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HEARING BEFORE THE

HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"THE EXPANDING AMERICAN HOMEOWNERSHIP ACT OF 2007: H.R. 1852 AND RELATED FHA MODERNIZATION ISSUES"

WRITTEN TESTIMONY OF
IONA C. HARRISON, GRI

NATIONAL ASSOCIATION OF REALTORS®
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Introduction

Madam Chairman, Ranking Member Biggert, thank you for the opportunity to testify before the Subcommittee. My name is Iona Harrison and I am a broker with Realty Executives/Main Street USA in Upper Marlboro, Maryland. I am the 2006-2007 Secretary of the Maryland Association of REALTORS®, the immediate past Chair of the National Association of REALTORS'® Housing Opportunity Advisory Board, and a member of the National Association of REALTORS'® Federal Housing Policy Committee.

I am here to testify on behalf of 1.35 million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on the importance of FHA mortgage insurance and the urgent need for reform. 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.

Consumers Need a Safe, Affordable Mortgage Alternative

The current increase in foreclosures is troubling to all of us. In 2006, 1.2 million families entered into foreclosure, 42 percent more than in 2005[1]. Predatory lending, exotic mortgages and a dramatic rise in sub-prime lending – coupled with slowing home price appreciation - have all contributed to this crisis.

In 1934 the Federal Housing Administration was established to provide consumers an alternative during a similar lending crisis. At that time, short-term, interest-only and balloon loans were prevalent. Since its inception, FHA has insured more than 34 million properties. However, because it hasn't evolved, FHA's market share has been dropping. In the 1990s FHA loans were about 12 percent of the market. Today, that rate is less than 3 percent. This statistic is unfortunate given that FHA is needed now as much as it was in 1934. At the same time, the sub-prime market has skyrocketed. In 2003, the sub-prime market share was 8.5 percent. By 2005 it was at 20 percent. In 2006, FHA/VA market share dropped 37.8 percent; conventional loans dropped 9.8 percent; while sub-prime loans increased another 15.7 percent.

When formed, FHA was a pioneer of mortgage products. FHA was the first to offer thirty-year fixed-rate financing at a time when loans were generally for less than five years. Unfortunately, FHA has not changed with the times. Where they were once the innovator, FHA has become the lender of last resort. As conventional and sub-prime lenders have expanded their repertoire of loan products, FHA has remained stagnant. As a result, a large number of homebuyers have decided to use one of several new types of non-traditional mortgages that let them "stretch" their income so they can qualify for a larger loan.

Non-traditional mortgages often begin with a low introductory interest rate and payment—a "teaser"—but the monthly mortgage payments are likely to increase significantly in the future.

[1] *A Flood of Foreclosures, But Should You Invest?*, Market Watch, February 18, 2007.

Some of these loans are "low documentation" mortgages that provide easier standards for qualifying, but also feature higher interest rates or higher fees. Mortgages such as interest-only and option adjustable rate mortgages (ARMs) can often be risky propositions for some borrowers. For many of these products, the borrower is only qualified on their ability to make the initial payment amount. When the introductory period expires and monthly payments increase by as much as 50 percent or more, or when their loan balances get larger each month instead of smaller, many borrowers ability to pay will be put at risk. Mortgage experts estimate that approximately $1.5 trillion worth of ARMs will reset by the end of 2007[2]. While some borrowers may be able to make the new higher payments, many will find it difficult, if not impossible.

As the market has changed, FHA must also change to reflect consumer needs and demands. If FHA is enhanced to conform to today's mortgage environment, many borrowers would have available to them a safer alternative to the riskier products that are currently marketed to them.

To Be Viable, FHA Must Reform

To enhance FHA's viability, legislation has been introduced that proposes a number of important reforms to the FHA single-family insurance program that NAR believes will greatly benefit homebuyers by improving access to FHA's safe and affordable credit.

The legislation proposes to increase the loan limits, eliminate the statutory 3 percent minimum cash investment and downpayment calculation, allow FHA flexibility to provide risk-based pricing, and move the condo program into the 203(b) fund. The National Association of REALTORS® strongly supports these reform provisions.

Loan Limits. FHA mortgages are used most often by first-time homebuyers, minority buyers, and other buyers who cannot qualify for conventional mortgages because they are unable to meet the lender's stringent underwriting standards. Despite its successes as a homeownership tool, FHA is not a useful product in high cost areas of the country because its maximum mortgage limits have lagged far behind the median home price in many communities. As a result, working families such as teachers, police officers and firefighters are unable to buy a home in the communities where they work. In your home state of California, Madam Chairman, FHA is virtually unusable due to the loan limits. In Representative Biggert's state of Illinois, which is not generally considered high cost, NAR projects that the loan limit change alone will increase FHA usage by 71%, resulting in a savings of over $41.4 million to Illinois homeowners over what they are paying for subprime loan products.

This is why NAR strongly supports proposals to change the FHA loan limits. Under the legislation, FHA's limits for single unit homes in high cost areas would increase from $362,790 to the 2006 conforming loan limit of $417,000. In non-high cost areas, the FHA limit (floor) would increase from $200,160 to $271,050 for single unit homes. This increase will enhance FHA's ability to assist homebuyers in areas not defined as high-cost, but where home prices still exceed the current maximum of $200,160. This includes states such as Arizona, Colorado,

[2] *Homeowners Brace For ARMs' New Rates*, The Seattle Times, February 17, 2007.

Florida, Georgia, Illinois, Maine, Minnesota, Nevada, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, and Washington. While none of these states is generally considered “high cost”, all have median home prices higher than the current FHA loan limit.

Down Payment Flexibility. The ability to afford the downpayment and settlement costs associated with buying a home remains the most challenging hurdle for many homebuyers. Eliminating the statutory 3-percent minimum downpayment will provide FHA flexibility to offer varying downpayment terms to different borrowers. Although housing remains strong in our nation’s economy and has helped to increase our nation’s homeownership rate to a record 69 percent, many deserving American families continue to face obstacles in their quest for the American dream of owning a home. Providing flexible downpayment products for FHA will go a long way to addressing this problem.

In 2005, 43 percent of first-time homebuyers financed 100 percent of their home. NAR research indicates that if FHA were allowed to offer this option, 1.6 million families could benefit. According to NAR’s Profile of Homebuyers, 55 percent of homebuyers who financed with a zero-downpayment loan in 2005, had incomes less than $65,000; 24 percent of those who used a zero-downpayment product were minorities; and 52 percent of people who financed 100 percent of their home purchased homes priced at less than $150,000. It is important to note that FHA will require borrowers to have some cash investment in the home. This investment can be in the form of payment of the up-front premium or closing costs. No loan will be made for more than 103 percent the value of the home.

Risk-based Pricing. Another key component of the legislation is to provide FHA with the ability to charge borrowers different premiums based on differing credit scores and payment histories. Risk-based pricing of the interest rate, fees and/or mortgage insurance is used in the conventional and sub-prime markets to manage risk and appropriately price products based on an individual’s financial circumstances. Currently, all FHA borrowers, regardless of risk, pay virtually the same premiums and receive the same interest rate.

FHA financing, with risk-based premium pricing, will still be a much better deal for borrowers with higher risk characteristics than is currently available in the “near prime” or sub-prime markets. Risk-based pricing makes total sense to the private market, and should for FHA as well. Giving FHA the flexibility to charge different borrowers different premiums based on risk will allow FHA to increase their pool of borrowers. If FHA is also given authority to provide lower downpayment mortgages, premium levels will need to reflect the added risk of such loans (as is done in the private market) to protect the FHA fund.

Changes to the Fund Structures. The legislation also proposes to combine all single-family programs into the Mutual Mortgage Insurance Fund. The FHA program has four funds with which it insures its mortgages. The Mutual Mortgage Insurance (MMI) Fund is the principal funding account that insures traditional Section 203b single-family mortgages. The Fund receives upfront and annual premiums collected from borrowers as well as net proceeds from the sale of foreclosed homes. It is self-sufficient and has not required taxpayer bailouts.

The Cooperative Management Housing Insurance Fund (CMHI), which is linked to the MMI Fund, finances the Cooperative Housing Insurance program (Section 213) which provides mortgage insurance for cooperative housing projects of more than five units that are occupied by members of a cooperative housing corporation.

FHA also operates Special Risk Insurance (SRI) and General Insurance (GI) Funds, insuring loans used for the development, construction, rehabilitation, purchase, and refinancing of multifamily housing and healthcare facilities as well as loans for disaster victims, cooperatives and seniors housing. Currently, the FHA condominium loan guarantee program and 203k purchase/rehabilitation loan guarantee program are operated under the GI/SRI Fund.

NAR strongly supports inclusion of the FHA condominium loan guarantee program and the 203k purchase/rehabilitation loan guarantee program in the MMIF. Both of these programs provide financings for single family units and have little in common with multifamily and health facilitates programs covered by the SRI and GI funds. In recent years programs operating under the GI/SRI funds have experienced disruptions and suspensions due to funding commitment limitations. Maintaining the single family condo and purchase/rehabilitation programs under the GI/SRI funds exposes these programs to possible future disruptions. Thus, from a conceptual and accounting standpoint, it makes sound business sense to place all single-family programs under the MMIF.

Program Enhancements. As well as combining the 203(k) and condominium programs under the MMIF, NAR also recommends key enhancements to increase the programs' appeal and viability. Specifically, NAR recommends that HUD be directed to restore investor participation in the 203(k) program. In blighted areas, homeowners are often wary of the burdens associated with buying and rehabilitating a home themselves. However, investors are often better equipped and prepared to handle the responsibilities related to renovating and repairing homes. Investors can be very helpful in revitalizing areas where homeowners are nervous about taking on such a project.

We also recommend that HUD lift the current owner-occupied requirement of 51 percent before individual condominium units can qualify for FHA-insured mortgages. The policy is too restrictive because it limits sales and homeownership opportunities, particularly in market areas comprised of significant condominium developments and first-time homebuyers. In addition, the inspection requirements on condominiums are burdensome. HUD has indicated that it would provide more flexibility to the condo program under the MMIF. We strongly support loosening restrictions on FHA condo sales and 203k loans to provide more housing opportunities to homebuyers nationwide.

FHA Protects Borrowers

The universal and consistent availability of FHA loan products is the principal hallmark of the 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.

The FHA program makes it possible for higher-risk, yet credit-worthy borrowers to get prime financing. According to a recent Federal Reserve Bank review,[3] the average credit score for sub-prime borrowers was 651. This is higher than FHA's median credit score borrower, which demonstrates that these borrowers are likely paying more than they need to pay. By offering access to prime rate financing, FHA provides borrowers a means to achieve lower monthly payments – without relying to interest-only or "optional" payment schemes. FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization.

When the housing market was in turmoil during the 1980s, FHA continued to insure loans when others left the market; following 9/11, FHA devised a special loan forbearance program for those who temporarily lost their jobs due to the attack; after Hurricanes Katrina and Rita, FHA provided a foreclosure moratorium for borrowers who were unable to pay their mortgages while recovering from the disaster. FHA's universal availability has helped to stabilize housing markets when private mortgage insurance has been nonexistent or regional economies have faltered. FHA is the only national mortgage insurance program that provides financing to all markets at all times. Simply put, FHA has been there for borrowers.

Now, more than ever, FHA needs to be strengthened to continue to be available to borrowers. In just the past few months, at least 25 sub-prime lenders have exited the business, declared bankruptcy, announced significant losses, or put themselves up for sale.[4] After making record profits, these lenders are simply bailing as the bad loans they made begin to fail. FHA, who is more careful with its underwriting standards, can be a safe alternative for buyers who have been lured into unnecessary sub-prime loans.

FHA is a leader in preventing foreclosures. FHA's loss mitigation program authorizes lenders to assist borrowers in default. The 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 the year 2004 alone, more than 78,000 borrowers were able to retain their home through FHA's loss mitigation program; and two years later, nearly 90 percent of these borrowers are still in their homes. By encouraging lenders to participate in these loss mitigation efforts and penalizing those who don't, FHA has successfully helped homeowners keep their homes and reduced the level of losses to the FHA fund.

Can FHA Help with the Current Foreclosure Crisis?

The National Association of REALTORS® has provided HUD Secretary Jackson with a proposal that would allow FHA to help many families with recent or impending interest rate adjustments refinance into a loan they can afford. Our proposal is to allow credit-worthy borrowers who may not be "current" on their existing loan, refinance into an FHA loan.

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[3] Federal Reserve Bank of St. Louis Review - January-February 2006
[4] *The Mortgage Mess Spreads*, BusinessWeek.com, March 7, 2007.

Many homeowners who were able to make timely payments under their original terms of their loan are finding it difficult to make payments after rate adjustments. This is occurring and will continue to occur across a wide spectrum of ARM products including 2/28 and 3/27 products issued over the past few years. Many of these homeowners that would otherwise qualify for FHA insured mortgages will be preempted by guidelines that prohibit refinance when loans are not current and will eventually be subject to foreclosure. We believe FHA can design a mechanism where creditworthy borrowers could refinance subject to prudent guidelines and avoid losing their homes. NAR believes in a strong FHA and would support efforts to ensure that only borrowers who truly have the capacity to repay receive the opportunity to refinance under such changes.

NAR also believes that many homeowners aren't aware that FHA exists as a financing option. While FHA isn't useful to many without reforms, once reformed we believe a large public awareness campaign will be necessary to fully inform homeowners of all their options. NAR pledges to be a partner in such efforts and has already demonstrated its commitment by producing a joint FHA education brochure, "**FHA Improvements Benefit You"** with FHA and HUD distributing over 50,000 copies across the nation.

We believe this is just the beginning. REALTORS® believe that financial education is an important defense to helping prevent consumers from getting into abusive mortgages that will undoubtedly be financially destructive. NAR, in partnership with the Center for Responsible Lending, has issued three consumer education brochures, **"How to Avoid Predatory Lending," "Specialty Mortgages: What Are the Risks and Advantages?"** and **"Traditional Mortgages: Understanding Your Options**." The brochures emphasize how important it is for consumers to make sure they fully understand how traditional and non-traditional mortgages work before deciding which is the right choice and how to avoid the pitfalls and entrapments of predatory loans.

In addition to NAR's consumer education materials, many of our state and local associations have high-profile financial education programs in partnership with cities and community groups. Some examples include:

- In Maryland, a number of local REALTOR® associations, including in Anne Arundel County, Howard County, Prince George's County, and the Greater Baltimore Board of REALTORS® have partnered with Freddie Mac to develop CreditSmart, a credit education workshop. REALTOR® instructors teach the course to renters, homebuyers, students, and others, on how to manage critical money skills. The skills that course participants obtain help point them in the right direction to managing credit and saving to buy a home.

- In 1996, the Illinois Association of REALTORS® organized the Partnership for HomeOwnership, Inc. to help assist low-income rural Illinois residents achieve the dream of homeownership. The Partnership has administered several multi-million dollar mortgage programs (in excess of $130 million), provided pre-purchase homebuyer counseling to over 1,500 Illinois residents, and is a HUD approved housing counseling agency. The Partnership also recently oversaw the development of high school financial educational Web site at that is available both in English and in Spanish.

- In Arkansas, the Fort Smith Board of Realtors® and the city of Forth Smith have teamed up to create a homebuyer assistance program. Participants receive credit counseling and mortgage readiness education. The program also offers a five-week financial fitness course on budgeting, money management, credit and avoiding predatory lending. Since 1997, more than 200 families have purchased a home as a result of the program.

NAR stands ready to work with the FHA to not only help Americans achieve the American Dream but to keep it as well.

Conclusion

Thank you again for the opportunity to testify on this important issue. Now is the time when the country needs FHA. As sub-prime loans reset and real estate markets are no longer experiencing double digit appreciation; a reformed FHA would be perfectly positioned to offer borrowers a safer mortgage alternative and bring stability to local markets and local economies. The National Association of REALTORS® stands ready to work with the Congress on passage of FHA reform.