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WRITTEN TESTIMONY OF

MAURICE "MOE" VEISSI
2012 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING REGARDING

PERSPECTIVES ON THE HEALTH OF THE FHA SINGLE-FAMILY INSURANCE FUND

DECEMBER 1, 2011

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Introduction

Chairman Bachus, Ranking Member Frank, and members of the Committee; my name is Moe Veissi. I have been a REALTOR® for 40 years, and am broker/owner of Veissi & Associates, Inc. in Miami, Florida. I currently serve as the 2012 President of the National Association of REALTORS®.

I am here to testify on behalf of the 1.1 million members of the National Association of REALTORS®. 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.

FHA is an insurance entity within the Department of Housing and Urban Development (HUD) that ensures American homeowners access to with safe and stable financing in all markets. FHA has insured home loans for more than 37 million American families since its inception in 1934, and has never required a federal bailout. While many have recently questioned the program's recent performance, we would argue that, in fact, FHA has shown its considerable strength during the significant housing and economic crisis our country is still experiencing.

In a time when many of the large private banks, investment firms, and other financial institutions have needed bailouts, restructuring or have even collapsed, FHA has weathered the storm very well. FHA continues to have significant resources to pay 30 years' worth of expected claims on their portfolio, which is 30 times more than banks, which are only required by the Financial Accounting Standards Board (FASB) to hold one year of reserves. In addition, FHA continues to have additional reserves of more than $2.5 billion. This is truly an achievement; FHA should be lauded for its financial stability in a most challenging environment and held up as a standard for strong underwriting and risk avoidance.

FHA's Mission

A common misconception exists that FHA was originally intended to only fund modest home purchases and benefit low-income borrowers who could not afford a large down payment on a new home. A review of the program's early loan limits, average prices of homes purchased with FHA loans and loan-to-value ratios demonstrates that this was not the case.

In the program's first years, for example, the maximum insured loan amount was $16,000. While this may seem to be an exceptionally modest amount today, in 1930 only 3.2 percent of homes were valued between $15,000 and $20,000.[1] The majority of values lay between $2,000 and $7,500, with

1. 15th Census of the United States, Population, Volume VI: Families, U.S. Census Bureau, 1930, P. 17

the largest number of these between $3,000 and $5,000.[2] The national median home value was $4,778.[3] So an upper limit of $16,000 in was more than 330% of the median American home value then.

Of course, the $16,000 loan limit does not paint the entire picture of FHA's target demographic. To better understand this, we should look at how the program was used by borrowers. In its third annual report to Congress for 1936, FHA's statistics showed that most of the homes insured were valued in the $3,000 to $6,000 range and the average single-family home value for an insured mortgage was $5,497, more or less reflecting the average costs of homes at the time.[4] Only 2.8 percent of FHA-insured homes were valued below $2,000, and only 2.1 percent above $15,000.[5] This is strong evidence that FHA was not originally targeted to any income group, but rather was intended to help families across the spectrum finance their purchase homes. These statistics varied slightly from year to year, with the size of insured mortgages somewhat lower in 1937 (median 4,288), and then higher in 1938 (median $4,491).[6, 7] In general, these trends have followed income levels of FHA-insured borrowers.[8, 9]

In a similar vein, the original loan-to-value ratio (LTV) limit for FHA mutual mortgage insurance was set at 80 percent. This sounds like a high down payment requirement today, but it was a considerably less constraining than what lenders had previously required. As a result, in 1930 the American homeownership rate was below 50 percent.[10] This change proved very popular: nearly 60 percent of FHA-insured borrowers in 1937 had LTVs between 76 and 80 percent, a jump from 47 percent in the preceding year.[11] Indeed, the lower down payment requirement proved successful enough for FHA to raise the limit again in 1938 to 90 percent for some loans.

FHA's popularization of amortizing loans with lower down payments have led some to propagate the fiction that FHA helps families get into homes they cannot afford. Since the value of insured mortgages has tracked borrower incomes fairly closely, it is no surprise that FHA borrowers have generally not had mortgage payments that are large in comparison to their incomes. In 1937, 61 percent of new FHA borrowers spent less than 15 percent of their incomes on monthly mortgage

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2. Id.

3. Id. at 18

4. Third Annual Report of the Federal Housing Administration for the Year Ending December 31, 1936. U.S. Government Printing Office. 1937. P.35

5. Id.

6. Fourth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1937. U.S. Government Printing Office. 1938. P.58

7. Fifth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1938. U.S. Government Printing Office. 1939. P.85

8. Fourth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1937. U.S. Government Printing Office. 1938. P.61

9. Fifth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1938. U.S. Government Printing Office. 1939. P.91

10. 15th Census of the United States, Population, Volume VI: Families. U.S. Census Bureau, 1930. P. 12

11. Fourth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1937. U.S. Government Printing Office. 1938. P.60

payments, and 92 percent of borrowers paid less than 20 percent.[12] In 1938, 97 percent of borrowers paid less than 20 percent of their incomes on monthly mortgage payments.[13] From the very beginning, FHA was a program helping people purchase homes they could well afford.

The Importance of FHA

With the collapse of the private mortgage market, the importance of the Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, FHA is one of the primary sources of mortgage financing available to families today. Without FHA, many families would be unable to purchase homes and communities would suffer from continued foreclosure and blight. FHA also continues plays a very critical role for those borrowers who are traditionally underserved by the private market. According to the Federal Reserve, FHA insured 60 percent of all African-American and Hispanic homeowners in FY2010. FHA is also the leader in serving first-time homebuyers. In FY2010, FHA insured 56 percent of all first-time homebuyers. In total, of all FHA borrowers, 75 percent were first time homebuyers. FHA also helped many American families refinance into loans with lower interest rates. More than 440,000 homebuyers saved an average of $160 per month, thanks to their new FHA loan.

Despite *not* being subsidized, and being fully funded by the premiums paid by its borrowers, FHA provides also significant benefits to consumers and the FHA fund as the result of the program's focus on foreclosure mitigation. FHA's loss mitigation program includes mortgage modification and partial claim options. Mortgage modification allows borrowers to change the terms of their mortgage so that they can afford to stay in the home. Changes can include extension of the length of the mortgage or changes in the interest rate. Under the partial claim program, FHA lends the borrower money to cure the loan default. This no-interest loan is not due until the property is sold or paid off.

In FY 2011, FHA loss mitigation tools were used to cure 362,000 defaults, and yielded the lowest re-default rates of the past five years. In addition, this year FHA made enhancements to its loss mitigation requirements to increase the use of trial payment periods prior to the mortgagee executing a Loan Modification or Partial Claim action to cure a default. Trial payment plans are expected to reduce re-default rates on loan modifications and partial claims, and thereby reduce costs to the FHA Insurance Fund. By encouraging lenders to participate in these loss mitigation efforts and penalizing those who don't, FHA has successfully helped homeowners keep their homes <u>and</u> reduced the level of losses to the FHA fund.

The universal and consistent availability of FHA loan products is the hallmark feature of a program that has made mortgage insurance available to individuals regardless of their racial, ethnic, or social characteristics during periods of economic prosperity and economic downturn.

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12. Id. at 63

13. Fifth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1938. U.S. Government Printing Office. 1939. P.95

FHA Strength/Solvency

FHA's 2011 actuarial review demonstrates that its capital reserve fund remains below the Congressionally-mandated 2 percent ratio. The capital reserve ratio reflects the reserves available (after paying expected claims and expenses) as a percentage of the current portfolio, to address unexpected losses. While this is sobering news, most reports have overlooked the fact that the capital reserve fund is not FHA's only reserve fund. FHA also has a cash reserve account separate from the capital reserve. Consequently, FHA's actual total reserves are higher than they have ever been with combined assets of $33.7 billion. This is an increase of $400 million over the previous year.

What the audit confirms is that FHA has "positive" reserves, meaning they have adequate resources to cover all claims and expenses resulting from their portfolio. It is critical to note that FHA's fully capitalized cash reserves account for paying <u>all</u> claims over a 30 year period. By comparison, the Financial Accounting Standards Board only requires financial institutions to hold reserves for losses over the next 12 months. In essence, the FHA loan program has 30 times that amount in cash reserves, with another $2.55 billion in the excess capital reserves, than would be required if they were a privately-held financial institution. In addition, the audit shows that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent by 2014—sooner than was projected in last year's actuarial report.

The reason the capital reserves have fallen below 2 percent actually is unrelated to FHA's current business activities. There has not been a significant increase in defaults on the part of borrowers, nor underwriting problems experienced by FHA and its lenders. The decline is precipitated by the falling estimates of the value of homes in the portfolio. As such, the decrease in the capital reserve account is a direct reflection of the state of our economy and our housing markets.

Obviously, the economic crisis our country is facing is far beyond the control of FHA. 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."[14] Given the devastating impact home price declines have had on banks, lenders, and the government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae, FHA has performed remarkably through this crisis. Why? FHA has never strayed from the sound underwriting and appropriate appraisal policies that have traditionally backed its loans. For example, FHA borrowers' credit profile has never been stronger. FHA credit quality has improved steadily since 2007, 4th quarter. Over 50 percent of FHA loans made in every quarter since 2009 (2nd quarter) had credit scores above 680. Today, FHA's borrowers have an average credit score of more than 700, higher than it has ever been—a factor that has helped contribute to FHA's financial reserves.

FHA has met the needs of America's homebuyers, but has never resorted to abusive loans, improper or nonexistent underwriting, or other bad practices. As a participant in the home mortgage process,

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

FHA cannot be immune to the pitfalls of the housing crisis. Solid policies and practices have protected it from the biggest failures.

FHA's Recent Changes

For the past several years, FHA has reacted to the lower reserves by making changes to its program. FHA now has a Chief Risk Officer to oversee FHA's efforts to mitigate risk. This was a new position created just two years ago, and we applaud this decision. Assigning one senior staff member with the responsibility for coordinating FHA's risk management activities makes good sense.

FHA has also increased premiums multiple times in the last several years. Beginning in 2010, FHA raised its mortgage insurance premiums three times. FHA's current premium levels are the highest they have ever been in the agency's history. The new annual mortgage insurance premium structure alone led to an increase in the FY 2011 economic value of the Mutual Mortgage Insurance (MMI) Fund of $1.37 billion. We also expect an additional premium increase in the next several months.

NAR strongly supports changes that are vital to retaining the strength and solvency of the FHA fund. However, we do not want to make changes that artificially increase the costs of homeownership in order to fund other government programs and disenfranchise families who wish to purchase a home. Therefore, we strongly urge FHA and Congress to use caution when making changes to ensure that they are necessary for the financial stability of the fund.

NAR Additional Recommendations for FHA

NAR advocates additional changes for FHA to ensure its continued strength and availability to homeowners.

Condominium Rules

Condominiums are often the only affordable option for first time home buyers or borrowers with good credit, but small downpayments. FHA announced updated condominium rules on June 30, 2010, that included some improvements but we continue to have significant concerns with the rules and recommends changes that will provide greater liquidity to this sector of the real estate market without causing additional risk to the Mutual Mortgage Insurance Fund (MMIF). We support enhancements to the rules and limits relating to owner-occupancy, two investor ownership, and delinquent home owner association (HOA) assessments.

NAR recommends elimination of the owner-occupancy requirement for FHA condo mortgages. The GSEs do not have an occupancy ratio for condominium projects if the borrower is going to occupy the unit, which would be the case for all FHA borrowers. Eliminating this requirement will allow more buyers to purchase condominiums which are often more affordable, raise occupancy levels, and stabilize these developments and their communities. If FHA retains the occupancy ratio, NAR recommends amending the rules so that all bank-owned REOs are not counted for the purposes of the occupancy ratio. Again, this will align FHA with industry practices in this area.

FHA made positive changes to the condominium rules but more can be done. NAR, along with a coalition of real estate partners, previously recommended enhancements to concentration and pre-sale requirements that were made permanent in FHA's condominium rules announced on June 30, 2011. However, FHA can provide additional flexibility on condominium recertification requirements and fidelity insurance coverage requirements. NAR also recommends FHA reconsider the elimination of the Spot Loan Approval Process. Spot loans can be critical for borrowers who wish to use FHA to purchase a condominium in a project that is not FHA approved.

Mortgage Loan Limits

We also strongly support making permanent the FHA mortgage loan limits that are currently in effect. FHA has played a critical role in providing mortgage liquidity as private financing has dried up. We applaud Congress for extending the current loan limits through 2012, but strongly believe that these limits need to be made permanent.

In today's real estate market, lowering the loan limits restricts liquidity and makes mortgages more expensive for households nationwide. FHA and GSE mortgages together continue to constitute the vast majority of home financing available today, which makes it particularly critical that the current limits continue. Without the additional liquidity created by maintaining loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

Many argue that the loan limit increases help only the higher cost areas, but this is not the case. According to a recent HUD report, only 3 percent of FHA loans are above $362,750, and less than 2 percent are above $417,000. But decreasing the loan limits would impact 612 counties in 40 states plus the District of Columbia. More than 100 counties throughout the Midwest and more than 200 counties in the South would experience declines averaging more than $64,000. The majority of markets that were impacted by the loan limit decline are NOT high cost. If the limits were to fall, more than half of all existing homes nationwide will be ineligible for FHA mortgage financing. If families cannot obtain financing to buy, sellers will need to further reduce the price on their home. This will further erode the wealth of American families and will prolong the nation's economic recovery.

In addition, higher balance FHA loans perform better than lower balance ones. According to the FY 2010 audit, "FHA experience indicates that more expensive houses tend to perform better compared with smaller houses in the same geographical area, all else being equal." 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.

We strongly support the legislation introduced by Committee members Brad Sherman (D-CA) and Gary Miller (R-CA), H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act" to make the current loan limits permanent. We urge the Committee quickly consider this important legislation to ensure that liquidity in this tenuous market is not put at risk.

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 one third 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

We strongly urge Congress to pass 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 very different types of units 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 Congress to pass legislation to increase the elevator loan limits for multifamily to assure all our nation's families can find affordable rental housing.

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.

It can be argued that FHA's market share is a good indicator of the state of housing markets. 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. Conversely, with FHA such a huge portion of the market today, it is clear that the private market has 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 over the long run. We look forward to FHA's continued declining market share, as private lenders step up to meet the needs of American homebuyers.

However, this decline must be allowed to happen gradually and naturally, as confidence in mortgage markets returns and encourages private investment to once again provide for the needs of the majority of qualified borrowers. Although FHA market-share has begun returning to historic levels, we aren't out of the woods yet. Our recent research found that nearly 33 percent of the market today is composed of 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.

Conclusion

The National Association of REALTORS® feels strongly about 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 wholeheartedly support the FHA program and we stand ready to work with Congress to enhance FHA's mission, service and purpose. We thank you for this opportunity to testify, and look forward to working with you to accomplish our recommended proposals.