Testimony of Barry Rutenberg

On Behalf of the

National Association of Home Builders

Before the

House Financial Services Subcommittee on Insurance, Housing and Community Opportunity

Hearing on

"Legislative Proposals to Determine the Future Role of FHA, RHS, and GNMA in the Single and Multifamily Mortgage Markets"

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Introduction

Chairman Biggert, Ranking Member Gutierrez and Members of the Subcommittee on Insurance, Housing and Community Opportunity, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on the future role of the Federal Housing Administration (FHA), the Rural Housing Service (RHS) and the Government National Mortgage Association (Ginnie Mae) in the single and multifamily mortgage markets. We appreciate the invitation to appear before the Subcommittee on this important issue.

My name is Barry Rutenberg; I am a home builder from Gainesville, Florida, and the 2011 First Vice Chairman of the Board of NAHB. NAHB represents over 160,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's builder members construct approximately 80 percent of all new housing in America each year, and many of our builders rely on the use of HUD's programs (largely FHA's) in order to help provide decent, safe, and affordable housing to many of our fellow citizens.

We commend the Subcommittee for its work to reform FHA, Ginnie Mae, and RHS. NAHB supports efforts to reform FHA, and we understand that this is not a simple undertaking, yet we want reform to be approached with a certain degree of caution. Reform of these programs cannot be separated from the larger discussion of reforming the complex housing finance system, including future reforms to Fannie Mae and Freddie Mac.

As we have testified in other committees, NAHB believes that a stable, effective and efficient housing finance system is critical to the housing industry's important contribution to the nation's economic performance and to the achievement of America's social goals. The federal government, through FHA and Fannie Mae/Freddie Mac, is currently accounting for nearly all the credit flowing to home buyers and rental properties. Even with this federal support, fewer mortgage products are being offered, and these loans are being underwritten on much more stringent terms. In addition, Congress and the regulators are piling on layers of regulations in an attempt to prevent a recurrence of the mortgage finance debacle that is still playing out, which in turn, creates a devastating effect on home builders and buyers alike.

This is not an arrangement that can continue indefinitely. A conversation needs to be had on how to change the unsustainable status quo of the housing finance system. NAHB has had a longstanding belief that it is crucial for the federal government to continue to provide a backstop to ensure a reliable and adequate flow of affordable housing credit. NAHB feels the federal backstop must be a permanent fixture to guarantee a consistent supply of mortgage liquidity as well as to allow rapid and effective responses to market dislocation and crises. That being said, NAHB looks forward to a continued dialogue with the members of this Subcommittee.

Importance of the Federal Housing Administration

FHA was created in 1934, at a time when America was in the midst of the Great Depression. Since then, it has had a long track record of achievement in insuring loans for over 37 million American families, many of whom would not otherwise have been able to own a home. FHA pioneered the concept of a 30 year fixed-rate mortgage and low down payments, and we still benefit from that program today. FHA maintains strong underwriting criteria to protect the tax payers and is intended to be self-funded through the upfront and annual mortgage insurance premiums that borrowers pay.

Contrary to the belief of some, FHA is not a subprime lender and has never required a federal bailout. Although the program is experiencing shortfalls in its excess reserves due to the effects of the worst economic downturn since the Great Depression, FHA remains an integral part of our nation's economic recovery. Housing has led America out of every economic downturn and can do so again if the future policies regarding housing finance reform are addressed in a manner that provides liquidity for the entire housing sector in all markets.

If we look to the dramatic increase of FHA's market share over the past few years, we can see how essential the program is for our nation's economic recovery. In 2006, the FHA's market share was at an all time low of two percent when subprime loans were at a 20 percent level. Over the last two years, FHA insured nearly 30 percent of the single family mortgage market, of which nearly 80 percent of those FHA purchase loans were to first-time home buyers. This dramatic shift is evidence that FHA is performing its mission of providing the federal backstop to ensure that every American has access to a stable mortgage product. While we still believe that the private market should be the primary source of mortgage financing, that market is extremely limited; until it returns, FHA and other federally backed programs are needed to keep our economy afloat.

FHA historically also has played an important role in the financing of multifamily rental housing, and it is especially important now during the current economic crisis. In 2008, FHA endorsed just over $2 billion in multifamily loans, which grew to $10.3 billion in 2010. HUD estimates that it will endorse another $10 billion in loans in 2011. The FHA multifamily mortgage insurance programs have enabled the construction of needed affordable rental housing units over the years, as well as contributed to the ability of property owners to rehabilitate and preserve the existing stock of affordable housing.

FHA, along with Fannie Mae and Freddie Mac, provide the majority of multifamily financing today. While it is expected that other lenders will slowly return to the market, FHA is serving one of its critical roles - providing sufficient liquidity to meet market demand for financing multifamily housing during an economic crisis.

FHA Single Family Programs

Recent Policy Changes to FHA's Single Family Underwriting

FHA has implemented a series of policy changes over the last two years, including higher mortgage insurance premiums, tighter underwriting requirements, and stricter mortgage lender enforcement, all intended to strengthen the performance of the Mutual Mortgage Insurance Fund (MMIF) and rebuild the capital reserve ratio. These changes are the most sweeping combination of reforms to credit policy, risk management, lender enforcement in FHA history.

The MMIF provides the backing for FHA's single family mortgage insurance program. HUD released the 2010 annual independent actuarial review of it's the MMIF on November 16, 2010. The actuarial review, which is required by Congress, provides an estimate of the capital reserve ratio, or the cushion that would remain after anticipated losses are taken over the term of the loans outstanding with FHA mortgage insurance.

The 2010 FHA Actuarial study found that FHA's capital ratio remained flat at 0.50 percent in 2010, slightly less than the 0.53 percent registered in 2009 and well below the 2.0 percent mandated by Congress. Despite the dip, FHA viewed the report as positive as earlier forecasts suggested that the ratio could have gone negative, in which case FHA would have needed government funding.

FHA attributes the performance to reforms over the past year that have boosted capital levels, which have been offset by a continuing drag from past business. FHA's capital resources are at the highest level ever due to the strong 2010 book of business, which has the best credit characteristics in FHA's history, and to the series of policy actions (described below) taken to strengthen the fund. Without any further policy actions, FHA's capital ratio is expected to exceed the two percent statutory requirement by 2015.

Restructuring FHA Mortgage Insurance Premiums (MIP)

FHA implemented a three-stage process to restructure its mortgage insurance premiums. The first stage became effective in April 2010, when FHA increased the upfront MIP on single family loans by 50 basis points from 1.75 to 2.25 percent.

The second stage occurred in September 2010 shortly after enactment of H.R. 5981, which gave FHA the authority to raise the maximum allowable annual mortgage insurance premium. The new law permits FHA to increase the annual MIP to 1.50 percent, from the previous 0.50 percent for mortgages with a loan-to-value ratio (LTV) equal to or less than 95 percent. For mortgages with a LTV greater than 95 percent, the FHA is authorized to increase the annual MIP to 1.55 percent (previously 0.55 percent).

FHA promptly moved to increase the annual premium, but correspondingly lowered the upfront premium. Effective, October 4, 2010, the FHA upfront MIP was reduced to one percent. The annual MIP was increased to 0.85 percent for loans with LTVs of 95 percent or lower and to 0.90 percent for loans with LTVs exceeding 95 percent.

The third, and most recent stage, in the process, occurred in February 2011. FHA announced in Mortgagee Letter 2011-10 that it would again raise the annual premium by another .25 percent for loans with case numbers assigned on or after April 18, 2011.

Updating Credit Score/Downpayment Guidelines

FHA published changes to LTV and credit score requirements in September 2010. The rule sets the minimum FHA-insured single family mortgage programs credit score at 500 and creates a two-part credit score threshold. Borrowers with a credit scores of 580 and above continue to make the standard downpayment of 3.5 percent, and borrowers with credit scores between 500 and 579 are required to make a 10 percent minimum down payment.

The new credit score and downpayment requirements became effective in October 2010. These changes have produced, according to Secretary Donovan, the highest quality FHA book-of-business on record and the future looks even brighter. The average credit score on current insurance endorsements has risen to nearly 700.

Lender Oversight and Enforcement

FHA introduced policy changes and improved lender oversight and enforcement to increase the quality of FHA insured loans. In April 2010, FHA published a rule eliminating FHA approval for loan correspondents and increasing net worth requirements for lenders, thereby strengthening FHA's counterparty risk management capabilities. In addition to FHA's increased oversight and enforcement many lenders are using more stringent overlays to FHA's policies to manage credit risk.

Legislative Proposals for FHA Single Family Reforms

NAHB generally has been very supportive of FHA's changes to ensure the MMIF is sustainable to support FHA's goal to strengthen the nation's housing market to bolster the economy and protect consumers. NAHB understands FHA currently has a disproportionate share of the mortgage market and current levels are not desirable or sustainable.

The changes proposed in the Discusison Draft , including increasing the downpayment to five percent, prohibition of financing certain closing costs, potentially higher mortgage insurance premiums, and lowering mortgage limits will restrict access to FHA credit which is the only low downpayment program. NAHB has strong concerns regarding the impact of these proposed reforms and for FHA's ability to maintain its critical mission, of providing support for home buyers during this tenuous juncture in the economic recovery.

Higher Downpayments

NAHB is concerned that increasing the downpayment from 3.5 percent to five percent will create a substantial burden for all American homebuyers, especially younger buyers and those with strong credit profiles but not enough available funds to make the increased downpayment. Also adversely affected will be current homeowners looking to move up who will not be able to do so because of the reduced number of qualified borrowers.

The increased downpayment burden provides minimal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default but causes homebuyers to use more of their reserves for the downpayment. In testimony before this Subcommittee in March 2010, then-FHA Commissioner David Stevens noted that HUD research found that increasing the downpayment requirement from 3.5 percent to 5 percent, along with prohibiting the financing of the upfront MIP, would reduce FHA's volume of loan endorsements by 40 percent and disenfranchise more than 300,000 responsible homebuyers.

Sound underwriting is the key to minimizing foreclosures and defaults not downpayments. This is demonstrated by current FHA foreclosure reports on loans made to borrowers with sound credit profiles, which have significantly improved. Last week, the Mortgage Banker's Association's National Delinquency survey reported that FHA was the only product type that experienced a drop in total delinquency rate in the first quarter of 2011. This is corroborated by FHA's data on portfolio performance, which shows that the serious delinquency rate for the total portfolio at the end of Q1 2011 was 8.78 percent, which is substantially lower than the 9.44 percent rate observed one year earlier. FHA attributes this improved loan performance to the stronger 2009-2011 book of business, which now represents half of all FHA-insured loans, by number of loans.

Potential Increases to FHA Annual Mortgage Insurance Premiums

NAHB appreciates the continued focus on strengthening the FHA's risk management practices. However, we are concerned that the proposal to remove the ceiling on the annual MIP, presently at 1.50 percent, could result in a higher annual MIP. Having already implemented a three step MIP increase, FHA's recent strong performance and the forecast that the MMIF will exceed the capital reserve ratio in 2015, now is not the time to further increase insurance premiums. Increasing the insurance premiums now will put additional financial strains on homebuyers who potentially could be buying excess housing inventory.

The strong performance of recent loans made under the revised underwriting criteria makes a compelling case that more restrictive reforms are not warranted. It is critical that any reforms to FHA are carefully evaluated, in conjunction with other mortgage industry reforms, to ensure the still fragile recovery stays on track and protects the long-term value of homeownership in the U.S.

Loan Limits

NAHB supports making permanent the current loan limits for FHA and the GSEs as calculated by formulas set in the *Economic Stimulus Act of 2008*. With no Congressional action, the limits will be reduced to the limits established by the *Housing and Economic Recovery Act (HERA) of 2008* on October 1, 2011. The new limits will be calculated based on 115 percent of area median house price, down from 125 percent and the ceiling for a high-cost area will fall from $729,750 to $625,500. The floor for FHA loans would remain $271,050. To keep the FHA and GSE loan limits at the current level, NAHB strongly supports H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act," introduced by Reps. Gary Miller (R-CA) and Brad Sherman (D-CA).

In contrast, the legislative proposal as drafted would calculate the FHA loan limits based on 125 percent of median home price by county, with no floor and a ceiling equal to that established in HERA. NAHB has grave concerns with this proposal. Eliminating the floor for FHA loans would reduce the loan limits for a significant number of areas throughout the country, leaving large numbers of first-time home buyers without a key source of mortgage financing. While we do not know the exact data that would be used to calculate these limits, it is clear that overhauling the way that the loan limits are set will have a significant impact on the availability of FHA-insured mortgages. Counties across the country would see their loan limit reduced by tens of thousands of dollars. This would place further downward pressure on home prices.

As an example, I live in Alachua County, Florida which currently has a loan limit of $271,050. Under this proposal, NAHB estimates that the new loan limit would be about $190,000 (based on 2010 home sales price data from CoreLogic) – a decline of 30 percent.

The reduction in the loan limits would have a significant impact on the ability to use FHA-insured mortgages to purchase new homes. New homes with energy efficient features and improved construction standards generally have a higher price point, and are more likely to be priced above of the new FHA loan limits.

Chief Risk Officer

FHA hired its first Chief Risk Officer (CRO) in its 75-year history in 2009. Last summer, FHA received Congressional approval to formally establish this position and create a permanent risk management office within FHA. The Discussion Draft proposes to elevate the current FHA CRO position to Deputy Assistant Secretary for Risk Management and Regulatory Affairs within FHA to be appointed by the HUD Secretary. NAHB commends the Subcommittee for creating this position which would allow FHA to enhance its focus on financial and operational risk management and to better respond to market developments.

Required Capital Ratios for General and Special Risk Insurance Funds

Section 2 of the draft discussion bill proposes to establish capital ratios for the General Insurance and Special Risk Insurance (GI/SRI) funds. Currently, there is no statutory requirement for capital ratios for either fund. While NAHB understands that members of Congress and the Administration are focused on strengthening the risk management practices for the FHA programs (both single and multifamily), we strongly urge you not to implement capital ratios until an in-depth analysis is conducted to determine the appropriate levels and time frame in which to implement them, as well as the projected impact on the mortgage insurance premiums (MIPs) for the FHA multifamily programs. The proposed capital ratios are similar to those for the MMIF, which guarantees the FHA single family mortgages. NAHB does not believe it is appropriate to use the MMIF capital ratios for the GI/SRI fund, because the nature of the multifamily portfolio is significantly different from the single family portfolio insured under the MMIF.

NAHB believes that it is important to note that over the last 18 months, the department has instituted a new risk management protocol for the FHA multifamily mortgage insurance programs. The new protocol tightens underwriting requirements and institutes a national loan review committee. Much effort has been made to strengthen and standardize processes and procedures throughout the field offices, and there is closer scrutiny on market strength and FHA presence than before the economic crisis struck. NAHB has been actively engaged in working with the department as these requirements have been implemented.

However, it is also important to note that the implementation of the new risk management protocol did not include an increase in the MIP for any of the FHA multifamily mortgage insurance programs. The purpose of charging a MIP to borrowers of FHA-insured loans is to collect sufficient sums to insure that, in the case of defaults, the government can cover the cost of paying off its financial obligation to the lenders. The Federal Credit Reform Act (FCR) of 1990 directs government agencies to provide a realistic picture of the cost of government loans and guarantees. To comply with the FCR in determining the costs of the FHA multifamily mortgage insurance programs, HUD uses an economic model that takes into account the risks and costs of each program and has traditionally set the MIP for a specific program at a level sufficient to protect the integrity of the insurance fund without overcharging borrowers. The practice, since 2003, has been that the MIPs for the FHA Section 221(d)(4) and most other programs are set at roughly breakeven levels.

Thus, any proposal to implement a capital ratio on the GI/SRI funds could have a significant impact on MIPs. Higher MIPs will lead to higher costs for borrowers and renters who are served by the FHA multifamily programs. A key example is the Section 221(d)(4) program where a higher MIP will raise the required borrower debt service and/or equity contribution, resulting in a lower mortgage amount at a higher rate of interest. These higher costs would be passed along to the low- and moderate-income families who use the program in the form of higher rents or could result in properties not being built or rehabilitated because of the higher equity contribution required.

At this time, there are few alternative sources of financing for multifamily rental housing. FHA, Fannie Mae and Freddie Mac have provided the vast majority of financing for multifamily rental housing during this economic crisis and will continue to do so for the foreseeable future. Although we do expect some of the other sources of multifamily financing to return to the markets slowly, only projects in the strongest markets will benefit. This makes it especially critical to conduct a thorough analysis as to the appropriate level of capital ratios for the GI/SRI funds before any action is taken.

HUD Management of Rural Housing Programs

Section 13 of the discussion draft bill would transfer the functions, personnel, assets and liabilities of the Rural Housing Service (RHS) of the Department of Agriculture (USDA) to HUD. This includes all of the single and multifamily housing programs authorized under Title V of the Housing Act of 1949. The discussion draft bill would establish a Deputy Assistant Secretary for Rural Housing under the Office of Housing to administer the transferred programs.

NAHB does not support the transfer of the RHS programs to HUD. The RHS programs have financed over two million units for homeowners and over 500,000 rental units for low and moderate income households living in rural areas. In addition, the RHS has provided funding to repair thousands of single family homes, as well as rental assistance to thousands of low and moderate income persons, many of whom are elderly, and financing to provide affordable housing to migrant workers. 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 from those found in urban and suburban areas. We also are concerned that the transfer of the RHS programs to HUD could lead to a consolidation of the programs into existing HUD programs. If that were to occur, the network of state offices that administer the RHS single family programs would be lost, making it more difficult and more expensive for persons living in rural areas to obtain an affordable mortgage to purchase a home.

Further, if the RHS multifamily programs were consolidated into HUD programs, it would be considerably more difficult to finance small properties in rural areas because HUD does not have a program that meets this need effectively. State housing finance agencies (HFAs) with specific rural interests have taken a much larger role in financing small rural multifamily properties, largely through coupling Low Income Housing Tax Credits (LIHTCs) with RHS programs.

NAHB suggests that a more productive action would be to strengthen the RHS programs by allocating the agency sufficient funding and resources to address housing issues in rural areas. The USDA commits funding and resources to business and economic development in rural areas, and it should continue to do that for housing in rural areas. A strong commitment from

USDA to administer its housing programs in an efficient and effective manner would yield more for households residing in rural areas than transferring the programs to HUD.

Guarantee Fees for Rural Multifamily Rental Housing Loans

Section 14 of the discussion draft proposes to set guarantee fees for the Section 538 program. The Section 538 program provides affordable rental housing to low and moderate income households in rural areas. The program is often used in conjunction with the Low Income Housing Tax Credit program and, thus Section 538 housing serves many very low income households as well.

Section 14 proposes that, at the time of issuance of the guarantee, a fee equal to one percent of the principal obligations of the loan would be charged. An annual fee of 0.5 percent of the outstanding principal obligation of the loan would also be charged, and if this amount is not sufficient, the Secretary may determine a fee that would cover the program costs, as required by the Federal Credit Reform Act of 1990.

NAHB supports the Section 538 guarantee loan program and believes that the suggested fees are appropriate to ensure that the program remains available and is budget neutral.

Conclusion

Few things are more important to Americans than their homes. Whether they rent or own, Americans want to choose where they live and the type of home that best meets their needs. Rental housing is the choice for millions, from all ages and walks of life. For many others, the opportunity to own a home is the cherished ideal. Today, even though the housing market is still suffering from the effects of the worst housing market downturn since the Great Depression, Americans still believe in homeownership, which is why NAHB appreciates the key role FHA has played in keeping our housing market liquid, stable and affordable.

NAHB commends the Subcommittee for its work on the draft proposal. We understand that looking at ways to improve the housing market is not an easy task. NAHB does have some serious concerns on how to move forward that may differ from the Subcommittee. However, we would like to continue discussions on how to address the complete housing finance system, as FHA, Ginnie Mae and the GSEs are part of the larger financial system that is essential to moving our economy forward.

Thank you again for the opportunity to address you today. I look forward to any questions.

United States House of Representatives
Committee on Financial Services

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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:
Barry Rutenberg	National Association of Home Builders
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: Barry B Rutenberg	

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