Testimony of

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On Behalf Of the

National Association of Home Builders

Before the

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<u>The Expanding American Homeownership Act of 2007:</u>

<u>H.R. 1852 and Related FHA Modernization Issues</u>

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Introduction

Chairwoman Waters, Ranking Member Biggert, distinguished Members of the Subcommittee on Housing and Community Opportunity, on behalf of the more than 235,000 members of the National Association of Home Builders (NAHB), thank you for this opportunity to testify today on the important subject of the revitalization of the Federal Housing Administration (FHA) single family and multifamily mortgage insurance programs. My name is Bill Killmer, and I am NAHB's Group Vice President for Advocacy.

First, I want to thank you, Ms. Waters, Chairman Frank, and the Members of the Financial Services Committee, for your strong support of FHA revitalization last year. We were gratified when the House of Representatives overwhelmingly approved H.R. 5121, which, as you know, was not taken up in the Senate.

The ongoing turmoil in the subprime mortgage market has greatly increased the urgency for enactment of FHA revitalization legislation. While subprime mortgage programs have been a valuable tool in efforts to expand homeownership opportunities, some lenders have resorted to lax lending practices that have harmed borrowers and the housing finance system. The unfortunate experiences of such borrowers provides a compelling reason why FHA needs the tools to meet its mission objectives more effectively. If granted the proper authorities by Congress, FHA's single family mortgage insurance programs could insure fixed-rate, adjustable-rate, and hybrid adjustable-rate mortgage loans to borrowers with limited cash reserves and/or slightly tarnished credit and at far better terms than the subprime loans that are making adverse headlines daily.

The Relevance of the Federal Housing Administration

Since its creation in 1934, FHA has established a strong track record of innovation and achievement while insuring mortgage loans for millions of American families, many of whom would not have otherwise been able to own a home. The concepts of the 30-year mortgage loan and loans with low downpayments were the result of FHA's pioneering efforts in years past. Today, enhanced statutory authority is needed to restore FHA as a leader in developing loan products that are helpful to and appropriate for mortgage borrowers who could otherwise end up with an inappropriate mortgage. I believe that much of the subprime mortgage hardships could have been avoided if the FHA had been in a better position to respond to changing market forces in the past few years.

The popularity and relevance of FHA's single family mortgage insurance programs have waned over the past two decades as FHA's programs have failed to keep pace with mortgage market developments and needs. In the latter part of that period, competing subprime mortgage loan programs have lured many borrowers into less advantageous mortgages. As FHA's share of the market fell from 7 percent in 1995 to less than 2 percent in 2005, the share accounted for by subprime loans surged to 20 percent. FHA's lack of responsiveness to market needs has placed some borrowers in highly risky and inappropriate loan structures, charge unreasonably high fees and interest rates, and demand onerous prepayment terms. Many of these borrowers, despite limited cash resources and/or tarnished credit, could have qualified for market-rate FHA-insured loans. In numerous instances, statutory constraints have limited FHA's ability to respond to the needs of borrowers who might have otherwise chosen FHA.

All too often, significant differences between FHA's requirements and those for conventional mortgages have been viewed by lenders, appraisers and others as a disincentive to use FHA programs. Likewise, FHA's unique and often burdensome requirements have caused many home builders to avoid using FHA's programs to build homes – including condominiums – that otherwise would have been well-suited to borrowers using FHA-insured mortgage loans.

The decline in FHA mortgage insurance activity, both in real terms and when measured against conventional loan programs, is problematic in other respects as well. For example, FHA-insured loans serve as collateral for mortgage-backed securities guaranteed by the Government National Mortgage Corporation (Ginnie Mae), which, like the FHA, is part of the U.S. Department of Housing and Urban Development (HUD). Ginnie Mae serves a vital role in America's housing finance system by providing liquidity for lenders to offer mortgages that are insured or guaranteed by FHA and other government agencies. Because the bulk of Ginnie Mae securities are backed by FHA-insured loans, the declining trend in FHA-insured loan originations, if unabated, could call into question the viability of the Ginnie Mae program.

<u>Congress Should Act Quickly to Empower FHA With the Right Tools</u>

There are currently two comprehensive FHA revitalization proposals before the Subcommittee. In the days since these two bills were introduced, NAHB's leadership and staff have fielded numerous queries regarding this organization's support for one proposal over the other. To all, I say that the National Association of Home Builders supports FHA reform - period!

Mortgage Limits

The limit for FHA-insured mortgages is established in statute as 95 percent of the median home price of an area, within the bounds of a national ceiling and floor. FHA's single family loan limit for the 48 contiguous states is currently capped at $362,790, which is 87 percent of the Fannie Mae / Freddie Mac conforming loan limit. This limit is too low to enable deserving potential home buyers to purchase a home in many high-cost areas. Likewise, the FHA "floor" of $200,160, which is indexed at 48 percent of the conforming loan limit, is too low.

The artificially low FHA loan limits restrict choices for home buyers who use FHA-insured mortgage loans to the lowest echelon of available homes throughout much of the country. In many areas, FHA borrowers are precluded from considering the purchase of a new or recently-constructed home. For example, NAHB does not believe that Congress created the FHA in 1934 with the intent of constraining borrowers to homes priced only at the lowest end of the market. In fact, NAHB's Board of Directors adopted specific policy in 2005 in support of increasing the national FHA loan ceiling up to the conforming loan limit. NAHB also supports the proposals in both H.R. 1852 and H.R. 1752, which would recalibrate local loan limits to 100 percent of the area median from the current 95 percent and increase the national floor for FHA loan limits. We believe it is entirely reasonable to allow FHA borrowers access to at least the lower half of homes in a local market.

Mortgage Insurance Premiums and Borrower Cash Requirements

NAHB believes that FHA can effectively serve a broad range of borrowers while acknowledging that the risk of default varies widely. In fact, some delineation in credit risk is necessary if FHA is going to prudently provide an alternative to subprime borrowers who cannot currently get reasonable loan terms on conventional mortgages. The authority to set insurance premiums that are commensurate with credit risk will open the FHA program to borrowers who currently are shut out of the mortgage market by a tightening of qualification criteria or are facing onerous and possibly inappropriate terms on alternative forms of financing. A flexible premium structure also would allow FHA to offer more attractive pricing to lower-risk borrowers and stanch the decline in its market share while improving the risk profile of its portfolio.

To be competitive and meet increasing market needs, FHA must also have greater flexibility in establishing downpayment requirements. Significant advances have occurred in mortgage credit analysis that have allowed conventional lenders to reduce upfront cash requirements while sustaining favorable loan performance. FHA needs similar tools to remain a meaningful participant in ongoing efforts to expand homeownership opportunities and in more recent forays to find appropriate financing solutions for borrowers with less than pristine credit records.

Both H.R. 1852 and H.R. 1752 contain provisions that would alter the present structure for determining the amount of cash a borrower would have to invest to qualify for an FHA-insured loan as well as the premium that would be charged on various loan structures. Either approach could work. However, both of the proposed structures are complex. In its deliberations, NAHB encourages the Subcommittee to be mindful of the fact that the borrower cash requirements <u>and</u> mortgage insurance premium structures will need to be straightforward and easy for lenders and prospective borrowers to understand.

Regardless of what cash requirement and mortgage insurance premium options are eventually adopted by this Subcommittee, I encourage the Subcommittee to retain a mortgage insurance premium structure that rewards higher-risk borrowers who establish a track record of timely payments. Variations on this concept are contained within both bills.

Borrower Protections

Many borrowers who would obtain FHA-insured mortgage loans could be considered relatively unsophisticated regarding financial matters. Research has shown that pre-loan counseling can result in improved borrower loan payment performance. If counseling requirements are placed in statute, as has been proposed, it is vital that sufficient funds are appropriated on an ongoing basis for the development and maintenance of an adequate and stable, nationwide system of counselors. The Administration has proposed that $50 million in HUD's FY2008 budget be earmarked for housing counseling. Housing counseling agencies, which are predominately non-profit organizations, need grants from HUD to provide counseling services for prospective borrowers as well as borrowers who are having difficulty meeting their financial obligations. I encourage Members of this Subcommittee to take whatever steps are needed to ensure that sufficient funds are appropriated on an ongoing basis for housing counseling.

Loan Maturities

One underlying theme of FHA's revitalization is based upon the need to increase the affordability of the home financing process for prospective home buyers. By extending the maximum loan maturity to 40 years, FHA will enable borrowers' monthly loan payments to be reduced. Unlike the interest-only loans that are currently popular, an FHA-insured mortgage loan with a 40-year maturity will ensure that some part of the borrower's monthly payment is used to reduce the outstanding loan balance. NAHB believes that 40-year maturities will become commonplace in the not-to-distant future and that FHA should be well-positioned to meet emerging market needs.

Condominium Loans

In many communities, condominiums increasingly represent the most affordable path to home ownership. Data from the American Housing Survey show that in 2005 almost half of condominium purchasers were first-time home buyers, up from one-third in 1997. Unfortunately, FHA's requirements for condominium loans are burdensome and differ significantly from the requirements for mortgage loans that are secured by detached single family homes. For a condominium unit to be eligible to be sold to a purchaser who uses an FHA-insured loan, FHA requires the condominium developer to provide documentation related to historical and environmental reviews for the entire project. In contrast, on conventionally financed condominiums, requirements of this nature are commonly dealt with at the state or local level. Moreover, it is common to have town homes that are sold as part of a condominium located near town homes that are part of a planned unit development (PUD). In early 2003, FHA found that its PUD approval process was redundant with local governmental review practices and subsequently dropped its PUD approval requirement. FHA's condominium approval processes are similarly redundant; however, FHA has been forced to retain these because of statutory requirements.

These different requirements exist because condominiums and detached single family homes are authorized under different sections of the National Housing Act and insurance for these loans is backed by different insurance funds. NAHB has heard from its members who develop condominiums that the burden of the additional and unnecessary requirements, and the delays encountered in attempting to comply with FHA's requirements, have caused these builders who once served the FHA market to abandon the FHA program in favor of conventionally financed borrowers. NAHB has urged HUD to move condominium unit financing and the processes for accepting such loans for insurance under FHA's single family mortgage insurance program. We are very pleased that both bills contain provisions that would unify the coverage of all of the FHA's single family mortgage insurance programs under the Mutual Mortgage Insurance Fund.

Home Equity Conversion Mortgages

FHA's Home Equity Conversion Mortgages (HECMs) allow homeowners who are at least 62 years old to access the equity in their homes without having to make mortgage payments until they move out of their home. HECMs have found increasing acceptance among seniors as a financial alternative, however, the current program cap and the unrealistically low loan limits keep FHA from serving this growing segment of the population. NAHB is glad to see that these bills would permanently remove the existing 275,000 loan volume cap while increasing the maximum loan to the Freddie Mac / Fannie Mae conforming loan limit. The proposed changes would also permit a borrower to purchase another home without incurring the costs and delays of multiple mortgage transactions, which currently is one impediment preventing seniors from using an FHA-insured HECM in the purchase of a more suitable home. NAHB also feels there should be legislative language to clarify that FHA is permitted to insure loans secured by homes less than one-year old, which are currently not eligible. These changes would help expand seniors' options in securing housing with lower maintenance and operating costs. NAHB also supports the proposal to shift the insurance for HECMs from the General Insurance Fund to the more stable Mutual Mortgage Insurance Fund.

Multifamily Loan Limits

NAHB supports the provision in Section 21 of H.R. 1852, which would give the HUD Secretary additional flexibility to increase the FHA multifamily mortgage loan limits in high cost areas. Currently, there are some areas of the country where construction costs are so high that use of the FHA programs is not possible. NAHB believes that providing this additional flexibility to the HUD Secretary would greatly improve the FHA multifamily mortgage insurance programs. With severe shortages of affordable rental housing in most of the high cost markets, this change would enable developers to provide much-needed new affordable housing to low- and moderate-income families.

NAHB also supports Section 22, which would correct a technical deficiency having to do with appraisals related to HUD's sales of multifamily properties.

Conclusion

In closing, I would like to reiterate NAHB's strong support for FHA and its revitalization. The current leadership team at HUD has worked hard at re-establishing FHA's relevance while keeping the program financially sound, but they need Congress to empower HUD with improved tools to pursue their mission and to keep the Mutual Mortgage Insurance Fund solvent without requiring Congressional appropriations. FHA needs programs and processes now more than ever to be in the best position to assist the many thousands of borrowers who desperately need alternatives to existing subprime loans. With Congress' help, FHA will resume its long record of leadership in serving America's home buyers. Thank you, once again, for this opportunity. I welcome any questions you may have for me.