Testimony of Greg Ugalde

On Behalf of the

National Association of Home Builders

Before the

U.S. Senate Committee on

Banking, Housing, and Urban Affairs

Hearing on

"Chairman's Housing Reform Outline: Part I"

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Introduction

Chairman Crapo, Ranking Member Brown and members of the Committee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on housing finance reform. My name is Greg Ugalde and I am NAHB's 2019 Chairman of the Board.

NAHB represents over 140,000 members who are involved in building single-family and multifamily homes, remodeling, and other aspects of residential and light commercial construction. NAHB's members construct approximately 80 percent of all new housing in America each year. Our builders rely on both government and private programs and financing sources to help provide decent, safe, and affordable single-family and multifamily housing to our fellow citizens.

We believe an effective housing finance system must address liquidity as well as affordability and that those two elements are very closely related. Therefore, while it is important for the system to provide housing credit at affordable terms as well as address specific housing needs, it also is essential that credit is consistently available on those terms regardless of domestic and international economic and financial conditions.

Housing Affordability

Safe, decent, affordable housing provides fundamental benefits that are essential to the well-being of families, communities and the nation. For these reasons, housing affordability is among NAHB's top advocacy issues this year. We are working with Congress, the Trump Administration, and state and local officials to help hard-working Americans purchase or rent affordable homes. Through these actions, we also will create jobs and move the economy forward.

NAHB's research shows that housing affordability in the single-family market remains at a 10-year low.[1] Only 56.6 percent of new and existing homes sold in the fourth quarter of 2018 (October through December) were affordable to families earning the U.S. median income of $71,900. Although the national median home price decreased from the third quarter of 2018 to the fourth quarter, average mortgage rates rose by 17 basis points over the same period. This was the fourth straight quarterly rate hike and the highest rate level since the second quarter of 2011.

Several factors account for the affordability crisis. Ongoing job creation and solid household formations are driving strong demand for housing. Unfortunately, rising costs are constraining builders' ability to construct new homes and apartments at affordable prices to meet the demand. For example, excessive regulations at all levels of government now account for 24.3 percent of the final price of a new single-family home built for sale[2] and 32.1 percent of

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[1] Rose Quint, "Housing Affordability Holds Steady at a 10-Year Low in the Fourth Quarter," NAHB Eye on Housing Blog, February 14, 2019.

[2] Paul Emrath, Ph.D. "Government Regulation in the Price of a New Home," NAHB Economics and Housing Policy Group Special Studies, May 2, 2016.

multifamily project costs[3]. Construction costs also are increasing due to a scarcity of buildable lots, persistent skilled labor shortages, and tariffs on lumber and other key building materials. These costs are having a direct negative effect on housing affordability. NAHB's "Priced Out" Estimates for 2019[4] show that 127,560 households would be priced out of the housing market if the median U.S. new home price rises by $1,000. In other words, based on their incomes, 127,560 households would be able to qualify for a mortgage to purchase the home before the price increase, but not afterward. Similarly, a $1,000 increase in the cost of building a new rental unit will price out almost 20,000 renters for that apartment;[5] the household would be rent-burdened after the rent increase, but not before.

For these reasons, NAHB calls on Congress and the Trump Administration to make housing affordability a national priority. An essential component of any strategy for housing affordability must be advancing comprehensive housing finance reform, which will ensure the capital and liquidity necessary for housing developers, builders, lenders and consumers to access stable financing. In addition, NAHB urges federal policymakers to take appropriate actions to ease regulatory burdens, adopt sensible workforce development and immigration policy that will help our industry fill open jobs, and fund federal housing programs.

Need for Comprehensive Housing Finance System Reform

NAHB remains a staunch supporter of comprehensive housing finance system reform. To NAHB this means effective reform of the conventional mortgage finance market, including Fannie Mae and Freddie Mac (the Enterprises), private capital sources and federal mortgage finance programs, in particular those of the U.S. Department of Housing and Urban Development (HUD), most involving the Federal Housing Administration (FHA), the U.S. Department of Agriculture's Rural Housing Service (RHS) and the U.S. Department of Veterans Affairs' (VA) Home Loan Guaranty Program. Additionally, we support an enhanced role for state and local housing finance agencies. These organizations play an important role in meeting affordable housing needs and NAHB believes they hold great potential to augment a reformed housing finance system.

NAHB believes comprehensive reform must come through Congress and focus on fixing the structural flaws that still persist ten years after the great recession. Comprehensive legislation, including a determination of the future of Fannie Mae and Freddie Mac, is the only way to ensure a stable housing finance system, preserve access to credit and protect taxpayers.

In September 2018, Fannie Mae and Freddie Mac completed their tenth year in conservatorship under the control of their regulator, the Federal Housing Finance Agency (FHFA). This was a stark reminder that housing finance system reform, which seemed so urgent following the mortgage market and financial crisis, is still unfinished business. NAHB believes strongly that having the Enterprises continue in conservatorship, with no end in sight, contributes to

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[3] Paul Emrath, Ph.D. and Caitlin Walter, Ph.D. "Multifamily Cost of Regulation 2018 Special Study," National Association of Home Builders and National Multifamily Housing Council, June 12, 2018.

[4] Na Zhao, Ph.D. "NAHB Priced-Out Estimates for 2019," NAHB Economics and Housing Policy Group Special Studies, January 2, 2019.

[5] Based on the 2018 median rent of $2,189, a $1000 increase in the cost of building a new apartment unit would price out 19,617 renters.

uncertainty regarding mortgage availability and affordability and is therefore both undesirable and unsustainable.

Administrative Housing Finance Reform

Last September, as the 10-year anniversary of conservatorship of Fannie Mae and Freddie Mac approached, and again earlier this year after FHFA Director Watt's term ended, NAHB joined 28 other organizations in sending letters to Congress and the Administration urging policymakers to be cautious in making any administrative reforms to Fannie Mae and Freddie Mac before Congress has passed legislation to resolve the conservatorships. Absent legislation to change the structure of the Enterprises, administrative reforms to the Enterprises should seek to maintain and enhance the stability and liquidity of the housing finance system while considering the potential impact on borrowers, taxpayers, and market structure dynamics such as an expanded private market and a level playing field among market participant seeking market access through the Enterprises. Legislation must incorporate positive administrative changes already in place.

In January 2019, the term of FHFA Director Mel Watt ended and the Comptroller of the Currency, Joseph Otting, was named by the Administration as Acting Director. President Trump nominated Mark Calabria, who is awaiting full Senate confirmation, to be the next FHFA director. As conservator and regulator, the FHFA Director has the authority to make reforms administratively. In the absence of Congressional action, NAHB is concerned that administrative reforms could be more conservative than legislation that would require bipartisan approval. However, NAHB enjoys a positive working relationship with Dr. Calabria and we are confident we will have opportunities to discuss any concerns going forward.

We believe it is particularly important for FHFA to provide notice and comment opportunities on proposed administrative changes and to provide adequate transition periods to allow market participants to adjust to new guidelines and circumstances. It is critical to avoid disruptions and dislocations in the mortgage credit market that would increase prices or decrease availability of credit for home owners and home buyers.

Chairman Crapo's Housing Reform Outline

NAHB appreciates Chairman Crapo's effort to put forth a thoughtful outline for housing finance reform that includes the essential elements for a comprehensive reform bill, but leaves other significant details open for discussion and bipartisan agreement. NAHB supports the broad concepts of the Outline. In particular, we appreciate the Chairman's continued support for an explicit government backstop for a key portion of the conventional mortgage market. We firmly believe this is critical to ensuring the ongoing availability of the 30-year, fixed-rate mortgage that is so essential to affordable homeownership.

NAHB is pleased that initial reform plans that called for winding down Fannie Mae and Freddie Mac have moderated to allow the Enterprises to remain important participants in the proposed new system. The Chairman's Outline calls for Fannie Mae and Freddie Mac to become private guarantors, which essentially preserves the current secondary market role of the Enterprises and allows the mortgage market to continue to benefit from their comprehensive and well-tested infrastructure. New, additional entities also would become private guarantors. Private guarantors will guarantee the timely repayment of principal and interest to investors of eligible mortgages that are securitized.

The Outline would designate Ginnie Mae as the operator of the securitization platform. It appears the Outline would require Ginnie Mae to operate a securitization platform that securitizes mortgages backed by eligible conventional mortgages, significantly expanding the current role of Ginnie Mae whose securitization platform today securitizes only mortgages collateralized by government-insured and -guaranteed mortgages. Ginnie Mae would provide the explicit federal government guarantee for all these MBS. NAHB believes there are advantages to using the existing Ginne Mae securitization platform to issue MBS collateralized with conventional mortgage loans although statutory changes will be needed to allow Ginnie Mae to perform this new function. NAHB cautions that with this considerable expansion to Ginnie Mae's MBS issuance there must be assurances that it would be able to scale up as quickly and effectively as needed in order to maintain market liquidity.

The Outline allows that the technology and infrastructure developed as part of the Enterprises' Common Securitization Platform (CSP) could be sold or transferred to Ginnie Mae. NAHB appreciates this is noted as a possibility. In addition to potentially increasing the bandwidth for Ginnie Mae's securitization operations, knowing so many resources have been invested and the enormous effort undertaken by many stakeholders to develop the CSP, NAHB is pleased the Chairman recognizes the value of this new infrastructure and acknowledges that it may benefit a restructured housing finance system.

As included in the Outline, NAHB supports mortgage requirements substantially similar to the qualified mortgage (QM) as a base for the definition of a sustainable, conforming mortgage, but believes that the new system should be given additional flexibility to establish underwriting criteria beyond baseline QM. In addition, NAHB believes the current, statutory requirements for determining conforming loan limits and loan limits for federally insured and guaranteed mortgage loans should remain intact. The authority to increase loan limits is important for the conforming mortgage market to remain relevant when house prices are increasing. This ensures conventional mortgage credit remains affordable and accessible to consumers.

NAHB sees the value of mortgage market participation by lenders of all sizes. However, we appreciate the Chairman has made a considerable effort to show support for small lenders by prohibiting volume-based discounts on guarantee fees and other terms. In a reformed housing finance system, access to the secondary mortgage market and pricing should not be based on the volume of business or size or geographic location of the selling institution.

Since 2013, the Enterprises have used credit risk transfers (CRTs) to reduce the risk to taxpayers and encourage the return of private investors to the mortgage market. The current use of innovative CRT structures by the Enterprises has been very successful in attracting private capital and NAHB believes allowing guarantors to continue to lay off risk using approved CRT structures will continue to be positive for the market. As new guarantors enter the market, it is prudent to require that the FHFA approve CRT structures and allow only approved structures to be used by guarantors. The CRT approach has been untested in distressed markets so NAHB appreciates caution before relying on this framework too much. Also, any such program should have the dual purpose of lessening risk exposure and allowing for a reasonable interest rate/borrowing cost for borrowers.

The Outline proposes to replace current affordable goals and duty-to-serve requirements with a new Market Access Fund. The Market Access Fund, and the current Housing Trust Fund (available to provide housing for extremely low- and very low-income households, including homeless families) and Capital Magnet Fund (used to finance community service facilities and affordable housing activities and related economic development activities) will be funded through an annual assessment of 10 basis points of the total annual loan volume guaranteed by each guarantor.

NAHB has strongly and consistently urged Congress to ensure that the Enterprises, or their successors, demonstrate leadership in affordable housing by providing liquidity and supporting housing for families at different income levels in various geographic markets and in various market segments. NAHB supports an approach that would require the entities providing resources for this purpose to be accountable for the effectiveness of the programs to which such funds are distributed. In addition, NAHB believes the definition of affordable housing should be expanded from a focus on very low- and low-income families to include workforce housing that serves the needs of moderate-income families as well. Again, NAHB welcomes an opportunity to work with this Committee and other stakeholders to develop the details for this section of the bill.

The Outline includes a robust role for the regulation of guarantors. As proposed in the Outline, NAHB believes the regulatory agency should be governed by a bipartisan board of directors instead of a single director. Board governance would mitigate the potential for extreme and abrupt changes in policy that are possible under the existing, single director regulatory regime. The significant oversight of the guarantors, including the establishment of prudential standards with regard to capital requirements, appears in-line with ensuring a safe and sound mortgage finance system. However, as the regulator contemplates the complex aspects of determining capital requirements, the industry should be consulted through notice-and-comment rulemaking.

Elements of a smooth transition have been addressed in most housing finance system reform plans. NAHB is pleased that the Chairman's Outline is no exception. A careful transition is essential to ensure the new system is workable and effective. Any changes to the housing finance system should be undertaken with extreme care and with sufficient time to ensure that U.S. home buyers, owners, and renters are not placed in harm's way and that the mortgage funding and delivery system operates efficiently and effectively as the old system is wound down and a reformed system is put in place. Every effort should be made to reassure borrowers and markets that credit will continue to flow to creditworthy borrowers and that mortgage investors will not experience adverse consequences as a result of changes in process.

We look forward to continuing to work with this Committee to achieve comprehensive housing finance system reform that has bipartisan support, addresses the flaws of the current and previous system and is sustainable for the long term.

Preserve the Enterprises' Successful Multifamily Housing Finance Framework

NAHB believes it is essential to have an efficient and stable secondary market where conventional multifamily mortgages are aggregated and placed into diversified pools for securitization and sale to investors worldwide. Therefore, NAHB has consistently advocated for preserving Fannie Mae's and Freddie Mac's successful multifamily financing infrastructure. The Enterprises' multifamily programs have consistently performed well, even in stressful market conditions. NAHB is pleased that the Chairman's Outline proposes a continued role for the multifamily financing infrastructure. Nevertheless, we believe there are some aspects of this proposal that require further consideration, and NAHB looks forward to working with the Committee to address these concerns.

NAHB is pleased that the Outline recognizes the importance of multifamily financing in providing options for affordable rental housing, but we are concerned that the Outline appears to require the Enterprises to divest their successful multifamily business. The Outline envisions Fannie Mae and Freddie Mac as private guarantors, and "The multifamily businesses of Fannie Mae and Freddie Mac will be sold and operated as independent guarantors." We are concerned that this specific language may have the unintended consequence of precluding the Enterprises from addressing critical secondary multifamily market needs.

A delicate balancing act is necessary to facilitate entry to the secondary multifamily market for new independent guarantors and to preserve the successful multifamily business lines and infrastructure from the status quo. As the Committee moves forward with housing finance reform legislation, NAHB requests that Fannie Mae and Freddie Mac receive the capacity and flexibility to fill gaps in the multifamily marketplace that others are not addressing. Legislation and subsequent regulation should support strong and sustained liquidity in the multifamily rental market.

To better appreciate the role that the Enterprises' multifamily financing plays in the secondary multifamily market, it is important to understand that not all private market sources of capital for multifamily financing are available for all segments of the multifamily market. Each source has strength in specific niches and markets and also moves in and out of the market as economic conditions and investment goals change. Life insurance companies typically target low-leverage, high-quality deals in the strongest markets (usually urban) and typically serve the highest income households. Once they meet their own portfolio investment targets, life insurance companies retract their lending. Banks do not provide long-term financing and are subject to significant restrictions in terms of capital requirements. Banks also have significant exposure to regulatory pressure that influences their lending decisions, including obligations under the Community Reinvestment Act (CRA). While the commercial mortgage-backed securities (CMBS) market was significant at one time, it has not recovered from the financial crisis and is not expected to resume its past levels of volume.

These facts point to the need to maintain a viable, liquid and efficient secondary market for multifamily rental financing where the federal government continues to play a role. In addition, the secondary market must be structured to ensure that the appropriate range of products is available to provide the capital needed to develop new and to preserve existing rental housing, as well as to refinance and acquire properties. An adequate flow of capital will ensure that demand for rental housing is met and that affordable options are available for a range of households and communities.

The critical consideration in a new system is broad and continued liquidity during all economic cycles and for all geographic areas. For these reasons, NAHB cautions against over-reaching in regard to reforming the multifamily finance system. This component of the nation's housing finance system has performed, and continues to perform, very well. Housing finance reform should preserve the successful framework of the current system—including the federal backstop for conventional and federally-insured multifamily mortgages.

Additional Considerations for a Reformed Housing Finance System

The elements below are not included in Chairman Crapo's Housing Reform Outline, however, NAHB believes they all should be considered in a comprehensive housing finance system reform proposal.

Appraisal System Reform

NAHB is a strong proponent of a sound and effective appraisal system. The protocol for establishing appraisal standards and guidelines should be reformed. Such provisions should not be left exclusively to the system guarantors, as is currently the case. This arrangement inappropriately restricts appraisers in their task of achieving the most accurate estimates of value. The new system should include a means for all mortgage market stakeholders to contribute to the system's appraisal standards to allow appraisers greater latitude in completing their assignments.

Currently, Fannie Mae and Freddie Mac impose de facto appraisal authority through the guidelines they have established for appraisals on the mortgages they purchase and the forms they use to collect appraisal information. These Enterprise appraisal rules tend to restrict appraisers' ability to pursue approaches that could result in more accurate valuation. In addition, confusion arises over how to interpret the Enterprises' appraisal guidelines in relation to the rules established by The Appraisal Foundation in the Uniform Standards of Professional Appraisal Practice (USPAP) and the appraisal regulations of the banking regulators. This has prompted industry participants to impose overlays that further impede the ability of appraisers to produce accurate valuations.

NAHB urges the establishment of a single, consistent set of rules and guidelines for appraisers and appraisals, not controlled by the Enterprises. NAHB recommends establishing a Collateral Valuation Oversight Committee in the reformed housing finance system. This oversight committee would consist of a broad group of housing market stakeholders, including home builders, and, in consultation with federal regulatory agencies, would be responsible for establishing and maintaining guidelines for the secondary mortgage market, appraisal reporting formats, and a repository for valuation reports. This committee could set standards to ensure the engagement of an appraiser who has the training and experience necessary for the assignment and has flexibility to conduct the analysis most effectively.

In addition, NAHB encourages the development of a timely and workable process for appealing inaccurate or faulty appraisals that is fair, balanced and appropriate to allow all parties of the transaction to appeal appraisals that do not meet USPAP standards or are based on inaccurate data or assumptions. NAHB has been a proponent of the VA's "Tidewater Initiative" which encourages open communications and the sharing of information that assists appraisers in their analysis. NAHB also is encouraged by The Appraisal Foundation's white paper on best practices and guidelines for an efficient and effective Reconsideration of Value process.

Support for Acquisition, Development and Construction Financing

Discussions of housing finance system reform should include how to increase the availability of capital to meet the growing supply needs of the nation's housing market. NAHB believes one of the barriers to increased housing supply and affordability is a lack of acquisition, development and construction (AD&C) financing for home builders and land developers. According to NAHB analysis of data from the Federal Deposit Insurance Corporation (FDIC), the stock of outstanding 1-4 unit residential construction loans at FDIC-insured banking institutions totaled $79 billion at the end of the final quarter of 2018. While this is a significant improvement of the $40.7 billion total from the first quarter of 2013, it is substantially smaller than the $203.8 billion stock outstanding from early 2008. Without an adequate pipeline of financing, developers and builders struggle to afford to buy lots which are increasingly expensive due to low or very-low lot supplies noted in NAHB surveys. This lack of supply is driving up prices and impacting housing affordability, especially for entry level and first-time home buyers. NAHB believes the Enterprises should support community banks' AD&C lending activities and Congress should authorize such support in housing finance reform legislation.

A Carefully Regulated Fully Private Mortgage-Backed Securities System

The conventional MBS market should operate in tandem with a fully private MBS system. A robust market for private label MBS will be critical to the availability of mortgage products that do not meet the conforming, conventional underwriting and credit guidelines or the programs of FHA, USDA and VA. NAHB believes it is essential to have an efficient and stable secondary market where conventional single-family and multifamily mortgages are aggregated and placed into diversified pools for securitization and sale to investors worldwide. This includes considering provisions to support and encourage the return of the private label mortgage securitization market. The government guaranteed and non-guaranteed market segments can and should complement each other by specializing in distinct market niches while also competing on price and product for overlapping market segments.

Investors in private label mortgage-backed securities (PLS) suffered enormous losses in the financial downturn and have not returned to the marketplace in any significant way. In fact, PLS currently comprise only about 4 percent of MBS securitizations. NAHB encourages policymakers to work with the investor community prior to finalizing legislation in order to ensure that the private market is able to gain enough momentum to support the housing market when housing finance reform legislation is enacted. It is important to make sure the legislation does not have unintended consequences that would prevent private capital from returning.

Role for the Federal Home Loan Banks

NAHB always has viewed the Federal Home Loan Banks (FHLBanks) as having an important role in the housing finance system. NAHB's members rely on commercial banks, and in particular, community banks for their AD&C financing needs as well as for the mortgage credit needs of their home buyers. The FHLBanks were a steadfast source of financing throughout the most recent downturn. Their specific mission is to provide liquidity to their members, primarily banking institutions, to support housing finance and community investment. Their role should not be overlooked in a restructured housing finance system. NAHB believes there should be explicit acknowledgement of the significance of the FHLBanks to the housing finance system in any proposed reform legislation.

Affordable Credit

NAHB would like to emphasize that increased fees and interest rates are ultimately paid by home buyers. Since financing costs have a significant bearing on the ability of home buyers to purchase a home, NAHB cautions that any fees contained in a legislative framework will likely be added to the interest rate and may have a negative effect on the market if the cumulative impact substantially raises the cost to buyers.

Prospective home buyers are adversely affected when interest rates rise. NAHB estimates that with a quarter-point increase in the rate on a 30-year fixed rate mortgage, as many as 1 million U.S. households would be priced out of the market for a median-priced new home.[6]

Conclusion

NAHB thanks Chairman Crapo for his focus on housing finance system reform and for releasing his Housing Reform Outline. I appreciate the opportunity to submit our perspectives on housing finance system reform. We look forward to working with the Senate Committee on Banking, Housing, and Urban Affairs and others to build on this effort and develop legislation consistent with NAHB's recommendations and the consensus elements that have emerged over the last several years.

NAHB believes many regulatory reforms undertaken at the Enterprises under the direction of the FHFA have strengthened the safety and soundness of the housing finance system, and ultimately need to be codified in legislation.

Whether they rent or own, Americans want to choose where they live and the type of home that best meets their needs. Given the significant role that housing plays in the economy, we urge Congress to take a long-term, holistic approach to housing finance system reform. NAHB also urges Congress to carefully consider the differences between the single-family and multifamily market and not apply solutions to one piece of the market that are not appropriate for the other.

NAHB thanks this Committee for its leadership on this important issue, and stands ready to work with you to achieve such reforms and provide much-needed stability for this critical sector of the economy.

[6] Na Zhao, Ph.D. "NAHB Priced-Out Estimates for 2019," NAHB Economics and Housing Policy Group Special Studies, January 2, 2019.