Written Testimony

of

William Apgar
Senior Advisor to the Secretary for Mortgage Finance
U.S. Department of Housing and Urban Development

on

"Legislative Proposals to Improve the Efficiency and Oversight of Municipal Finance"

before the

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Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for the opportunity to testify. HUD is pleased to see that the Financial Services Committee is examining a range of issues, and considering legislation, related to the lack of liquidity and other constraints within the municipal bond markets. The disruption in these markets has severely hindered the ability of state and local Housing Finance Agencies (HFAs) to achieve their mission of facilitating the availability of affordable mortgages and rental housing and could undermine the housing and economic recovery.

While the Administration is not yet able to take a position on the proposed legislation, taking appropriate steps to improve the functioning of the municipal bond market can be an important component of our overall response to the current housing crisis. In that context, I would like to discuss the Administration's efforts relating to HFAs, provide additional details on the role that HFAs play in the housing market, and the challenges they face in the current market environment.

OVERVIEW OF THE ADMINISTRATION'S HFA INITIATIVE

I serve as Senior Advisor for Mortgage Finance for HUD Secretary Shaun Donovan and have worked closely on the development and implementation of the Administration's Homeowner Affordability and Stability Plan (HASP) which was announced on February 18, 2009. In recognition of the important role that HFAs play, the President announced as part of this plan, his intention to develop an initiative to support HFA's and their efforts to aid distressed homeowners, stimulate first-time home buying, and provide affordable rental homes.

Building on the President's announcement of February, the White House, Treasury, and HUD are now finalizing the details of an initiative designed to address three distinct but interrelated challenges facing HFAs:

- Lack of Financing for New HFA Housing Bond Issuance;
- Lack of Liquidity to Support State HFA Variable Rate Debt Obligations; and
- Ongoing credit and balance sheet stress for HFAs at risk of ratings downgrades.

Working in consultation with the Federal Housing Finance Agency, Fannie Mae, and Freddie Mac, along with the National Council of State Housing Agencies and the National Association of Local Finance Agencies, and individual HFAs, the Administration's HFA working group is now exploring how best to support HFAs. Work continues to complete program design. Detailed guidance on this effort should be available in the near term.

THE ROLE OF HFAs

In strong and weak economies, HFAs have been reliable sources of flexible, affordable mortgage money for lower-income first-time home buyers. Using single-family Housing Bonds or, as they are commonly known, Mortgage Revenue Bonds (MRBs), the National Council of State Housing Finance Agencies (NCSHA) HFAs have made 2.6 million families first-time homeowners, adding another 100,000 families each year.

FHA has enjoyed a very strong partnership with various state HFAs. Over the years, the HFAs have worked very collaboratively with FHA to offer low-and moderate-income families access to special affordable housing programs that rely on FHA financing. More recently, the HFAs have been engaged in dialogue with FHA on issues related to the current market crisis and the types of programs that can help families keep their homes. Many of the discussions have focused on using state resources to complement and support the Federal programs, including the HOPE for Homeowners program, which may become one of the primary vehicles to help struggling families keep their homes, when pending legislation to modify the program is enacted.

Recognizing that not everyone is ready or suited for homeownership, HFAs also play a key role in the delivery of many other federal housing resources in addition to Housing Bonds, including the Low Income Housing Tax Credit, the HOME Investment Partnerships Program, and Section 8, programs that are central to HUD's efforts to promote expanded access to affordable rental housing. HFAs and their partners have produced nearly 2 million affordable rental homes with equity provided by the Housing Credit. Nearly half of these homes are multifamily Housing Bond-financed. HFAs have financed nearly another 1 million affordable rental homes with Housing Bonds alone. Using Housing Bonds and the Credit, HFAs add another 150,000 homes to our country's affordable rental housing inventory each year.

HFAs FACE SIGNIFICANT MARKET CHALLENGES

In light of their strong track record and considerable capacity, last year under the Housing and Economic Recovery Act (HERA), Congress provided HFAs $11 billion in new Housing Bond authority, to be available through 2010 to finance affordable single-family and multifamily mortgages. Unfortunately, HFAs have not been able to translate these additional resources into expanded housing opportunities in this time of expanded housing need. As is the case with many financial institutions, HFAs now face severe economic dislocation arising from a housing finance crisis they did not create. Though state HFAs did not engage in subprime lending and their delinquency and foreclosure rates are continue to be lower than industry averages, they are climbing. In cases where the HFA holds loans in portfolio, the loans with private mortgage insurance have also been adversely affected by the recent downgrading of the major mortgage insurers, putting some HFAs at risk of downgrades themselves, which may exacerbate the difficulties the HFAs currently face in funding new activity.

Moreover, for many months now, HFAs have been virtually frozen out of the tax-exempt Housing Bond market, unable to find investors willing to buy their long-term, fixed-rate bonds at rates that allow HFAs to lend the proceeds affordably. Investor interest has diminished dramatically because of declining investor income, financial institution deleveraging, and uncertainty about the economic outlook, especially for housing. Fannie Mae and Freddie Mac, traditionally large purchasers of Housing Bonds, are out of the market. Other traditional purchasers, such as banks, mutual funds, property and casualty insurance companies, and other financial institutions, have strictly limited their purchases or dropped out of the market altogether.

Some HFAs have managed to keep their mortgage programs operating, though at severely curtailed production levels and at higher interest rates, by selling modest amounts of short-term bonds to retail investors, relending loan sale proceeds, accessing credit lines, and tapping their own resources. Under normal market conditions, HFAs have typically offered high LTV mortgages to lower income and first time home buyers at approximately 50 basis points below conventional rates (although down payment assistance and other HFA services may be as important to HFA borrowers as a below-market mortgage rate).

As discussed, current market conditions have caused long-term municipal bonds to be priced at yields above comparable term Treasuries, thus driving up mortgage financing costs for HFAs, which have historically been reliant on favorable municipal financing. The result is that new long-term MRB issues cannot be priced to produce the mortgage market rates necessary for the HFA programs to originate mortgages. To a large extent, HFA lending activities have come to a standstill. This withdrawal from the market eliminates an important source of good quality home purchase lending for low- and moderate-income borrowers that not only benefit from the favorable rates historically linked to HFA finance, but also benefit from the counseling and down payment assistance programs that HFAs commonly provide.

Even further constrained is the lending and financial capacity of state HFAs that issued Variable Rate Debt Obligation (VRDO) in recent years. These VRDOs were issued to enable HFAs to offer mortgages at interest rates lower than those supported by fixed-rate debt. Unfortunately, these HFAs now struggle to remarket this debt, as the institutions they have relied upon in the past to remarket and serve as buyers of last resort of VRDOs have left the market, have been significantly downgraded, or are imposing unreasonable terms and excessive rates. State HFAs have over $23 billion in VRDOs outstanding. Nearly $3 billion of existing liquidity facilities have already expired or will expire by the end of 2009. Those unable to find buyers for their VRDO have been forced to convert it to “bank bonds,” requiring them to pay it off under accelerated amortization schedules at high interest rates, further depleting their housing resources and weakening their financial positions. Rating agency downgrades of private mortgage insurance providers, bond insurers, and liquidity providers, deteriorating performance of HFA mortgage portfolios, and dislocations in the VRDO market could also result in downgrades of the credit ratings of some of the largest HFAs. Such downgrades would further exacerbate the VRDO market crisis.

CONCLUSION

The sidelining of HFAs could not come at a worse time for our housing and economic recovery. HFAs are a key source of affordable, flexible mortgage money for lower-income first-time home buyers, who often also need the counseling and down payment assistance that HFAs provide to access homeownership. The opportunity for HFAs to help lower-income families achieve homeownership is greater now than in some time, with the increased affordability created by today's declining home prices and the expanded lower-cost housing stock produced by home foreclosures. HFAs project they could issue $33 billion in tax-exempt bonds over the next two years in response to growing demand provided that the municipal bond markets are properly functioning. HFAs' inability to respond to the growing demand from first time homebuyers for their mortgages could negatively impact the broader housing market, as homeowners looking to trade up are unable to sell their homes to first-time buyers.

HUD looks forward to working with the Committee on solutions to address the disruptions in the municipal bond markets.