Testimony of
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"Home = Life: State of Housing in America"

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Chairman Brown, Ranking Member Toomey, and Members of the Committee:

Thank you for inviting me to testify today. My name is Edward DeMarco, and I am the President of the Housing Policy Council (HPC), a trade association comprised of the nation's leading firms in housing finance and dedicated to advancing responsible and sustainable homeownership opportunities.

The past twelve months have placed extraordinary stress on families, our economy, and our society. Despite these stresses, the housing finance system generally, and mortgage servicers in particular, responded effectively to the needs of homeowners. Millions of homeowners whose income was disrupted by the pandemic received immediate payment relief through mortgage forbearance plans. Still, there are challenges and risks ahead.

One of the most pressing challenges is addressing the racial gap in homeownership, which we must do if we are to expand wealth-building opportunities for individuals and families of color. While this is a challenge and priority, it also is an opportunity. It is an opportunity for this Committee, the administration, consumer advocates, and the housing finance industry to think differently about the most effective ways to meet this challenge and promote sustainable homeownership for individuals and families who have the means to own a home but have been unable to realize that dream.

One key element in meeting this challenge extends beyond the scope of most federal programs designed to support homeownership: there simply is not enough housing to meet the needs of new homeowners. Fundamentally, we need to build more housing.

Beyond these new challenges that are top of mind today, we cannot lose sight of a huge challenge that has been with us for more than a dozen years now, one that I have testified on before this Committee numerous times, in multiple capacities: housing finance reform.

The rest of my written statement will elaborate on these points.

COVID-19 and the Single-Family Mortgage Market

A year ago, the mortgage servicing industry was working furiously to comprehend and respond to the unknown magnitude of economic disruption facing us due to the sudden business shutdowns. The whole country was trying to grasp what we might be facing. The uncertainty was enormous, and in some sectors of the economy, the job losses were massive and immediate.

More than half a million Americans have died from the virus and millions continue to face extraordinary hardship. Yet we can take heart in the efforts of so many Americans who responded admirably in the face of such adversity. We have seen medical advances at amazing speed, producing vaccines that point us to a brighter future. Many businesses have shifted to remote work and, as a result, many parts of the economy have rebounded remarkably, while other businesses and parts of the economy remain shuttered or operate at less than full capacity.

The industry that I represent, mortgage lenders and servicers, has worked diligently to meet this moment. Servicers quickly established processes to offer homeowners mortgage payment forbearance plans, while simultaneously converting their operations to accommodate their employees working from home. By mid-April, more than 2 million families had requested and received forbearance. By late May, that number peaked at nearly 5 million.[1] Homeowners have been able to request and receive mortgage payment forbearance simply by contacting their mortgage servicer and declaring a financial hardship due to the pandemic.

While forbearance plans were mandated by the CARES Act, mortgage forbearance was already part of the servicing toolkit and had been used previously by servicers in response to natural disasters. Having this toolkit in place allowed servicers to deploy forbearance assistance across the country at a previously unseen scale in a matter of days. Servicers also voluntarily provided the same support for mortgages held in bank portfolios and private label securities, not just on the government-backed loans required by the CARES Act. Mortgage insurers have worked with servicers to align operations and support forbearance and post-forbearance solutions.

The rapid roll-out of these plans is not just a success story for mortgage servicers, it reflects the incredible effort of many others as well. While not a comprehensive list, I particularly want to acknowledge the leadership and staff at the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the US. Department of Agriculture's Rural Housing Service, Ginnie Mae, the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac (the GSEs)[2], and the Consumer Financial Protection Bureau (CFPB) for responding quickly and appropriately to the challenges faced by consumers and mortgage servicers. Each of these government agencies and programs worked diligently with industry representatives and with each other to tailor responses to the needs of homeowners.

Homeowners have also been engaged and are working with their servicers. Since the peak in forbearance requests, more than half of homeowners have resumed making their payments or have paid off their mortgages. Today, about 2.6 million homeowners are still in forbearance, and most of those are coming up on the one-year anniversary of being in forbearance.[3] Recently, FHFA and the government-insured loan programs indicated that forbearance could be extended up to six more months, for a total of 18 months. HPC supports this action.

Despite this tremendous response by mortgage servicers and homeowners, much work remains. By this fall, as forbearance begins to wind down, homeowners will face choices to resume payments. The silver lining is that the situation is not as dire as the one we faced in the Great Recession. In most markets, house prices have increased and most homeowners in forbearance have at least 10 percent equity in their home. Mortgage servicers remain ready to use all of their resources to help each homeowner find the best available outcome for their circumstances.

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[1] Andy Walden, Economist and Director of Market Research at Black Knight, Inc. March, 12, 2021 "Forbearances See Largest Weekly Decline Since Beginning of 2021". Washington, DC.

[2] For purposes of this testimony, the "GSEs" (Government-Sponsored Enterprises) or "Enterprises" refer to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

[3] Walden, Forbearances See Largest Weekly Decline.

I also hope the constructive engagement between industry and government agencies that developed in response to this crisis will continue. For example, many industry participants, including the Housing Policy Council, partnered last summer with housing and consumer advocates and the CFPB to launch an outreach campaign targeted at homeowners who had missed mortgage payments but were not in forbearance or were nearing the end of their forbearance period. This type of public/private partnership improves our collective ability to assist homeowners in need.

For the remainder of 2021, I expect COVID-related challenges to be the industry's number one priority. While some of the 2.6 million households in forbearance today are likely to return to work as public health and economic conditions improve, others may face a permanent job loss. Working with those borrowers will be job one.

Racial Ownership Gaps and Demographic Challenges

In 2020, the deaths of George Floyd, Breonna Taylor, Ahmaud Arbery and others opened a wider and more urgent demand to address racial disparities, including the racial homeownership gap. Unlike the pandemic, this gap did not appear overnight nor will it go away quickly. But there is broad consensus that we must grapple with it. We face other important challenges ahead as well; significant demographic changes require housing policy attention in the years ahead, such as senior housing, multi-generational housing, and the emergence of the enormous millennial generation into the housing market.[4]

Two years ago, I testified before this Committee[5] and set forth the Housing Policy Council's views on expanding opportunities for homeownership. Because I believe those views are still relevant today, I will repeat that testimony:

> The various housing finance reform proposals put forward over the last several years have all included a mechanism to generate funds to stimulate the production and preservation of affordable rental housing and to bolster targeted homeownership assistance programs. HPC supports this approach. Our members recognize that appropriations for housing programs are not keeping pace with housing need in this country. Therefore, given the benefits derived from the government guarantee envisioned in housing finance reform, it is reasonable for legislation to establish an obligatory contribution of dollars through transaction fees to expand the supply of desperately-needed affordable housing.
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> HPC also supports funding for specialized homeownership programs. However, it is the preference of HPC members to direct new funds for homeownership assistance to

[4] The Urban Institute's Housing Finance Policy Center has produced multiple research articles and blogs on these topics. For example, see Future of Headship and Homeownership, January 2021, which addresses all these issues: senior households, multi-generational living, changing demographics, and rising millennials. Other relevant work includes By 2040, the US Will Experience Modest Homeownership Declines. But for Black Households, the Impact Will Be Dramatic, What Will It Take to Support 5.5 Million More Senior Renters by 2040, and The Number of Hispanic Households Will Skyrocket by 2040. How Can the Housing Industry Support Their Needs?

[5] Edward J. DeMarco, President, Housing Policy Council. March 26, 2019. "Testimony before the Senate Committee on Banking, Housing, and Urban Affairs on Chairman's Housing Reform Outline." Washington, DC.

programs that contribute directly to the households in need, reducing the barriers to entry and financial challenges that these individuals and families face. HPC would prefer that new funds not be used to simply subsidize higher-risk loans or to compensate the industry to make loans that may not perform using more lenient underwriting criteria.

We believe that funds used to address the areas of risk that drive the increased pricing, rather than subsidizing that pricing, would better serve the households in need. Examples of these types of programs are down payment assistance grants that enable households to enter homeownership with some amount of equity in the property; savings programs that offer matching funds to increase the down payment amount or, equally importantly, that create "rainy-day" reserves to address future needs; and dedicated accounts that could be tapped by homeowners in financial distress, to avoid missed payments and / or foreclosure. The application of dollars to these types of programs, as well as critical homeownership counseling and education services, would help families prepare for and sustain homeownership, improve access, address the real barriers, and create a true financial benefit and performance boost for low- and moderate-income (LMI) households.

Along these same lines, HPC recognizes that there may be interest by some in preserving the GSE Affordable Housing Goals and Duty-to-Serve activities. The intent of these programs is to ensure the secondary mortgage market makes credit available for more low- and moderate-income households, and targeted market segments (affordable housing preservation, rural markets, and manufactured housing) than the private sector may serve on its own without government support. However, HPC believes that it is worthwhile to assess and revisit the impact and outcomes of these programs and consider alternatives that better achieve the intended objectives. Rather than repeat the use of methods that have had, at best, mixed results, we should seek new types of measurable targets and financing goals to ensure that traditionally underserved segments are targeted for guarantor support. For example, there may be high-impact ways to use additional funding, modeled on the Federal Home Loan Bank System's Affordable Housing Program, which has effectively served communities nationwide for decades now.

More recently, HPC addressed the matter of affordable housing for low-and moderate-income families and families of color in a comment letter to the FHFA on the GSEs' affordable housing goals. In our comment letter,[6] HPC noted that there is limited evidence that the housing goals have expanded low-income homeownership.

The driving factor for why the GSE housing goals have been unable to move the needle on addressing these structural challenges is that the program subsidizes demand primarily through the cross-subsidization of mortgage rates rather than directly addressing the barriers many families face in attaining homeownership. To achieve the goals, the GSEs offer relaxed underwriting criteria and pricing benefits to some consumers who might not otherwise qualify for a mortgage. This subsidy is based on a borrower's credit risk, not race or income or wealth or financial readiness. It is poorly targeted, and it fails to address the barriers many Black,

[6] Edward J. DeMarco, President, Housing Policy Council. February 25, 2021 "Comments on Enterprise Housing Goals Advance Notice of Proposed Rulemaking."

Latino, and low income/low-wealth families face in trying to attain homeownership, such as a lack of downpayment, financial education, or a rainy-day reserve.

Moreover, with an inelastic housing supply, continued subsidization of the mortgage rate has the counter-productive effect of boosting home prices. Simply put, making it less expensive to borrow money to purchase a commodity in short supply (houses) results in added demand, increasing the sales price. In effect, the subsidy built in to the GSE housing goals ends up going to the home seller, not the home buyer. This has the perverse effect of making housing less affordable, not more affordable.

In summary, before doubling down on past programs, we should consider whether such programs have actually helped close the racial gap in homeownership or otherwise enhanced the homeownership outcomes for lower- and moderate-income households. We also should be mindful that, with house prices soaring in the face of limited supply, subsidy programs that are not properly designed risk enriching current homeowners, not creating new homeowners.

Let me conclude this section with four final thoughts.

First, any discussion of broadening homeownership opportunities should include consideration of the FHA. FHA is the country's flagship program to support homeownership, but it is sorely in need of repair. While important improvements have been made in recent years, FHA servicing rules and practices remain a challenge and aligning FHA requirements with current market practices would be helpful. We look forward to working with Secretary Fudge on modernization and alignment initiatives to see them completed. We also hope to work with this Committee on how FHA can be a meaningful component of efforts to build wealth through homeownership. Likewise, Ginnie Mae needs to continue its modernization efforts.

Second, a critical factor to consider when pondering new approaches to expand homeownership opportunities is the changing characteristics of household income. In today's economy, household income has become more unpredictable and volatile.[7] We underwrite mortgage loans considering traditional wage income and assets to determine a borrower's ability to repay. However, income increasingly is subject to variability, in part due to more households relying on multiple part-time or seasonal jobs as the so-called gig economy expands. These changes may need to be considered in underwriting mortgages, especially for lower-income workers and certain minority communities. Consideration of these factors may help to create new pathways to homeownership.

Third, and related to the previous point, we should not measure success simply by observing positive changes in homeownership rates. Any such gains must be sustainable through the economic cycle. We currently are experiencing enormous house price growth, fueled largely by historically low interest rates and pandemic-related changes in demand for housing. We need to ensure we do not encourage marginal borrowers into highly leveraged mortgages on houses reflecting temporary house price gains. Otherwise, we may cause serious harm and set back the long-term efforts to close the racial gap in homeownership.

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[7] Seidman, Ellen, and Ratcliffe, Caroline. 2017 "Everyone benefits when the financial sector serves people with volatile income." Washington, DC: Urban Institute.

Lastly, we need a regulatory environment that accounts for these considerations. On that score, the CFPB's multi-year process to evaluate and update the Qualified Mortgage rule was a welcome development that should help to close the racial gap in homeownership by responsibly expanding access to credit. Thus, it was troubling to see the CFPB last month start to backtrack on the new rule just weeks after finalizing it.

Housing Supply: We Need to Build More Housing

The Chairman's letter of invitation asked me to report on conditions in the housing market affecting affordability and availability, and the challenges facing various households. The single biggest challenge is clear. We do not have enough houses.

Housing construction ground to a trickle with the Great Recession and its long aftermath. Meanwhile, a demographic wave was building that would increase demand for housing. Today, the greatest imbalance, and the greatest challenge, in housing is this supply-demand imbalance. A relatively fixed supply and growing demand, fueled by historically low interest rates, and a pandemic-driven change in the demand for housing, has made it even harder for individuals and families to break into the ranks of homeownership.

This lack of supply is both a rental and an ownership challenge. The Housing Policy Council's focus is homeownership, but to assess the state of housing, it is important to understand the needs of both renters and homeowners. Homeownership remains the most common avenue to wealth-building, particularly for low and moderate-income families, and most future homeowners will come from the ranks of renters, so both matter.[8] Other witnesses today will expand on the critical housing issues in the rental market.

As an economic principle, unmet demand should lead to higher prices and higher prices should induce more supply. However, building housing in most communities requires navigating a labyrinth of approvals, restrictions, and building requirements. The combined effect of these requirements is that fewer houses are built and the ones that are built are higher cost properties.

The solution to this problem is simple, but politically complex. It primarily requires thousands of local jurisdictions to evaluate land use restrictions, zoning laws, building codes, and other requirements to ensure that home construction is encouraged, not discouraged. It also requires programs to address labor shortages, particularly in skilled positions such as carpenters, electricians, and plumbers.

Finally, the supply problem is not just an issue of new construction but also an issue of rehabilitating existing supply to extend its useful life. In many parts of the country, we have an aging housing stock, and some of those properties may not be up to modern health, safety, and energy efficiency standards. One way to increase housing supply is to think about preserving and modernizing existing housing stock as well as identifying other existing structures that could be

[8] A recent report published by the Harvard Joint Center for Housing Studies describes many of the supply issues in the apartment market and offers strategies that developers and builders could deploy. See Hannah Hoyt. 2020 "MORE FOR LESS? AN INQUIRY INTO DESIGN AND CONSTRUCTION STRATEGIES FOR ADDRESSING MULTIFAMILY HOUSING COSTS." Cambridge, MA: Joint Center for Housing Studies of Harvard University.

repurposed for housing.

The GSE Conservatorships: *Still* a story that needs an ending

More than nine years ago, as Acting Director of the Federal Housing Finance Agency, I submitted a report to this Committee titled "A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending."[9] Here we are, nine years later and more than a dozen years since the GSEs failed and were placed in conservatorships, and that story *still* needs an ending. On behalf of the members of the Housing Policy Council, I make the same plea today I made all those years ago: the end of the story needs to be written by Congress.

My last testimony before this Committee focused almost entirely on this issue.[10] At that time, I testified on a thoughtful reform outline put forth by then-Chairman Crapo.

Today, I will reiterate a few key points: Ending the conservatorships requires permanent change to the inherently flawed structures that led to the conservatorships in the first place. While administrative progress is welcome and can help to set a prudential framework for the GSEs post-conservatorship, we will not achieve true reform without Congress. Only Congress can revise the statutory charters of the GSEs, address the need for an explicit federal guarantee on the mortgage securities issued by the GSEs, and address other problems embedded in the GSEs' charters.[11]

Principles for Housing Finance Reform

An appropriate starting point for discussing major legislation that will affect so many citizens and a large segment of the economy is to agree to a set of principles that can guide reform. The Housing Policy Council centers its reform views on the following principles:

1. Fix what is broken and preserve what works in support of consumers and the market.
2. The transition from the old system to the new one should avoid disrupting consumers and markets.
3. Private capital should bear all but catastrophic mortgage credit risk so that market discipline contains risk. The government should provide an explicit, full faith and credit guarantee on mortgage-backed securities but with a pre-set mechanism to ensure any catastrophic losses that call upon taxpayer support will be repaid fully.
4. The government regulatory framework must be consistent and equitable across all participating companies and ensure that participants in the housing finance system

[9] Edward J. DeMarco, Acting Director, Federal Housing Finance Agency. February 21, 2012. "A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending." Washington, DC.

[10] Edward J. DeMarco, President, Housing Policy Council. March 26, 2019. "Testimony before the Senate Committee on Banking, Housing, and Urban Affairs on Chairman's Housing Reform Outline." Washington, DC.

[11] For example, as HPC noted in a recent letter to FHFA, the current statutory construct for resolving a failure of a GSE would seriously disrupt the housing finance system. See, Edward J. DeMarco, President, Housing Policy Council. March 8, 2021 "Comments on Enterprise Resolution Planning."

operate in a safe and sound manner.

The government-protected GSE duopoly should be replaced with a structure that serves consumers by promoting competition, affordability, transparency, innovation, market efficiency, and broad consumer access to a range of mortgage products. [12]

The good news is that these principles align well with those that underpin virtually all of the major reform proposals that Congress has debated over the past ten years. They also align with the reform principles introduced by Sen. Toomey yesterday. Much work has been done on this issue, including by members of this Committee, so there is much to build upon.

Consumers Would Benefit from Enhanced Market Competition

Key benefits of housing finance reform include greater market competition and greater reliance on private capital to manage mortgage credit risk. What do we lose when we lack competition in the secondary mortgage market? I believe we lose a lot – and our failure to appreciate what is lost keeps our housing finance system from realizing its potential to fully meet the needs of potential home buyers.[13]

Any list of the consequences of inhibiting a competitive housing finance system should start with these:

1. Systemic Risk: The absence of market competition concentrates risk among the few market participants, in this case, Fannie Mae and Freddie Mac. Systemic risk is exacerbated because this limited competition reduces attention to risk management.

2. Monopoly pricing: The absence of market competition means we get monopoly or oligopoly pricing, not a competitive market price. That means consumers may pay more than they need to and that at least some lenders may realize lower returns than if they had competitive bids for their loans.

3. Limited innovation: Absent the need to maintain an edge to stay ahead of the competition, the secondary market lacks incentive to continuously improve and the results include lack of innovation to serve emerging borrower needs and slow adoption of new technology to improve efficiency and customer experience and lower origination and servicing costs. Note that lower costs and more innovation will lead to more qualified borrowers.

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[12] For a more in-depth discussions of these principles and of the key policy issues involved in housing finance reform, see Edward J. DeMarco, President, Housing Policy Council. June 29, 2017 "Testimony before Senate Committee on Banking, Housing, and Urban Affairs on Principles of Housing Finance Reform." Washington, DC. and Edward J. DeMarco, President, Housing Policy Council. September 6, 2018. Testimony before the Housing Financial Services Committee on "A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk." Washington, DC.

[13] For a more in-depth discussion of these issues, see Edward J. DeMarco, November 2019. Remarks to the Exchequer Club, "Remember Where They Were so You'll Understand Where We Are: The State of Housing Finance Reform," Washington, DC; November 20, 2019

4. Misallocation of capital: By regulating Fannie and Freddie to materially lower capital standards relative to the rest of the market, we misallocate capital both within the housing finance system and between housing finance and competing capital uses, including those that could lead to greater economic growth or more housing construction.

5. Decreased access for small lenders: It is common sense that if a market has only one or two buyers, rather than dozens of buyers, it will be harder for small producers to access those buyers. In the mortgage world, the largest loan originators are going to be able to sell their loans into the secondary market because the secondary market thrives on scale. With only two buyers, not even mandates on guarantee-fee equivalency can mask the inherent challenge smaller production shops have selling their mortgages. Yet, if the market were more competitive, with numerous outlets to sell mortgages, there would be greater demand for the loan production of smaller lenders.

6. Decreased demand for affordable products: Congress imposed housing goals on Fannie and Freddie to ensure that they paid enough attention to loans in those markets. This is the same phenomenon that affects smaller lenders. Increased competition in the secondary market would mean increased competition for affordable loans as well. Think about this: Would we have greater access to credit and lower credit prices if we had just two banks operating nationwide and no community or regional banks to compete with them?

7. Policy distortions: It would be hard to overstate the political influence over housing policy wielded by Fannie Mae and Freddie Mac before conservatorship and the challenge that created to achieving sound public policy and regulation. These GSEs distorted our politics as well as our markets and we must factor that into our calculus of their systemic risk.

Systemic Risk in Housing Finance is Growing not Shrinking

In 2008, FHFA, assisted by Congressionally-authorized emergency funding, placed Fannie Mae and Freddie Mac into conservatorships because of the immediate and profound systemic risk they posed to the financial system and to the U.S. housing market.[14]

In conservatorships, these companies have drawn more than $190 billion from the U.S. Treasury Department to cover losses. More than that, their very ability to operate is due to the direct and ongoing commitment of taxpayer support that Congress authorized Treasury to put in place at the start of the conservatorships. While in recent years FHFA and Treasury have allowed the two companies to begin retaining earnings to rebuild capital, the taxpayer has ceased receiving

[14] Secretary Henry M. Paulson, Jr. September 7, 2008. "Statement on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers." Washington, DC. and FHFA Director James B. Lockhart. September 7, 2008. "Remarks on Housing GSE Actions." Washington, DC.

compensation for that support and instead has been receiving an increasing stack of IOUs in the form of an increased liquidation preference, to be satisfied whenever the conservatorships are finally resolved.

At the same time, the two companies loom over the housing finance system to an even greater degree than they did when they failed in 2008. FHFA has taken steps to establish a set of prudential standards for the Enterprises post-conservatorship, including a meaningful capital framework. It has also overseen the restructuring of the capital framework for mortgage insurance companies and the development of credit risk transfer structures, each of which has brought new and strengthened private capital support to this market.

Generally, these are positive and welcome steps. However, it is puzzling to HPC that the new FHFA capital rule gives limited benefit to the one reform in conservatorship that has reduced both taxpayer and systemic risk: credit risk transfer. In addition, while the pandemic's market disruptions last spring included a temporary shutdown of new credit risk transfer deals, Freddie Mac has returned to transferring risk into private markets, but Fannie Mae has not. The result is that Fannie Mae is reconcentrating mortgage credit risk on its own books, risk that is supported only by taxpayer-provided capital.

Members of the Committee, you can provide a permanent and reliable structure for the secondary mortgage market that reduces the systemic risk posed by the GSEs. Until then, consumers have fewer choices, racial ownership gaps are the same as they were decades ago, the mortgage market has less innovation than other markets, and taxpayers and the financial system are again put at risk of another housing collapse.

And lastly, in 2013, two members of this Committee – Senators Corker and Warner – identified the basic policy compromise that remains the foundation for bipartisan reform. Restore reliance on meaningful private capital to bear mortgage credit risk, backstop the system with a federal guarantee to ensure deep liquidity in all markets, and assess the system both for that government backstop and to fund affordable housing needs, including actions that would address our supply problems. The 10 basis points affordable housing fee the Senators proposed almost a decade ago became part of virtually every housing finance reform bill that followed, Democrat and Republican. Over the past ten years, such a fee could have raised over $30 billion for affordable housing. Think of the opportunity cost of our failure to act. We still have significant taxpayer exposure and systemic risk, and we missed the opportunity to expand funding to support affordable housing and housing supply.

Thank you for inviting me today. As always, the members of the Housing Policy Council look forward to working with the members of this Committee to tackle the challenging issues I have just described. We can only get this done by working together.

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