Testimony of Jerry Howard

On Behalf of the

National Association of Home Builders

Before the

House Financial Services Committee

Hearing on

"A Legislative Proposal to Provide for a Sustainable Housing Finance System: The Bipartisan Housing Finance Reform Act of 2018"

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Introduction

Chairman Hensarling, Ranking Member Waters and members of the committee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on housing finance reform. My name is Jerry Howard and I am NAHB's Chief Executive Officer.

NAHB represents over 140,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's members construct approximately 80 percent of all new housing in America each year. Our builders rely on both government and private programs and financing sources to help provide decent, safe, and affordable single family and multifamily housing to our fellow citizens.

We believe an effective housing finance system must address liquidity as well as affordability and that those two elements are very closely related. Therefore, while it is important for the system to provide housing credit at affordable terms as well as address specific housing needs, it also is essential that credit is consistently available on those terms regardless of domestic and international economic and financial conditions.

Need for Comprehensive Housing Finance System Reform

NAHB remains a staunch supporter of comprehensive housing finance system reform. To NAHB this means effective reform of the conventional mortgage finance market, including Fannie Mae and Freddie Mac (the Enterprises), private capital sources and federal mortgage finance programs, in particular the U.S. Department of Housing and Urban Development (HUD), most involving the Federal Housing Administration (FHA), the U.S. Department of Agriculture's Rural Housing Service (RHS) and the U.S. Department of Veterans Affairs' (VA) Home Loan Guaranty Program. NAHB believes comprehensive reform must come through Congress and focus on fixing the structural flaws that still persist ten years after the great recession. Comprehensive legislation is the only way to ensure a stable housing finance system, preserve access to credit and protect taxpayers.

In September, Fannie Mae and Freddie Mac completed their tenth year in conservatorship under the control of their regulator, the Federal Housing Finance Agency (FHFA). NAHB believes strongly that having the Enterprises continue in conservatorship, with no end in sight, is undesirable and unsustainable.

Since being placed in conservatorship, the Enterprises have paid Treasury a combined $285.8 billion. Significantly, this does not count as repayment for the $189.4 billion (including the initial $2 billion) of the capital support provided by Treasury. The Treasury has a remaining outstanding commitment of $254.1 billion available to the Enterprises to draw down. It is this commitment from Treasury that is supporting investor confidence in the Enterprises' mortgage-backed securities (MBS) and keeping the housing market liquid and operational.

While Fannie Mae and Freddie Mac are not granted an explicit government guarantee by their charters, Treasury's backing has turned the Enterprises' historical implicit guarantee into an explicit government guarantee. The Enterprises currently back about $4.5 trillion in mortgages. Combined with Ginnie Mae securities, which are backed by loans insured by FHA, RHS and mortgages guaranteed by VA, outstanding securities in the agency market totaled $6.6 trillion as of October 2018[1], a significant percentage of the entire U.S. economy. These loans all have a federal government backstop, which means taxpayers are at risk of loss due to a failure of the underlying mortgage loans. FHFA has taken steps to reduce taxpayer risk on Fannie Mae- and Freddie Mac-backed loans through Credit Risk Transfer (CRT) programs that shift a meaningful portion of credit risk to private investors on at least 90 percent of the Enterprises' targeted fixed-rate single family mortgage acquisitions.

In early September, as the 10-year anniversary of conservatorship of Fannie Mae and Freddie Mac approached, NAHB joined 28 other organizations in signing "An Open Letter to the Administration and Congress" urging policymakers to lock in recent reforms to Fannie and Freddie and complete additional reforms. The letter emphasized that significant reforms put in place during conservatorship must be retained, such as pricing parity across lenders, the transfer of risk off of taxpayers shoulders, a new infrastructure for the secondary market and support of strong and sustained liquidity in the multifamily rental market. Legislation must include these positive changes and permanently correct the structural flaws of Fannie Mae's and Freddie Mac's government charters that contributed to the financial crisis.

Administrative Housing Finance Reform

The Administration has signaled its intent to make additional reforms through regulation in the absence of Congressional action with a strong commitment to level the playing field between Fannie Mae and Freddie Mac and private market participants. NAHB looks forward to the opportunity to work with the new FHFA director and administration officials after Mel Watt's term ends in January to offer thoughts on reform efforts and ideas for moving sustainable reform forward.

NAHB believes any administrative reforms should be considered carefully and implemented in a way that will not adversely impact home mortgage liquidity or affordability in any geographic area. We believe it is particularly important for FHFA to provide notice and comment opportunities on proposed administrative changes and to provide adequate transition periods to allow market participants to adjust to new guidelines and circumstances. It is critical to avoid disruptions and dislocations in the mortgage credit market that would increase prices or decrease availability of credit for home owners and home buyers.

Ultimately, Congressional action on housing finance reform is the only way to achieve a comprehensive and sustainable solution that will support the future of homeownership and affordable multifamily housing in America.

The Bipartisan Housing Finance Reform Act of 2018

NAHB appreciates the chairman's effort to develop the legislative framework contained in the Bipartisan Housing Finance Reform Act of 2018 (the Act). We support many aspects of the Act,

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[1] "Housing Finance At A Glance: A Monthly Chartbook, November 2018." Urban Institute's Housing Finance Policy Center

but are especially pleased that the legislation includes an explicit government backstop for a key portion of the conventional mortgage market. The legislation would extend use of the existing Ginnie Mae securitization platform to issue mortgage securities backed by qualifying conventional loans in addition to the platform's current use for issuance of Ginnie Mae mortgage securities backed by government-insured and -guaranteed mortgages. NAHB believes there are advantages to using the existing Ginne Mae securities issuance platform to issue conventional MBS collateralized with conforming mortgage loans although statutory changes will be needed for Ginnie Mae to perform this expanded role. However, NAHB cautions that with this considerable expansion to Ginnie Mae's MBS issuance there must be assurances that it would be able to scale up as quickly and effectively as needed in order to maintain market liquidity.

NAHB believes that any new federally-guaranteed system should deal only with well-understood and well-tested products. NAHB supports using qualified mortgage (QM) as a base for the definition of a sustainable, conforming mortgage. NAHB believes the new system should be given additional flexibility to establish underwriting criteria beyond baseline QM. In addition, NAHB believes the current, statutory requirements for determining conforming loan limits and loan limits for federally-insured and -guaranteed mortgage loans should remain intact. The authority to increase loan limits is important for the conforming mortgage market to remain relevant when house prices are increasing. This ensures conventional mortgage credit remains affordable and accessible to consumers.

NAHB appreciates that the Act would preserve the common securitization platform (CSP), developed by Fannie Mae and Freddie Mac under the direction of FHFA. With so many resources invested and the significant effort by many stakeholders to develop the CSP, NAHB is pleased that the Act recognizes the benefits of this new infrastructure and establishes an enhanced use for it in a restructured housing finance system.

NAHB appreciates that the Act recognizes the importance of participation by lenders of all sizes and attempts to reduce barriers to entry to the secondary market for small lenders. In a reformed housing finance system, access and pricing should not be based on the volume of business or size or geographic location of the selling institution.

NAHB believes the requirement in the Act to mandate the Enterprises use of credit risk transfers (CRTs) is consistent with the intent to reduce the risk to taxpayers and encourage the return of private investors to the mortgage market. The current use of innovative CRT structures by the Enterprises has been very successful in attracting private capital. However, this approach has been untested in distressed markets so NAHB cautions against relying on this framework too much. Also, any such program should have the dual purpose of lessening risk exposure and allowing for a reasonable interest rate/borrowing cost for borrowers.

NAHB also is pleased the Act would preserve and build upon the successful multifamily mortgage programs of Fannie Mae and Freddie Mac. These programs continue to address key market needs and have not experienced any of the problems associated with the Enterprises' single family endeavors. We look forward to working with this Committee to flesh out the details of this section of the bill.

The affordable housing provisions in the legislation also contain limited details. NAHB has strongly and consistently urged Congress to ensure that the Enterprises, or their successors, demonstrate leadership in affordable housing by providing liquidity and supporting housing for families at different income levels in various geographic markets and in various market segments. NAHB supports an approach that would require the entities providing resources for this purpose to be accountable for the effectiveness of the programs to which such funds are distributed. In addition, NAHB believes the definition of affordable housing should be expanded from a focus on very low- and low-income families to include workforce housing that serves the needs moderate-income families as well. Again, NAHB welcomes an opportunity to work with this Committee and other stakeholders to develop the details for this section of the bill.

Regulatory oversight is another critical component to consider in a reformed housing finance system. NAHB believes the regulatory agency should be governed by a bipartisan board similar to the body governing the Federal Deposit Insurance Corporation (FDIC) with extensive expertise in the housing capital markets and housing finance needs. Board governance would mitigate the potential for extreme and abrupt changes in policy that are possible under the existing, single-director regulatory regime.

Finally, an important element that has not been addressed in this or other legislative proposals is the protocol for establishing appraisal standards and guidelines for the homes financed through a reformed housing finance system. NAHB believes such provisions should not be left exclusively to the system guarantors, as is currently the case. Such an arrangement inappropriately restricts appraisers in their task of achieving the most accurate estimates of value. The new system should include a means for all mortgage market stakeholders to contribute to the system's appraisal standards to allow appraisers greater latitude in completing their assignments.

Overall, NAHB is encouraged that recent reform plans have many common elements and that agreement on key portions of reform is emerging. We look forward to continuing to work with this Committee to find solutions for the remaining issues that continue to elude consensus.

NAHB's Priorities for a Reformed Housing Finance System

NAHB believes the U.S. housing finance system should be multifaceted with both competing and complementary components, including private, federal and state sources of housing capital. Key elements of NAHB's specific policy proposals covering both single family and multifamily housing are summarized below.

Importance of Federal Government Backstop and the 30-year Fixed-Rate Mortgage

As stated earlier, NAHB's first priority in housing finance system reform is ensuring liquidity for the housing sector in all markets throughout the economic cycle. An explicit, federal backstop is key to this objective as it assures market participants that the federal government will maintain stability, keep credit flowing and make investors whole in catastrophic circumstances. NAHB appreciates the inclusion of an explicit federal guarantee in the Act. This is critical to a reformed conventional housing finance market and the current government-insured and -guaranteed programs.

NAHB believes an explicit federal government guaranty is particularly important to the continued availability of the affordable 30-year fixed-rate mortgage (FRM), which has been a staple of the

U.S. housing finance system since the 1930s, and NAHB appreciates that the preservation of the 30-year FRM is emphasized in the Act. These loans are geared toward affordability; 30-year terms lock in low monthly payments, allowing households with average incomes to comfortably budget for their home loan. Knowing their monthly housing costs will remain the same year in and year out regardless of whether interest rates rise provides households with a sense of financial security and also acts as a hedge against inflation. Many young buyers know that as their incomes rise, their housing costs will stay constant and become less of a burden, enabling them to prepare for other long-term obligations, such as college tuitions and retirement savings.

Restart a Carefully Regulated Fully Private Mortgage-Backed Securities System

NAHB believes it is essential to have an efficient and stable secondary market where conventional single family and multifamily mortgages are aggregated and placed into diversified pools for securitization and sale to investors worldwide. This includes considering provisions to support and encourage the return of the private label mortgage securitization market.

The housing finance market as whole must work in order to maintain stable liquidity and ensure investor and home buyer confidence. As such, a government-guaranteed conventional MBS market should operate in tandem with a fully private MBS system. However, investors in the private label mortgage-backed securities (PLS) suffered enormous losses in the financial downturn and have not returned to the marketplace in any significant way. In fact, PLS currently comprise only about 4 percent of MBS securitizations. A robust market for private label MBS will be critical to the availability of mortgage products that do not meet the underwriting and credit guidelines of conforming mortgage loans or mortgage loans insured or guaranteed by FHA, USDA and VA. The government guaranteed and non-guaranteed market segments can and should complement each other by specializing in distinct market niches while also competing on price and product for overlapping market segments.

Several barriers have been identified as hurdles for restarting a robust PLS market, such as disclosure requirements, credit risk retention requirements, and several Basel III regulations. These concerns need to be addressed in order for private capital to be encouraged to reenter the mortgage market.

NAHB encourages policy makers to work with the investor community prior to finalizing legislation in order to ensure that the private market is able to gain enough momentum to support the housing market when housing finance reform legislation is enacted. It is important to make sure the legislation does not have unintended consequences that would prevent private capital from returning.

Continue Role of the Federal Home Loan Banks in the Housing Finance System

NAHB always has viewed the Federal Home Loan Banks (FHLBanks) as having an important role in the housing finance system. NAHB's members rely on commercial banks, and in particular community banks, for their acquisition, development and construction financing needs as well as for the mortgage credit financing needs of their homebuyers. The FHLBanks were a steadfast source of financing throughout the most recent downturn and NAHB appreciates that the Act acknowledges the potential for the FHLBanks to play a continued, and even more robust, role in a restructured housing finance system.

Keeping Credit Affordable

NAHB would like to emphasize that increased fees and interest rates are ultimately paid by home buyers. Since financing costs have a significant bearing on the ability of home buyers to purchase a home, NAHB cautions that the fees contained in the legislative framework will likely be added to the interest rate and may have a negative effect on the market if the cumulative impact substantially raises the cost to buyers.

Prospective home buyers are adversely affected when interest rates rise. NAHB estimates that with a quarter-point increase in the rate on a 30-year fixed rate mortgage, as many as 1.2 million U.S. households would be priced out of the market for a median-priced new home.[2]

Appraisal System Reform

The process to evaluate the collateral supporting real estate transactions is an important component of the overall housing finance system and improving the appraisal process should be considered in housing finance reform discussions. NAHB is a strong proponent of a sound and effective appraisal system.

Currently, Fannie Mae and Freddie Mac impose de facto appraisal authority through the guidelines they have established for appraisals on the mortgages they purchase and the forms they use to collect appraisal information. These Enterprise appraisal rules tend to restrict appraisers' ability to pursue approaches that could result in more accurate valuation. In addition, confusion arises over how to interpret the Enterprises' appraisal guidelines in relation to the rules established by The Appraisal Foundation (TAF) in the Uniform Standards of Professional Appraisal Practice (USPAP) and the appraisal regulations of the banking regulators. This has prompted industry participants to impose overlays that further impede the ability of appraisers to produce accurate valuations.

NAHB urges the establishment of a single, consistent set of rules and guidelines for appraisers and appraisals, not controlled by the Enterprises. NAHB recommends establishing a Collateral Valuation Oversight Committee in the reformed housing finance system. This oversight committee would consist of a broad group of housing market stakeholders, including home builders, and, in consultation with federal regulatory agencies, would be responsible for establishing and maintaining guidelines for the secondary mortgage market, appraisal reporting formats, and a repository for valuation reports. This Committee could set standards to ensure the engagement of an appraiser who has the training and experience necessary for the assignment and has flexibility to conduct the analysis most effectively.

In addition, NAHB encourages the development of a workable process for appealing inaccurate or faulty appraisals. It is extremely important to establish a timely value appeals process that is fair, balanced and appropriate to allow all parties of the transaction to appeal appraisals that do not meet USPAP standards or are based on inaccurate data or assumptions. NAHB has been a proponent of the VA's "Tidewater Initiative" which encourages open communications and the sharing of information that assists appraisers in their analysis. NAHB also is encouraged by The

[2] "Households Priced-Out by Higher House Prices and Interest Rates." www.NAHB.org

Appraisal Foundation's interest in developing best practices and guidelines for an efficient and effective Reconsideration of Value process.

Preserve the Enterprises' Successful Multifamily Housing Finance Framework

NAHB generally supports the multifamily principles articulated in the Act. NAHB commends the sponsors for recognizing the importance of multifamily financing in providing options for affordable rental housing, seeking to preserve what works in the market today, and acknowledging that an explicit government guaranty of multifamily securities provided by Ginnie Mae is crucial to housing finance reform.

It is important to understand that not all private market sources of capital for multifamily financing are available for all segments of the multifamily market. Each source has strength in specific niches and markets, and thus, moves in and out of the market as economic conditions and their investment goals change. Life insurance companies typically target low-leverage, high-quality deals in the strongest markets (usually urban) and typically serve the highest income households. Once they meet their own portfolio investment targets, life insurance companies retract their lending. Banks do not provide long-term financing and are subject to significant restrictions in terms of capital requirements. Banks also have significant exposure to regulatory pressure that influences their lending decisions, including obligations under the Community Reinvestment Act (CRA). While the commercial mortgage-backed securities (CMBS) market was significant at one time, it has not recovered from the financial crisis and is not expected to resume its past levels of volume.

These facts point to the need to maintain a viable, liquid and efficient secondary market for multifamily rental financing where the federal government continues to play a role. In addition, the secondary market must be structured to ensure that the appropriate range of products is available to provide the capital needed to develop new and to preserve existing rental housing, as well as to refinance and acquire properties. An adequate flow of capital will ensure that demand for rental housing is met and that affordable options are available for a range of households and communities.

On the other hand, NAHB cautions against over-reaching in regard to reforming the multifamily finance system. This component of the nation's housing finance system has performed, and continues to perform, very well. NAHB has advocated consistently that housing finance reform should preserve the successful framework of the current system—including the federal backstop for conventional and federally-insured multifamily mortgages. Taking draconian steps to "fix" an unbroken system is unwise and unnecessary. Again, NAHB believes that the critical consideration in a new system is broad and continued liquidity during all economic cycles and for all geographic areas.

Provide for a Smooth Transition

A careful transition is essential to ensure the new system is workable and effective. Any changes to the housing finance system should be undertaken with extreme care and with sufficient time to ensure that U.S. home buyers, owners, and renters are not placed in harm's way and that the mortgage funding and delivery system operates efficiently and effectively as the old system is wound down and a reformed system is put in place. Every effort should be made to reassure borrowers and markets that credit will continue to flow to creditworthy borrowers and that mortgage investors will not experience adverse consequences as a result of changes in process.

NAHB recommends including provisions in the legislation that would allow for some flexibility in the timing of the transition to the new system if the five years, as proposed, is not sufficient to have all the necessary regulations and market functions in place.

Conclusion

NAHB thanks Chairman Hensarling for his focus on housing finance system reform and for developing the draft Bipartisan Housing Finance Reform Act. I appreciate the opportunity to submit our perspectives on housing finance system reform. We look forward to working with the House Committee on Financial Services and others to build on this effort and develop legislation consistent with NAHB's recommendations and the consensus elements that have emerged over the last serval years of the Enterprises' conservatorships.

NAHB believes many regulatory reforms undertaken at the Enterprises under the direction of the FHFA have strengthened the safety and soundness of the housing finance system, and need to ultimately be codified in legislation. NAHB appreciates that the Act has incorporated several components of these reforms, including access for small lenders, the use of the common securitization platform, and pricing parity across lenders.

Whether they rent or own, Americans want to choose where they live and the type of home that best meets their needs. Given the significant role that housing plays in the economy, we urge Congress to take a long-term, holistic approach to housing finance system reform. NAHB also urges Congress to carefully consider the differences between the single family and multifamily market and not apply solutions to one piece of the market that are not appropriate for the other. NAHB thanks this Committee for its leadership on this important issue, and stands ready to work with you to achieve such reforms and provide much-needed stability for this critical sector of the economy.