National Association of Mortgage Brokers

Testimony of

George Hanzimanolis, CRMS, President

National Association of Mortgage Brokers

on

"Modernization of Federal Housing Administration Programs"

before the

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Chairman Dodd, Ranking Member Shelby and members of the Committee, thank you for inviting NAMB to testify today on the Administration's proposals to modernize Federal Housing Administration ("FHA") programs. In particular, we appreciate the opportunity to address: (1) the need to reform the FHA program to eliminate barriers that restrict mortgage broker participation; (2) the positive effects on FHA's market share and profitability that will result from increased mortgage broker participation; (3) the importance of adjusting the current FHA loan amounts for high-cost areas; (4) the need to develop risk-based pricing for mortgage insurance on FHA loans; and (5) the need to grant FHA flexibility in offering borrowers 100%

financing products.

NAMB is the only national trade association exclusively devoted to representing the mortgage brokerage industry, and as the voice of the mortgage brokers, NAMB speaks on behalf of more than 25,000 members in all 50 states and the District of Columbia. NAMB members are typically small business men and women with 4 to 7 employees, who adhere to a strict code of ethics and best lending practices when presenting consumers with an array of mortgage financing options from which they can choose. Mortgage brokers typically maintain business relationships with various lenders so they can offer a variety of loan products for their customers to choose from. Our members play a critical role in helping the American economy and in making the dream of homeownership a reality for American families.

Making FHA a Real Choice for Subprime Borrowers

NAMB supports many of the proposed reforms to the FHA program, but believes we should first make certain that the FHA program is a **real choice** for prospective borrowers. Regardless of how beneficial a loan product may be, it requires an effective distribution channel to deliver it to the marketplace. The need to make the FHA loan product a viable option is even more acute today given recent developments in the subprime market, which is leading to less liquidity and increased costs.[1] Unfortunately, today many prospective borrowers are being denied access to the benefits of the FHA program because mortgage brokers – one of the most widely used distribution channels in the mortgage industry – are limited in their ability to offer FHA loan products to their customers.

[1] The federal banking agencies recently issued the *Statement on Subprime Mortgage Lending,* which is expected to further tighten underwriting guidelines and restrict volume of credit to the subprime markets. Ultimately, this will curtail the availability of subprime products for many borrowers who are, or will be, in need of refinancing into affordable loans. *See* Inside Regulatory Strategies, *Fewer Loans Expected in Wake of Guidance*, p. 1 (July 9, 2007).

A stated objective of the FHA is to increase origination of FHA loan products and expand homeownership opportunities for first-time, minority and low to moderate-income families. NAMB supports increased access to FHA loans so that prospective borrowers who have slightly blemished credit histories, or who can afford only minimal down payments, have increased choice of affordable loan products. These prospective borrowers should not be forced by default into the subprime market. FHA must be modernized so that it can become an effective vehicle to provide borrowers, especially subprime borrowers, with affordable financing choices that can be sustained over the long-term.

A recent *Inside Mortgage Finance* publication estimated the current FHA market share at 2.7%.[2] NAMB believes the solution to increasing FHA loan origination and market share is increasing the number of origination sources responsible for delivering FHA loan products directly to consumers. Today, the most effective and efficient origination source is through mortgage brokers. Mortgage brokers originate over 50% of all home loans, yet brokers are responsible for just 10% of FHA's origination volume, or .27% of all home loans. This is due, in large part, to the fact that mortgage brokers are discouraged from participating in the FHA program by the unnecessarily burdensome financial audit and net worth requirements. These requirements erect a formidable barrier and prevent a significant majority of mortgage brokers from participating in the program.

NAMB estimates that less than 18% of all mortgage brokers are approved to originate FHA loans under the current requirements; however, recent NAMB surveys indicate that roughly 80%

[2] *See* Inside Mortgage Finance, *Mortgage Originations by Product,* p.7 (March 2, 2007).

of "non-participating" mortgage brokers would offer FHA loans to their customers if there were no financial audit or net worth requirement. NAMB predicts that such a change would increase mortgage broker participation in the FHA program from 18% to roughly 85%. This, in turn, would increase FHA's loan origination volume and market share by nearly 40%.

For example, in 2006, FHA's origination volume was roughly $80 billion.[3] All things being equal, the 67% increase in broker participation would increase FHA's origination volume to nearly $112 billion, and FHA's total market share from 2.7% to 3.78%. This increase of $32 billion and 1.08% total market share will be directly tied to an increase in mortgage broker participation in the FHA program.

<u>Mortgage Broker Participation in FHA Programs</u>

As a prerequisite to originating FHA loans, mortgage brokers currently are required to satisfy cost prohibitive and time consuming annual audit and net worth requirements. These requirements place serious impediments in the origination process, and functionally bar mortgage brokers from delivering FHA loans into the marketplace.

As small businesses men and women, most mortgage brokers find the costs involved with producing audited financial statements an unbearable burden. FHA audits must meet government accounting standards and only a small percentage of certified public accountants ("CPAs") are qualified to conduct these audits. Moreover, because many auditors do not find it feasible to audit such small entities to government standards, many qualified CPA firms are reluctant to audit mortgage brokers. Cost however, is not the only factor. A mortgage broker

[3] See Inside Mortgage Finance, *Mortgage Originations by Product*, p.7 (March 2, 2007).

can also lose valuable time – up to several weeks – preparing for and assisting in the audit process.

Because of the burdens imposed by the current financial audit and net worth requirements, many mortgage brokers do not engage in the FHA program. In this regard, the impediments stated herein have actually served to limit the utility and effectiveness of the FHA program and seriously restrict the range of choice available for prospective borrowers who can afford only a small down payment. At a minimum, NAMB believes annual bonding requirements offer a better way to ensure the safety and soundness of the FHA program than requiring originators to submit audited financial statements.

Some have expressed concerns over allowing mortgage brokers to post a surety bond instead of meeting current FHA net worth and audit requirements. We strongly believe these concerns are unwarranted for several reasons.

First, annual audit and net worth requirements are unnecessary. Today, mortgage brokers participate in the FHA program typically through a large lender responsible for underwriting the loan. Replacing net worth and audit requirements with a surety bond will not change the framework set to ensure responsibility and accountability. Rather, it will simply encourage brokers to participate thereby increasing the amount of FHA loans offered. The larger FHA-approved lenders will continue to submit to the standards deemed necessary by FHA (*i.e.*, audits, net worth, underwriting standards, etc.) before being approved to offer FHA loans through retail or wholesale channels. This affords the U.S. Department of Housing & Urban Development's ("HUD") adequate protection against loss to the FHA program. Brokers who choose to offer

FHA loan products will also continue to be governed by contract agreements with these respective FHA-approved lenders. Again, the surety bond does not alter this current allocation of risk. FHA approved lenders are currently the backstop liability under the FHA program as the delegated underwriter and will remain the backstop under a surety bond construct.

Second, brokers who participate in the FHA program will remain state-licensed entities subject to any state bond requirements, criminal background checks and education requirements (requirements that mortgage bankers do not have to adhere to in many states)[4] *in addition* to any FHA-required surety bond. This, in effect, creates a dual-layer of protection for both the FHA program and the consumer.

Last, the surety bond actually enhances the current laws governing broker originated FHA loans. The process of obtaining a surety bond itself involves stringent pre-qualification standards and review. Surety companies pre-qualify their customers to determine whether they are financially sound and have the baseline to conduct their business, *i.e.* ability to pay out upon a loss, before issuing a surety bond. Therefore, the surety bond reflects not only the quality of the originator, but also his/her ability to participate and sustain business successfully. In addition, the stringent process in place for obtaining a surety bond involves a diligent underwriting process that includes an evaluation of the applicant's net worth. In this current environment, there are mortgage lenders declaring bankruptcy quite often and their net worth has disappeared in a short period of time. A surety bond is reliable and is a guarantee of funds, which is not the case for the current net worth requirements.

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[4] Over the past five years, many states' regulation and oversight of mortgage brokers has eclipsed that of mortgage bankers and lenders.

Increase FHA Mortgage Amounts in High-Cost Areas

In an environment of rising interest rates and shrinking liquidity, many first-time, minority, and low to moderate-income homebuyers need the safer and less-expensive financing options that the FHA program can provide. For this reason, NAMB uniformly and unequivocally supports increasing FHA loan limits in high-cost areas. The benefits of the FHA program should be available equally to all taxpayers; especially those residing in high-cost areas, where borrowers are most often in need of affordable mortgage financing options.

For example, in California, twenty-nine of the fifty-eight counties are currently at the FHA ceiling of $362,790, with another six counties approaching the ceiling. These twenty-nine counties represent approximately eighty-five percent of California's population, many of whom are struggling to become or remain homeowners in an area where the median house price is currently $534,470. California is not alone. High-cost areas exist in many states. Maryland, for example, has five of twenty-four counties currently at the $362,790 FHA maximum with another seven counties within $1,885 of the limit. Again, these counties represent a great majority of the population for Maryland. Additional states that currently feature counties at or approaching the maximum FHA loan limit include Pennsylvania, Massachusetts, Connecticut, New York, and New Jersey among others.

Recognizing high-cost areas with regard to FHA loan limits is not new. Congress already recognizes high-cost areas for FHA loan limits in Hawaii, Alaska and various United States Territories. These areas feature an exception that takes their available loan limit to one hundred and fifty percent of the current FHA loan limit.

Congress must act to ensure that FHA loan programs continue to serve as a permanent backstop for all first-time homebuyer programs. We believe that Congress should allow for FHA loan limits to be adjusted up to 100% of the median home price, thereby establishing a logical loan limit that will benefit both the housing industry and consumers. Tying the FHA loan limit to the median home price for an individual county, and letting it float with the housing market, allows the FHA loan limits to respond to changes in home prices instead of an esoteric number derived from a complicated formula. In this fashion, the FHA loan limit will reflect a true home market economy.

FHA Risk-Based Premiums

The ability to match borrower characteristics with an appropriate mortgage insurance premium has been recognized as essential by every private mortgage insurer ("PMI"). PMI companies have established levels of credit quality, loan-to-value, and protection coverage to aid in this matching process. These companies also offer various programs that allow for upfront mortgage insurance premiums, monthly premiums, or combinations of both. This flexibility has enabled lenders to make conventional loans that are either not allowable under FHA or present a risk level that is currently unacceptable to FHA.

FHA is essentially a government mortgage insurance provider. Where FHA mortgage insurance is not available, PMI companies are free to increase premiums without fear of losing market share to a more competitively priced FHA loan product. FHA should be permitted to balance risk with premiums charged in order to increase competition and ultimately drive down costs for consumers. Since FHA is not required to make a suitable profit or demonstrate market growth to shareholders, it is likely that FHA can afford to assume greater risk levels than PMI companies can currently absorb. This increased capacity to assume and manage risk will allow FHA to not only serve borrowers who presently do not have PMI available as a choice, but also those borrowers whose premiums will be reduced because of the increased competition in the market.

The Elimination of the Down Payment Requirement

NAMB supports eliminating the down payment requirement and granting FHA the flexibility to offer 100% financing to aid in the effort to increase homeownership for first-time, minority, and low to moderate-income families.

Homeownership is a dream that many wish to experience, but for years barriers have existed that prevent many low-income and minority families from purchasing a home. In fact, a study published by the Center for Housing Policy[5] in 2006 revealed that many working minority families with children are less likely to achieve the dream of homeownership today than in the 1970s. A principal barrier to achieving homeownership for these families is financial – the lack of money for a down payment and closing costs. Elimination of the down payment requirement will help break down this financial barrier to homeownership for many low to moderate-income and minority families.

Future of FHA

Changes must be made to the FHA program to sustain its viability and to fulfill its stated objective of increasing origination of FHA loan products and expanding homeownership opportunities for first-time homebuyers, low and moderate-income families, and borrowers with slightly blemished credit. Without substantial reform of the FHA program, deserving

[5] The Center for Housing Policy recently released a study entitled "Locked Out: Keys to Homeownership Elude Many Working Families with Children," in 2006 which showed that the cost of homeownership outpaced income growth for many low to moderate-income working families with children.

homeowners will be locked out of FHA products and forced into subprime. We support efforts to restore FHA programs to a position of being able to respond to the changing needs of the marketplace with flexibility and innovation. To make FHA programs a real choice for borrowers, we must: (1) expand the distribution channels delivering FHA loan products to the marketplace (*i.e.,* allow for greater mortgage broker participation); (2) increase FHA loan limits to serve those borrowers residing in high-cost areas; (3) institute risk-based pricing to allow for marginal pricing of risk; and (4) grant FHA the flexibility to offer zero-down products to assist first-time homebuyers with the financial hurdle of downpayments. It is possible that without these reforms, FHA's pool of loans will grow too small to effectively manage risk, and FHA could ultimately be unable to fulfill is function of being a helping hand for those who need it the most. The ripple effects could easily extend to the homebuilding industry and even to the economy at large.

Congress has the opportunity to revitalize the FHA program by increasing its profitability and ensuring that borrowers across the country have an equal opportunity to obtain a better loan at a lower interest rate. Congress also has the opportunity to meet the needs of the many subprime borrowers that are facing, or will soon face, resets and are now unable to find affordable credit options in the private subprime marketplace.

NAMB appreciates this opportunity to offer our perspective on the need to modernize FHA programs. I am happy to answer any questions.