Testimony of Robert Nielsen

On Behalf of the

National Association of Home Builders

Before the

Subcommittee on Housing, Transportation and Community Development of the Senate Committee on Banking, Housing and Urban Affairs

Hearing on

<u>New Ideas to Address the Glut of Foreclosed Properties</u>

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Chairman Menendez, Ranking Member DeMint and members of the Subcommittee Housing, Transportation and Community Development, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on how to address the glut of foreclosed homes that are currently on the market. We appreciate the invitation to appear before the Subcommittee on this important issue. My name is Bob Nielsen and I am the 2011 NAHB Chairman of the Board and a home builder from Reno, Nevada.

NAHB represents over 160,000 members involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction. NAHB commends this subcommittee for seeking solutions to the major problem of home mortgage foreclosures, through this hearing on reducing the inventory of foreclosed homes as well as last week's hearing on new ideas for refinancing and restructuring mortgage loans. As these sessions illustrate, there are two distinct components to the foreclosure program – shrinking the large pool of foreclosed homes and reducing the flow of additional homes into that pool.

Home mortgage foreclosures continue to have a significant negative impact on the housing market and contribute to the lag in the nation's economic recovery. While the majority of foreclosures have been concentrated in a handful of states, no state has avoided the negative effects on prices created by foreclosures. Home prices have fallen by record amounts across the country, making consumers hesitant to undertake home purchases and making it more difficult for homeowners to sell their current home in favor of a new residence. Many mortgage borrowers are "underwater" - with their house values lower than what is owed on their mortgages. Not only is this impacting household wealth and spending, more recently there is a growing problem of strategic defaults, where borrowers who could afford to make their monthly payments instead choose to walk away from their homes.

The decline in house prices makes it difficult for new home construction to compete in current market conditions, as the cost of building a new home can be higher than the final appraised value. Many times foreclosed or distressed property sales are used as comparable sales in these appraisals, which further depresses home values and puts new construction at a disadvantage. As a result, new home construction is at a record low level. The downward spiral in values is also adversely affecting outstanding residential construction loans, as lenders demand equity pay-ins to offset declines in collateral value, and making it more difficult for builders to obtain adequate funding to start new projects.

Ultimately, stopping this trend in foreclosures will have benefits beyond the housing industry. Stabilizing home values will improve the balance sheets of financial institutions and will reassure home owners that their biggest asset will retain its value.

NAHB Recommendations

The Federal Housing Finance Agency (FHFA), in consultation with the U.S. Department of Housing and Urban Development (HUD) and the U.S. Department of Treasury, recently issued a Request for Information to solicit ideas for strategies on disposing of the substantial inventory of Real-Estate Owned (REO) properties held by Fannie Mae and Freddie Mac (the Enterprises) and the Federal Housing Administration (FHA). NAHB appreciates that the agencies are seeking input from industry stakeholders before moving forward with disposition strategies. We support the agencies' goals of reducing the REO portfolio in a cost-effective manner; reducing average loan losses to the Enterprises and FHA; addressing property repairs and rehabilitation needs; responding to economic and real estate conditions in specific geographies; and stabilizing neighborhoods and local home values. NAHB submitted comments to the agencies in response to the Request for Information, and we would like to share those comments with the Committee as they are relevant to today's hearing topic.

General Principles

NAHB believes that it is extremely important for the Enterprises and FHA to take a balanced approach in disposing of their large inventory of REO properties to avoid further disruptions to pricing and markets and to limit losses to the Enterprises and FHA. In particular, the Enterprises and FHA should avoid bulk sales to large investors that have no stake in the neighborhoods in which these properties are located. Local and small businesses should be the driving force behind the disposition of the REO inventory, which will result in the creation of jobs and the stabilization of neighborhoods. In addition:

- The FHFA should allow a more decisive approach to mortgage modifications, which would help reduce the number of foreclosures.
- The excessive bias against investors in the current system must be removed in order to facilitate innovative solutions and assure adequate capacity to effectively reduce the REO inventory.
- For profit companies should be permitted to fully participate in all aspects of the disposition of the REO properties, including the purchase, management, leasing, and rehabilitation of the properties. With the scale of the problem so large, it is necessary to deploy all resources in both the private and nonprofit sectors.

- The disposition process should facilitate local job creation. Local businesses and small businesses should be primary players in this effort, particularly local home builders and remodelers, as well as property managers and realtors.
- The disposition process should not further adversely affect values. Do not allow "fire sales" of REO properties. It is critical that the disposition process helps stabilize house prices, not contribute to further devaluation.
- The process should facilitate homeownership opportunities where feasible and available.
- Rental opportunities should be created where appropriate, but the agencies should ensure that the disposition of REO properties does not result in concentrations of large numbers of rental properties in any single neighborhood.
- It is essential to return to more balanced credit requirements for home purchasers. Current credit requirements are so restrictive that it is difficult for many potential purchasers to obtain a loan.
- NAHB strongly suggests extending the higher Economic Stimulus Act (ESA) loan limits beyond the September 30, 2011, expiration date. This is not a time to lower loan limits as the lower limits will exclude many homes and homebuyers from FHA and the Enterprises loan programs, particularly in areas like California where there is substantial foreclosure inventory. NAHB would specifically like to thank the efforts of Subcommittee Chairman Menendez for his leadership in extending the loan limits past the current expiration date, and strongly supports his legislation (S. 1508) to extend the higher loan limits through December 31, 2013.
- NAHB understands that establishing credit risk retention rules was required by the Dodd-Frank Act. However, NAHB is very concerned about the immediate impact this proposed rule will have at this precarious point in the economic recovery. We are also concerned about the implications of overly restrictive rules on future growth of the housing market and the entire economy. NAHB has recommended the elimination or postponement of any new restrictive regulations. The proposed rule has far-ranging implications across the housing and development sectors, particularly the narrow definition of a Qualified Residential Mortgage (QRM), which, if implemented, would have a severe adverse impact on the availability and cost of residential mortgages.

<u>Modify Federal Housing Programs to Allow Investor Participants</u>

Modifications to federal housing programs to allow investor participation in disposing of REO properties is appropriate at this time. These modifications could be made on a short-term basis while the inventory of REO properties remains high.

- Modify the FHA Section 203(k) program to allow for-profit investors, which will help expedite the sale of vacant and distressed properties until the foreclosure crisis is alleviated. Understanding that investor/non-owner occupant loans present higher risks, FHA could impose prudent restrictions such as higher down payments and providing owner-occupants a first look before offering to investors. In addition an incentive could be developed to encourage investors to sell the property to an owner occupant within a reasonable period of time through lease purchase or other targeted programs.
- Encourage HUD to provide guidance to participating jurisdictions (PJs) on the use of HOME funds to help purchasers buy foreclosed properties. Although PJs set their own priorities for spending HOME funds, HUD can play a role by providing best practice approaches for using HOME funds to help with neighborhood stabilization.
- Improve the Neighborhood Stabilization Program (NSP) to allow more for-profit participation, expand income levels served and generally streamline the process. States and localities should be encouraged to undertake both homeownership and rental programs.
- Encourage USDA Rural Development to use Section 502 to help homeowners purchase foreclosed homes or REO properties.
- Consider changes to loan terms in all federal programs (e.g., stretch amortization to 40 years; allow higher loan-to-value).
- Considering the most recent data, FHA-financed condominium purchases are performing stronger than other purchase loans with a delinquent/claims rate of 1.14 percent, which is less than half of the overall claims rate. The FHA condominium rules should be relaxed to provide greater liquidity to this sector of the market. We support enhancements that would 1) eliminate owner-occupancy ratios, enabling more buyers to purchase units and help stabilize those developments and the community; 2) amend or, at least, temporarily suspend the FHA concentration limit; 3) increase the investor ownership percentage owned by one investor, particularly if the investor is the builder or developer; 4) reduce or eliminate pre-sale requirements; and 5) extend delinquent Home Owner Association (HOA) assessments from 30 days to 90 days.

<u>Modify Fannie and Freddie Programs</u>

The economic crisis pushed the Enterprises to implement overly stringent credit requirements and other restrictions, in addition to ceasing programs that were once in operation. However, prudent modifications to several programs could greatly assist in the reduction of the REO inventory without excessive risk to the Enterprises.

- The Enterprises should prudently modify existing mortgage programs that are overly restrictive and prohibit originators from adding any overlays that would be more restrictive.
- The Enterprises should remove excessive bias against investors by increasing the number of GSE loans an investor can have. Currently Fannie Mae limits investor properties to 10, including their primary residence, and investors with five to ten properties face more rigid underwriting criteria. Freddie Mac is even more restrictive, allowing only four.
- The Enterprises' renovation programs like Fannie Mae's HomeStyle Renovation should be reevaluated. The guidelines should be targeted to include investors and to provide incentives to homebuyers to acquire deteriorated inventory and recondition them.
- Both Enterprises have operated lease-to-own programs in the past which are now dormant; the Enterprises need to do more in this area by facilitating the creation of investor lease-to-own programs that can be operated at scale.
- The Enterprises should ease their condo policies to provide needed liquidity to reduce the excessive inventory. Similar to recommendations for FHA, we support enhancements to owner-occupancy ratios, investor ownership ratios, pre-sale requirements and delinquent HOA assessments. Enhancements to the Enterprises' condominium rules will ensure the still-fragile recovery stays on track and will protect the long-term value of homeownership in the United States.

New Programs

NAHB suggests that new programs, such as described below, could contribute to the reduction of the REO inventory.

Investment Fund

The Enterprises could transfer REOs to a newly created investment fund (REIT-like) that is open to individual investors. The funds would have full faith and credit backing by the federal government and a guaranteed rate of return similar to the current Ginnie Mae (GNMA) rates. Local real estate management companies should be used to inspect and manage the properties and report quarterly on the condition of properties to the fund.

Lease-To-Own

A new lease-to-own program should be developed that is geared to all income levels, as the foreclosure crisis has affected families from all walks of life. Such a program could be operated at various scales, with 50 to 100 units as a minimum. An effective program would include the following elements:

- A 12 to 24-month lease period to allow time to save for the downpayment, repair credit, bring up FICO scores; downpayment funds would be escrowed over this period. There would be a penalty if the participant drops out (some or all of the escrowed funds would be forfeited; those funds revert to the builder/investor to be used to repair the unit and remarket it).
- Downpayment escrow of five percent of the purchase.
- Mandatory homeownership counseling to consist of both financial literacy (understanding mortgages, credit requirements, etc.) as well as home maintenance and responsibilities of being a homeowner.
- Participant responsibilities during the lease period to include interior maintenance; exterior maintenance responsibilities would depend on whether there is a homeowners association and if those services are included otherwise.

<u>Project Rebuild</u>

The President proposed in his *American Jobs Act of 2010* to create "Project Rebuild." Project Rebuild would authorize $15 billion to rehabilitate and refurbish vacant and foreclosed homes. Two-thirds of the funding would be allocated by formula to state and local governments, with the remainder allocated through a competitive process. NAHB is particularly pleased that the proposal would allow for-profits builders to compete directly for the funds. NAHB commends the Administration for recognizing the urgent need to deal both with vacant and foreclosed homes as well as to promote job creation in the construction industry.

While Project Rebuild has the potential to create more than 100,000 jobs[1] in the remodeling and home building sector, the draft legislation also seeks to impose the prevailing wage and administrative requirements of the Davis-Bacon Act of 1931 on the use of these funds. Extending Davis-Bacon in this manner will undermine the very objective of the legislation: job creation. The vast majority of home building and remodeling companies are very small businesses who simply lack the ability to tackle the complex administrative requirements of Davis-Bacon. Congress has previously imposed Davis-Bacon requirements on the use of stimulus funds in the American Recovery and Reinvestment Act (ARRA), and this requirement became a significant barrier preventing struggling construction companies from accessing these funds. A February 2010 Government Accountability Office report analyzing the effects of Davis-Bacon under ARRA noted that "…Davis-Bacon administrative requirements would require a more detailed payroll tracking system, which would be particularly burdensome for small companies." [page 16] Additional government regulation is not the path to successful small business job creation.

[1] NAHB estimates that for every $100,000 spent on residential remodeling, 1.11 jobs are created.

Conclusion

Thank you again for the opportunity to testify on this important issue. NAHB stands ready to work constructively with this Subcommittee, as well as the full Senate Banking Committee, to address the critical issue of foreclosures and their impact not only on the current housing market but on the economic recovery of the nation as a whole.