Testimony of

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Greetings, I am Peter Skillern, Executive Director of the Community Reinvestment Association of North Carolina, a non-profit advocacy and community development agency working at the local, regional and national levels. Thank you for the opportunity to speak on reforms in the secondary mortgage market.

On September 6th, 2000, I testified in the House of Representatives Subcommittee on Government Sponsored Enterprises to warn against Fannie Mae and Freddie Mac purchasing high cost subprime loans. I said "For the record…these high-cost loans will become a significant problem in the coming years. In the future, this committee will return to the issue of how the financial markets played a role in spurring high default rates and the decline of our neighborhoods."

That proved to be true. Subprime lending was bad for neighborhoods and the economy. The GSEs purchase of subprime securities was a primary cause of their failure.

Today I am concerned that reform proposals that eliminate the GSEs and convert to a solely private capital market will also be harmful for communities and our housing market as a whole. Reforms are needed to increase the private market role with adequate oversight and to reduce risk to tax payers. However the GSEs are needed as public purpose agencies for the stability of our nation's housing and finance markets.

GSEs Role in the Mortgage Markets

Megabanks have accelerated their market dominance and size since the financial crisis. Nationally, in 2008, 56 percent of mortgage originations were made by the top five banks; today 70 percent of originations are made by the top four banks. In the rural areas of Alabama, North Carolina, Oregon, Ohio and South Dakota, mega banks originated 75 percent of the loans and 88 percent of FHA loans. By comparison small institutions under $10 billion originated 16 percent of conventional loans (Federal Financial Institutions Examination Council, 2009). Concentration of capital and mortgage origination market share of big banks will continue.

Megabanks do not have dominance in the secondary market. There are three primary sectors that loans are sold to – 1) Private commercial entities like commercial banks, insurance companies and their affiliates 2) Fannie Mae and Freddie Mac and 3) Ginnie Mae, which deals exclusively with FHA.

Smaller financial institutions shop their loans among these secondary buyers. Loans are underwritten to a standard established by the GSEs and sold as a commodity that can to those offering the best price and services. This practice should be preserved.

If the GSEs are eliminated, the secondary capital markets may become dominated by megabanks, which will further concentrate capital in a vertical integration of the mortgage market. This will disadvantage small lenders access to capital, underwriting and technology controlled by their competitors.

If megabanks are too big to fail now, imagine their size, power and vulnerability, as they become guarantors and holders of the mortgage-backed security market.

Capital is scared and its volatility adds to swings during booms and busts. Private capital as the primary source of secondary markets will not act counter-cyclically to provide credit in a recession or to slow liquidity in a boom.

By analogy, mortgage credit is like water. We are concerned not only with the quality of water that comes that comes out of our tap, but who owns and controls the water and the plumbing from the water source of the glaciers to the spigot at home. Mortgage credit like water is critical and should not be entirely controlled by private interests.

If we should not privatize the secondary market, what should be done?

We believe that the GSEs should be converted into public purpose entities that are accountable to Congress, but are not a department of the government such as the Federal Housing Administration. The agency would provide liquidity for 30-year mortgages that are explicitly guaranteed, but priced for adequate reserves. The agency would provide liquidity for multifamily rentals. It would act as a provider of underwriting standards and technology for the benefit of the market. It would balance private market influence by providing choice on the secondary market.

As an example, the North Carolina Housing Finance Agency is not a government department, yet serves a public purpose of financing affordable homeownership and rental housing. While appointed by the governor and state legislature, the board is independent and operates without appropriations. It does not have a conflicting private profit motive with its public mission. Its staff is paid competitively, but not excessively. Likewise, the GSEs can serve the public purpose in the secondary market for rental and homeownership financing as an essential element to our national housing and financial policy.

Other Reforms:

The status quo is not acceptable in the long term for a healthy secondary market and its risk to taxpayers. We support reforms that include:

- Reducing the portfolio of GSE loans and liabilities. They have grown too large and the sell of assets can help to strengthen the capital base of the institutions.
- Pricing for explicit government guarantees on 30-year mortgages, which are placed in reserves.
- Reforming FHA to provide adequate infrastructure and oversight to its portfolio.
- The financial meltdown was caused in large part by private label mortgage backed securities. Private institutions should provide mortgage securities, but on the condition they are recognized as systemic risks to the market and have adequate oversight for safety and soundness.

Reform GSE Loan Level Pricing

The Community Reinvestment Association advocates for the reform of the GSE loan level pricing policy in order to reduce FHA volume and engage private capital in the mortgage market.

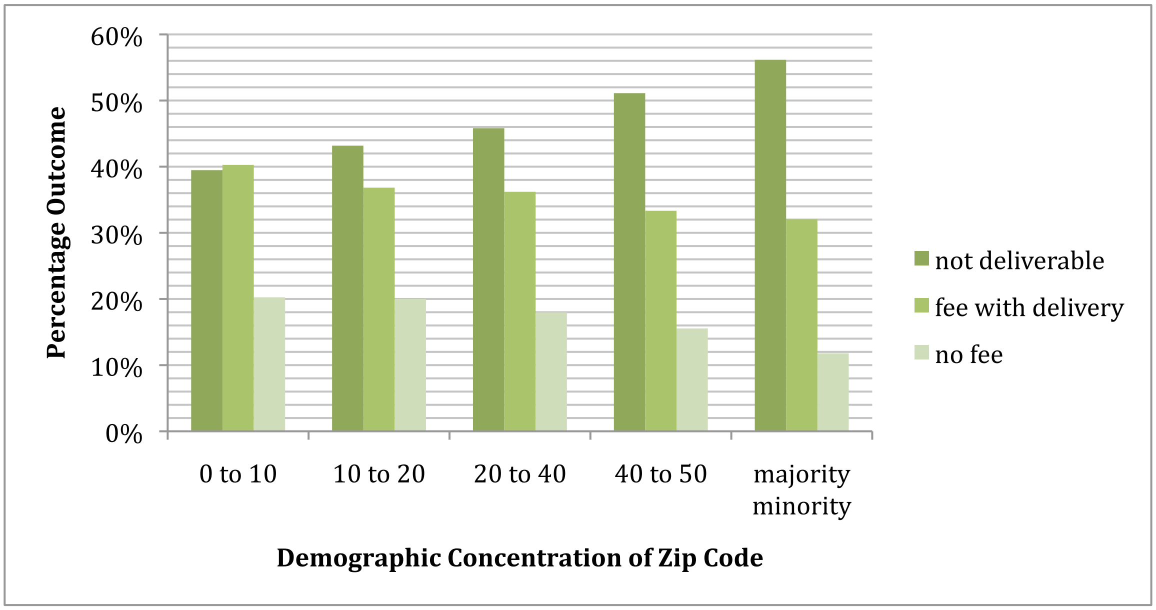
Federal Housing Administration loans are playing a significant role in the mortgage market. In 2005 FHA represented 6% of purchase mortgages, but grew to almost 40% by 2011, placing greater risk on the taxpayer (FHA, 2011). This is in part a result of the credit contraction by the private sector and the role of FHA in providing needed countercyclical liquidity.

It is also a direct result of current GSE Loan Level Pricing Adjustments LLPA. LLPA charges higher rates and fees for loans with down payments lower than 10 percent, credit scores below 720 and homes in a declining market. The GSEs are taking the crème of the mortgage market with new GSE loans having high credit scores and low loan to value ratios.

This has not lowered risk for taxpayers. LLPA prices loans away from the GSE portfolio and into FHA. If these loans did not have higher LLPA pricing, they would be insured by the private sector with private mortgage insurance (PMI). PMI premiums layered on top of higher GSE LLPA rates are not competitive with FHA loans with low down payments. PMI originations have dropped by two-thirds over three years.

The LLPA program also demonstrates the impact of requiring high down payments as a condition of the best pricing for loans. With higher down payments used as a proxy for underwriting, rather than ability to pay, credit worthy borrowers who can pay their mortgage are denied because of down payment requirements that will take years to save for. The result is fewer people can buy their first home and owners have greater difficulty in selling. The people most affected are low to moderate-income households and communities of color. For a more thorough analysis of the LLPA program please read *The New Hurdle to Homeownership* (Adam Rust, Community Reinvestment Association of North Carolina June 2011)

Chart 1: Disposition of Home Purchase Loans, by Racial and Ethnic Composition of Zip Code



We oppose the GSE loan level pricing program and recommend that it be amended to better utilize PMI. This will lower FHA volume and increase lending to credit worthy households with low down payments.

Conclusion

The proposals being discussed in reforming the secondary market potentially throw the good out with the bad in eliminating the GSE. The catastrophic failure of the GSEs in chasing the private label subprime mortgage markets is not a justification for eliminating the successful elements of the institutions' public purpose. A conversion to a completely private market delivery system will not serve the nation's economic or social interests.

Let me state for the record, if the proposal to eliminate the GSEs succeeds, this committee will meet in the future to address new problems. We will have more volatile capital markets; greater inequality in the access to mortgage credit; and disinvestment and decline of low and moderate-income communities. The real estate market will struggle as it becomes more difficult for renters to become first time homebuyers reducing household mobility. Small financial institutions will be less independent and competitive with megabanks.

If we phase out the GSEs completely, we will lack financing for affordable rental housing for our workforce. If the approach is not inclusive of low and middle income households, we will have a system that works very well for some, but not for many others and ultimately not for the greater good. The Community Reinvestment Association affirms the vision of an inclusive and healthy housing market.