Testimony of

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Introduction

Chairman Dodd, Ranking Member Shelby, distinguished Members of the Committee on Banking, Housing and Urban Affairs, 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 modernization of the Federal Housing Administration's (FHA's) single family mortgage insurance programs. My name is David Crowe, and I am NAHB's Senior Staff Vice President for Regulatory and Housing Policy.

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 borrowers have received loans with unfavorable terms that are beyond the household's capacity to repay. The unfortunate experiences of such borrowers are having broader adverse effects on the housing finance system and, therefore, provide a compelling reason why FHA needs the tools to meet its mission objectives more effectively.

The adverse effects of the subprime market have not only affected the financial markets, but also the housing markets and the economy. Growth of the Gross Domestic Product is off about 1 percentage point because of the slowdown in home construction and its attendant economic impacts. In addition, tightened lending standards mean that some borrowers who had planned to seek conventional loans will shift their focus to FHA instead. If granted the proper authority by Congress, FHA 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 so frequently in the news.

FHA's Importance

Since its creation in 1934, FHA has established a strong track record of innovation and achievement when 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 and loans with low downpayments were the result of FHA's pioneering efforts in years past. More recently, FHA has broken new ground in the area of reverse mortgages, which allow seniors to tap home equity to address housing, health or other living needs.

Beyond innovation, FHA, through its provision of the full faith and credit of the U.S. Government, has assured that affordable mortgage credit is available throughout the country during good as well as challenging economic times. FHA, as a result of more lenient loan qualification standards, also has the strongest record of serving minorities and lower income households, who have greatest difficulty in securing home financing. However, the role of FHA has declined significantly in recent years.

FHA's reticence has relegated the major government-backed mortgage finance program to an increasingly insignificant role in efforts to overcome housing affordability and financing obstacles and expand homeownership opportunities. FHA's current limitations have multiple impacts on the new home market. In addition to the support FHA's mortgage insurance can provide directly for the purchase of moderately priced new homes by first-time and other buyers of relatively modest incomes, FHA also has the potential to spur sales of existing homes, enabling more move-up buyers to acquire new homes.

FHA's lack of responsiveness to market needs has placed some borrowers in highly risky and inappropriate loan structures in the conventional mortgage market, which carry 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. Improving the FHA program would be a highly effective, and possibly the most appropriate, means for Congress to address problems in the subprime mortgage market.

Declining Role of the Federal Housing Administration

The popularity and relevance of FHA's single family mortgage insurance programs have diminished over the past two decades as they have failed to keep pace with mortgage market developments and needs. FHA's share of the market, in terms of number of loans, fell from 18 percent in 1990 to less than 4 percent in 2006. The fall-off in FHA's business is also striking in absolute terms, with its number of mortgages insured falling from 742,000 in 1990 to 302,000 in 2006. FHA's descent accelerated in the latter part of this same period as competing conventional (non-FHA) subprime mortgage loan programs lured many borrowers into less advantageous mortgages. The share accounted for by conventional subprime loans had surged to 20 percent by 2005.

All too often, significant differences between FHA's requirements and those for conventional mortgages have been viewed by lenders, appraisers and borrowers as a disincentive to use FHA programs. Likewise, FHA's unique and often burdensome requirements, particularly for condominium units, have caused many home builders to decline to go through the hoops that are necessary to make newly constructed homes eligible for FHA-insured mortgage financing. FHA's share of the new home market was only 5 percent in 2006, down from 13 percent in the early 1990s.

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 Association (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>

The Administration has proposed modernization changes for the FHA single family program in the form of greater flexibility on downpayment programs, authority to offer risk-based pricing, and increases in mortgage loan limits. NAHB supports these recommendations and believes there are several other areas that should be altered or updated.

Borrower Cash Requirements

One of the most common factors preventing potential home buyers from achieving their dream of homeownership is the lack of financial resources to pay the downpayment and closing costs. FHA's current statutory requirement for a cash contribution of 3 percent was innovative when downpayments of 10 percent or more were the norm. To be competitive and meet increasing market needs, FHA must have greater flexibility in establishing downpayment requirements. In addition, the present structure for determining the amount of cash a borrower would have to invest to qualify for an FHA-insured loan is unnecessarily complex and often confusing.

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.

Mortgage Insurance Premiums

NAHB believes FHA should have the authority to set mortgage insurance premiums at whatever levels are deemed necessary to maintain actuarial soundness while striving to serve borrowers with a wide variety of risk profiles. Accordingly, 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, while retaining the principle of actuarial soundness, would open the FHA program to the growing ranks of potential home buyers who currently are shut out of the mortgage market by a tightening of qualification criteria or are facing onerous and possibly predatory terms on alternative forms of financing. A flexible premium structure also would allow FHA to offer more attractive pricing to lower-risk borrowers and improve the overall risk profile of its portfolio while slowing the decline in its market share.

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

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 been told by 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 FHA 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. I encourage the Committee to consider provisions that would unify the coverage of all of the FHA's single family mortgage insurance programs under the Mutual Mortgage Insurance Fund.

Single Family 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. 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 supports recalibrating local loan limits to 100 percent of the area median from the current 95 percent and increasing 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.

Multifamily Loan Limits

NAHB also supports providing 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.

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 and would match a trend toward longer maturities that is being seen with conventional conforming loans. 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.

Borrower Protections

Many borrowers who obtain FHA-insured mortgage loans are considered relatively unsophisticated regarding financial matters. Research has shown that pre- and post-purchase home buyer counseling can result in improved loan payment performance. If counseling requirements are placed in statute, 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 realize that this is primarily an issue for the Appropriations Committee, however, I encourage Members of this Committee to take whatever steps are needed to ensure that sufficient funds are appropriated on an ongoing basis for housing counseling.

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 urges the Committee to remove the existing 275,000 loan volume cap permanently while increasing the maximum loan to the Freddie Mac / Fannie Mae conforming loan limit. These 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' housing options 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.

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 the Senate's 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.