongly opposes increasing the downpayment for FHA. The correlation between downpayment and loan performance is significantly less important than the linkage to strong underwriting, which FHA continues to have. FHA's foreclosure rate remains less than conventional mortgages, so we don't believe changes to the downpayment would do anything but disenfranchise many creditworthy homebuyers. In addition, NAR also strongly opposes the proposed changes to the FHA mortgage limits. Our housing recovery remains fragile at best, with home sales now trending down. As NAR's Chief Economist, Dr. Lawrence Yun has said, "Although existing-home sales are expected to trend up unevenly through next year, unnecessarily tight credit is continuing to restrain the market." Changing the loan limits at this critical time will only serve to restrain liquidity and hamper the recovery. We strongly urge the Subcommittee to support H.R. 1754, introduced by Reps. Miller (R-CA) and Sherman (D-CA), which would make the current limits permanent.

FHA has been a critical part of our nation's economic recovery, and has outperformed all expectations in their role of providing safe, affordable, mortgage financing to all markets during all economic conditions. This is due, in part, to a number of changes already made to the program in the last 18 months, and which are demonstrating results. FHA's average credit score is up to 703; default rates, which were already low, are decreasing even further. We strongly urge the Subcommittee not to make any additional changes that would unnecessarily constrain this valuable program that has served so many deserving American families for decades.

FHA's Historic Mission

The Federal Housing Administration (FHA) was created by the National Housing Act of 1934. FHA does not make loans but insures mortgage loans made by private lenders. FHA has insured more than 50 million purchase money and refinance mortgages since 1934 and currently has 4.8 million loans in its portfolio.[1] FHA revolutionized the real estate industry with the creation of the 20-year mortgage, which led to the 30-year mortgage that is standard today.[2] FHA has successfully operated for seventy-seven years as a self-sufficient entity, and without expense to the American taxpayer.

When the FHA was created by the 1934 National Housing Act, the primary goal of the Administration was to insure loans for home improvements.[3] In the wake of the Great Depression, the nation's housing stock was crumbling. Houses were not being maintained or modernized and the result was deteriorating living conditions and falling home prices. At the same time, painters,

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[1] History of FHA. http://www.hud.gov/offices/hsg/fhahistory.cfm

[2] FHA-Insured Home Loans: An Overview. Foote and Jones. January 18, 2011. P.1

[3] 13 Wayne L. R. 651, 652 (1967)

carpenters, landscapers, and more of the dozens of trades involved in home improvements were without work. By creating an agency to insure small, private capital loans for home improvements, the federal government hoped to address these two issues simultaneously.

While home improvement loans were the first goal of Title I of the National Housing Act of 1934, the full scope of the law went further. According to the 1934 Report of the House Committee, the intent of the National Housing Act of 1934 was:

> "to improve Nation-wide housing standards, provide employment, and stimulate industry; to improve conditions with respect to home mortgage financing, to prevent speculative excess in new-mortgage investment, and to eliminate the necessity for costly second-mortgage financing, by creating a system of mutual mortgage insurance and by making provision for the organization of additional institutions to handle home financing . . . ." [4]

Most of these goals have been achieved through what would become the Act's most enduring legacy: mutual mortgage insurance. Contained in Title II of the National Housing Act, FHA's mutual mortgage insurance first insured loans up to $16,000 for the purchase of homes and made these loans amortizing over a 20-year period. Up to this point, most home loans were five to ten year balloon loans that had to be refinanced every few years, creating uncertainty for both banks and homeowners as to the feasibility of refinancing. By giving loans an amortizing structure, the government hoped to introduce predictability for both homeowners and lenders.[5]

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[4] H.R. Rep. No. 1922, 73d Cong., 2d Sess. 1 (1934)

[5] First Annual Report of the Federal Housing Administration for the Year Ending December 31, 1934. U.S. Government Printing Office. 1935. p. 4

A common misconception exists that FHA was intended to only benefit low-income borrowers who could not afford a large down payment on a new home. While an upper limit of $16,000 for a home loan may seem exceptionally small today, in 1930 the national median home value was $4,778.[6] The majority of homes were valued between $2,000 and $7,500, with the largest number of them falling between $3,000 and $5,000.[7] Only 3.2 percent of homes were valued between $15,000 and $20,000.[8] So the upper limit of $16,000 was more than 330 percent of the median American home value at that time. Contrast that to today, where even the current higher loan limits are only at 125 percent of the local area median home price. Even at its inception, FHA was intended to provide safe, affordable mortgage financing for all homebuyers in all markets – high and low cost.

FHA Enhancements Over Last 18 Months

Over the last year, FHA has taken several administrative steps to mitigate risk that have resulted in great improvements to loan performance in the MMIF. These steps include increasing mortgage insurance premiums on two separate occasions, stepping up enforcement that resulted in suspending or withdrawing FHA approval for 1,500 lenders, hiring the agency's first Credit Risk Officer, implementing a credit score floor, requiring a greater downpayment for borrowers with lower credit scores, adopting a series of measures to increase lender responsibility and enforcement, and publishing a proposed rule to reduce permitted seller concessions. A brief description of the major initiatives follows.

[6] Id. at 18
[7] Id.
[8] 15th Census of the United States, Population, Volume VI: Families, U.S. Census Bureau, 1930, P. 17

Increased MIP

In April 2011, mortgage upfront insurance premiums on FHA-backed loans increased to 2.25 percent from 1.75 percent. That amounts to an additional $500 for every $100,000 in borrowing[9]. On a $300,000 loan, for example, a borrower will pay $6,750 upfront in insurance costs, compared to $5,250 at previous levels. Effective October 4, 2010, FHA increased the annual premium to 0.85 percent from 0.50 percent for loans with loan-to-value ratios (LTV) up to and including 95 percent and to 0.90 percent from 0.55 percent for LTVs above 95 percent. This added an estimated $300 million per month to the FHA fund. However, the combined premium increases raised the cost of housing by approximately $75 per month.

Credit Risk Officer

In October of 2009, FHA hired the first Chief Risk Officer in the organization's history. On July 28, 2010 FHA received Congressional approval to formally establish the position and create a permanent risk management office within FHA. The Risk Officer is now Deputy Assistant Secretary of this office. At the time, then FHA Commissioner Stevens testified that "[w]ith this new office and additional staffing, we have begun to expand our capacity to assess financial and operational risk, perform more sophisticated data analysis, and respond to market developments."

Seller Concessions

In July 2010, FHA published a notice that proposed to reduce permitted seller concessions to three percent. FHA currently allows for seller concessions up to six percent and concessions exceeding six

[9] Wall Street Journal blog. http://blogs.wsj.com/developments/2010/04/02/fha-mortgage-insurance-premiums-set-to-increase/

percent must be treated as inducements to purchase, resulting in a reduction in the FHA mortgage amount. FHA reasoned that conventional mortgage lenders have capped seller concessions at 3 percent of the sales price on loans with LTV ratios similar to FHA. Loans guaranteed by the Department of Veterans Affairs cap seller concessions at 4 percent of the sales price. In the notice, FHA shows that borrowers who received more than 3 percent in seller concessions had a significantly higher risk of losing their homes. While seller concessions above 3 percent would not be prohibited under this proposal, concessions that exceed FHA's 3 percent cap would be required to result in a dollar-for-dollar reduction in the sales price for the purpose of calculating the maximum FHA loan amount.

Credit Score Floor

Effective October 4, 2010, borrowers with a credit score below 500 are not eligible for FHA-insured mortgage financing. Borrowers with a credit score between 500 and 579 are limited to 90 percent LTV, which requires a 10 percent downpayment. Borrowers with a credit score of 580 or higher are eligible for maximum financing, which requires a minimum 3.5 percent downpayment. Borrowers with nontraditional credit histories may be eligible for maximum financing. In conjunction with updated down payment and credit score guidelines published on September 3, 2010, the changes to FHA's premium structure are projected to result in an additional $4.1 billion in FHA receipts in FY 2011.

Third Party Originator Policy

In a November 30, 2009, proposed rule[10], HUD advised that loan correspondents would continue to have the opportunity to participate in the origination of FHA mortgage loans as third-party originators (TPOs) through association with an FHA-approved mortgagee, but TPOs would no longer be subject to the FHA lender approval process. Since HUD would no longer be approving loan correspondents, FHA-approved mortgagees would assume full responsibility to ensure that their sponsored TPOs adhere to FHA origination and processing requirements. Responsibility for actions of TPOs is not a new responsibility for FHA-approved mortgagees. Only FHA-approved mortgagees would be allowed to submit loan documents to FHA to obtain FHA case numbers.

In the 111th Congress, the Senate failed to approve House-passed legislation permitting the loan to close in the originator's name, so any legislative fix in the 112th Congress must pass both Houses of Congress again. Accordingly, it is now unlikely that a sponsored originator will be able to close an FHA loan in its own name for the foreseeable future.

Impact of Changes

Combined, these changes have lead to a stronger, safer, well-performing government mortgage insurance program. Making the additional proposed changes at this time would only stress an already fragile economic recovery, and could cause a so-called "double dip" in the housing crisis. NAR strongly opposes those changes that will impact liquidity and the ability of credit-worthy borrowers to own their part of the American dream.

[10] Federal Register Docket No. FR 5356-F-02, RIN 2502-A181. Strengthening Risk Management through Responsible FHA-Approved Lenders.
http://portal.hud.gov/hudportal/documents/huddoc?id=FHARISKMGMTFINRULEWEBPOST.pdf

FHA's Role in Multifamily Markets

As in the single-family market, FHA's role in multifamily mortgage markets has never been more critical. More than 1/3 of American families rent their homes, and keeping a sufficient supply of affordable rental housing is essential. Without the liquidity provided by FHA multifamily mortgage insurance, these markets would be stalled.

In recent years, FHA's role in the multifamily market has increased dramatically – nearly 4 times its size from just several years ago. As lenders remain slow to provide financing for construction loans, FHA is the primary source of construction for multifamily developers and owners. Again, this demonstrates FHA's ability to step up and fill the gap when private markets will not or cannot act.

FHA has implemented a number of new procedures and requirements for its multifamily loans. They have strengthened underwriting by changing ratios and increasing documentation. They have also implemented a number of oversight and risk-management provisions.

In response to the increased demand and the changes to the program, FHA's ability to meet the needs of developers to create affordable rental housing has been challenged. FHA is working hard to meet the new demands responsibly. We urge them to look for ways to streamline procedures.

Multifamily Loan Limits

Last year, Congress passed legislation to increase the FHA Multifamily loan limits in high-rise properties. High rise construction has costs significantly different than garden-style apartments. Yet the loan limits for the two are nearly the same. Because the so-called "elevator" limits are so low, many urban areas have not had any properties endorsed with FHA multifamily insurance in the last several years. Since there is very limited private capital available, and high demand for affordable rental housing, our nation's urban dwellers are suffering. We urge this Congress to pass similar legislation to increase the elevator loan limits for multifamily to assure all our nation's families can find affordable rental housing.

FHA's Performance

Much has been made of FHA's audit that showed the capital reserves falling below 2 percent. The biggest contributor to FHA's audit findings is housing prices. As housing prices have fallen, so has the value of FHA's portfolio. This has nothing to do with the quality or the loans or the qualifications of the buyers. As a Congressional Research Service (CRS) report, published November 23, 2009, stated "FHA would not be able to prevent defaults arising from deteriorating financial and macroeconomic conditions."[11]

In fact, NAR believes that FHA has shown incredible strength in weathering this storm. Unprecedented declines in housing prices coupled with the rising levels of unemployment that this nation has experienced in the last few years have caused massive losses in lending institutions and even the GSEs. But FHA has persevered, and thanks to their strong underwriting requirements and

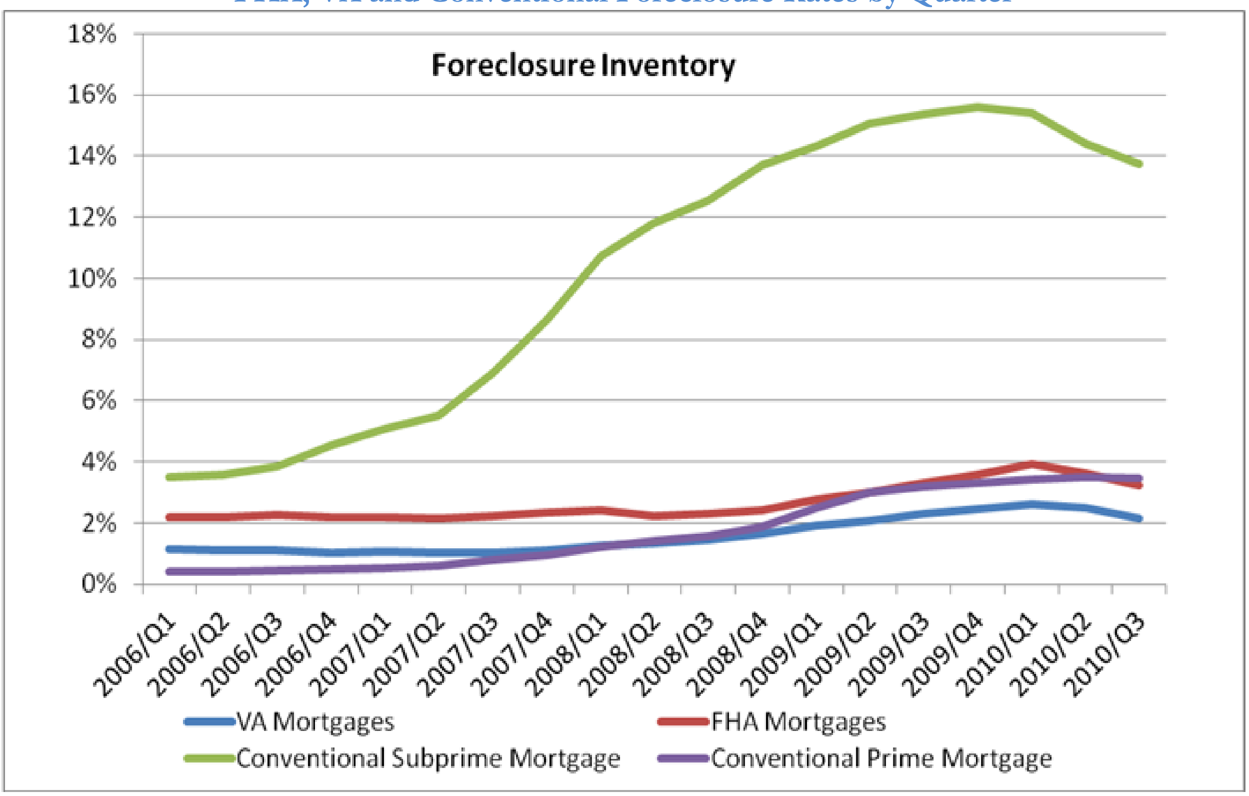
[11] CRS Report R40937, *The Federal Housing Administration (FHA) and Risky Lending*, coordinated by Darryl E. Getter.

prudent practices, has not suffered the devastating losses of other institutions. FHA's total capital resources are more than $33 billion, and FHA is outpacing expectations for rebuilding the required excess reserves.

FHA loans are performing better than ever even under these difficult times. Loans originated in FY10 are the highest quality FHA book-of-business on record.[12] The current average credit score for FHA borrowers continues to climb and is now at 700. FHA's seriously delinquent rate continues to decline, and FHA's foreclosure rate is lower than even prime convention loans. (See chart A).

Chart A

FHA, VA and Conventional Foreclosure Rates by Quarter



Source: Data from the Mortgage Bankers, Quarterly Survey of Delinquency and Foreclosure

[12] Testimony of Shaun Donovan before the Senate Appropriations Subcommittee on Transportation, Housing and Urban Development, April 7, 2011.

FHA Into the Future

FHA is performing exactly the role it was designed to do. It is filling the gap when the private market is not engaged in the market. Already, we have started to see FHA's market share drop as a tentative private investment considers returning to mortgage markets. According to FHA, applications are down nearly 40% in the last month, and more than 35% over the last year[13]. (Chart B)

It can be argued that FHA's market share is a good indicator of the state of housing markets. As is shown in the chart, when FHA was at 3 percent of the market, it should have been a warning sign that we were in a troubled mortgage market, with abusive lenders wooing homebuyers away from safer, stable mortgage products. When FHA was such a huge portion of the market, it was clear that the private market had yet to rebound. Historically, FHA's market share has hovered between 10 and 15 percent of the market. We believe this is an appropriate share for the FHA program. We look forward to FHA's continued decline, as private lenders step up to meet the needs of American homebuyers.

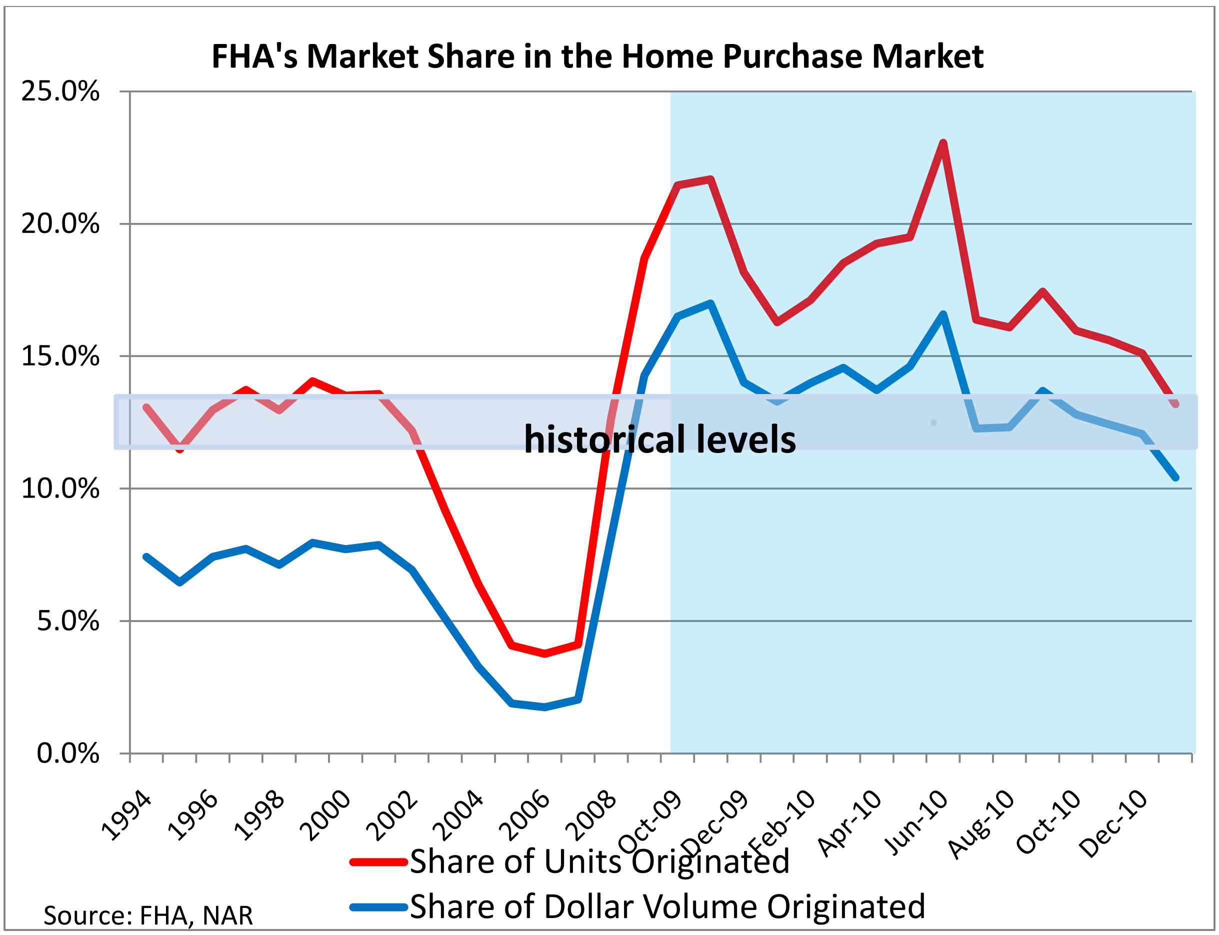
However, this decline must be allowed to happen naturally, as confidence in mortgage markets return, and private investment can provide for the needs of all qualified borrowers. Although this chart shows FHA market-share appearing to be returning to historic levels, we aren't out of the woods yet. Our most recent research found that nearly 33% of the market today is composed of

[13] Department of Housing and Urban Development, *FHA Single Family Outlook,* Monthly Comparisons, March 2011.

cash buyers, a great number of whom are investors rather than families looking to buy a home. The current market conditions are not healthy for American homebuyers, homeowners or real estate markets. We welcome a return to a stabilized market, with access to safe, affordable mortgage credit for American families.

Chart B

FHA's Market Share



The Association urges Congress to exercise caution before considering proposals that may have a profound adverse impact on our economic recovery and diminish programs that serve such a critical role to our nation's families.

Downpayment Requirement

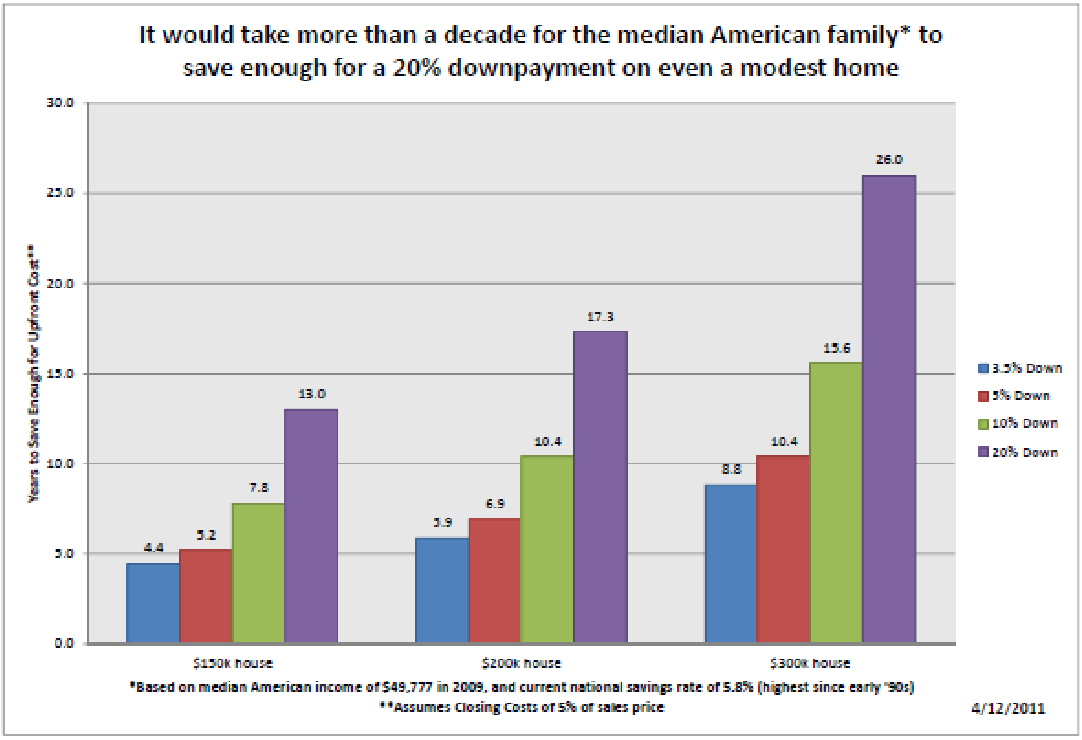
As it was when it was created, FHA remains a leader in providing safe low-downpayment to responsible, qualified borrowers. FHA's current downpayment requirement is 3.5 percent for borrowers with good credit. For more risky borrowers, FHA's downpayment requirement can be as high as 10 percent. Proposals to further increase FHA downpayment requirements are unwarranted and will not serve the purpose that proponents seek.

First of all, increasing FHA's downpayment will not add a penny to FHA's reserves. The reserves can only be increased by collecting premiums, and rising home prices. Increasing down payments does not put any additional money into reserves, it simply reduces the amount of the mortgage.

Second, while a higher downpayment requirement would increase an individual borrower's investment in the home, such an increase will disenfranchise many of the borrowers that the FHA has successfully served throughout its history, and for others could deplete their cash reserves for home and other emergencies. Closing costs average 3-5 percent of the cost of a home. Those costs combined with the current 3.5 percent downpayment requirement are sufficient to insure a borrower's commitment to homeownership, and already represent a significant financial commitment. Requiring a larger downpayment will make homeownership out of reach for many families and for others could deplete their cash reserves for home and other emergencies. According to our estimates based on very conservative assumptions, it would take the average American family, acting frugally, nearly 7 years to save for a 5 percent downpayment on a $200,000 home, and more than 10 years to save 10 percent down. (See chart C)

Chart C

Number of Years Needed to Save Required Downpayments, by Home Price and Downpayment



Source: National Association of REALTORS®

For example, when purchasing a modest $200,000 home with a 10 percent downpayment, the average total upfront cash investment (downpayment, closing costs and prepays) is $30,741. Given that the median income in the United States is $52,029, this up-front investment, even at the current national savings rate which is at a ten year high, would take the average family 10.4 years to accrue. A 20 percent downpayment on the same home would require 17.3 years of saving for this same family. For younger families preparing to settle down, have children and purchase their first home, the savings rate is likely to be much lower. Given the very conservative assumptions inherent in our calculations, it is apparent that increasing downpayment requirements will create a substantial burden for all American homebuyers and especially younger families.

This increased burden comes with only marginal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default, but can strip homebuyers of their savings and increases the number of borrowers who would be ineligible for homeownership.

A recent study showed that:

- Increasing a downpayment requirement from 5 percent to 10 percent reduces default rates by only 2/10ths of one percent, but could disenfranchise more than 8 percent of homebuyers.
- Increasing the downpayment requirement from 5 percent to 20 percent would reduce default rates by only 6/10ths of one percent, but would disenfranchise over 20 percent of homebuyers.[14]
- For FHA, increasing the downpayment requirement from 3.5 percent to 5 percent would disenfranchise more than 300,000 responsible homebuyers. [15]

If there is one lesson to be learned from the recent housing crisis, it is that the key to minimizing foreclosures and defaults is sound and careful underwriting and NOT downpayments. This is easily demonstrated by current foreclosure reports. FHA loans (with 3.5 percent downpayments) and VA loans (with zero downpayments) have a lower foreclosure ratio than prime conventional mortgages (Chart A). Why? These loans have solid, verified underwriting requirements. These loans were not

[14] Study done by the Community Mortgage Banking Project, "Study of 33 Million Home Loans Shows that Quality Underwriting Standards Reduce Default More than mandatory Down Payments."
[15] HUD Testimony, **before the House Financial Services Subcommittee on Housing and Community Opportunity, March 11, 2010**

made unless the borrower has documented their ability to repay the fully amortizing rate on the loan. In summary, increasing downpayments will slow our nation's recovery, disenfranchise potential homebuyers, and change the very fabric of the American dream.

Loan Limits

NAR strongly supports making permanent the FHA mortgage loan limits that are currently in effect. FHA has always played a critical role in providing mortgage liquidity and has continued to do so as private financing has dried up in recent years. Many argue that the higher loan limits help only the higher cost areas, but this is not the case. Reducing the current loan limits would reduce the availability of mortgage loans in 612 counties in 40 states plus the District of Columbia. The resulting average reduction in limits would be more than $50,000. This decline would have a dramatic impact on liquidity in these markets, and could halt the housing recovery.

In addition, such a move could result in a greater risk to the stability of the FHA program since higher balance FHA loans perform better than lower balance ones. According to the FY 2009 audit, "FHA experience indicates that larger houses tend to perform better compared with smaller houses in the same geographical area, all else being equal."[16] So despite arguments that FHA higher limits put taxpayers at risk, these loans actually add strength to the program, and reduce risk to the fund.

Others argue that high FHA loan limits restricts private market activity. We strongly dispute this argument. If the current limits were restricting the development or resurgence of a private market,

[16] *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund (Excluding HECMs)for Fiscal Year 2009,* by Integrated Financial Engineering Inc., November 6, 2009, pg 45.

we would expect to see private lenders providing more new "jumbo" loans – above $729,750 since there is certainly demand for these loans in high cost areas. But in fact, there are very few lenders willing to make these loans – even with high downpayments. When the private market returns, FHA will still have an important role in helping to serve the underserved in all parts of the country including in high cost area, just as it has from the program's very beginning when its loan limits equaled 330 percent of median home values.

Rather than reducing the current loan limits, NAR strongly urges this Subcommittee to approve H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act." This bill, introduced by Reps. Gary Miller (R-CA) and Brad Sherman (D-CA) will make the current limits for FHA and the GSEs permanent.

Conclusion

The National Association of REALTORS® believes in the importance of the FHA mortgage insurance program and believes FHA has shown tremendous leadership and strength during the current crisis. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry. We applaud FHA for continuing to serve the needs of hardworking American families who wish to purchase a home.

We urge the Administration and Congress to move cautiously before making changes to a program that has served the needs of millions of American families for nearly 80 years without needing a federal appropriation. FHA's recent audit shows that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years. We urge caution in making changes to a critical part of our nation's economic recovery, and disenfranchising American families.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Ronald L Phipps	NATIONAL ASSOCIATION OF REALTORS
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☒ No	☐ Yes ☒ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.