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THE STATE OF THE NATION'S HOUSING MARKET

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE STATE OF THE NATION'S HOUSING MARKET AND ITS EFFECT ON THE U.S. ECONOMY AND AMERICAN CITIZENS

OCTOBER 20, 2009

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C O N T E N T S

TUESDAY, OCTOBER 20, 2009

WITNESSES

Additional Material Supplied for the Record

THE STATE OF THE NATION'S HOUSING MARKET

TUESDAY, OCTOBER 20, 2009

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:33 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order again this morning, and let me welcome everyone to the Committee hearing this morning, my colleagues and guests who are in the audience, as well as our witnesses who will be here this morning. I want to particularly welcome our colleague from Georgia, Senator Johnny Isakson, whom we will get to momentarily.

I want to make some brief opening comments, turn to Senator Shelby for any opening comments he has, and then we will turn to our witness, Senator Isakson. Of course, we are honored as well to have Shaun Donovan, the Secretary of Housing, here with us this morning as well, and the very distinguished members of the third panel as well, whom I will introduce momentarily.

The title of our hearing today is "The State of the Nation's Housing Market," obviously a broad, big hearing with a lot of items to discuss when we have a hearing of that magnitude, but I thought it would be important for us, in light of all the things that are going on and the efforts of this Committee over a number of months on trying to address the housing issue, that we ought to have just a hearing on this subject matter generally. And that is why we asked for you all to be here this morning.

We examine, obviously, the catastrophic problem that has undercut the financial security of millions of American families and nearly destroyed our economy, and that is the U.S. housing market. Housing prices, as everyone in this room knows, fell by nearly a third from mid-2006 when the bubble was at its peak to this summer. That decline has hurt middle-class Americans acutely.

Most Americans, of course, do not own huge stock portfolios, as we all know. Their wealth, for most Americans, nearly all of their savings, is in their homes. Too many have seen, of course, that wealth wiped out in the last couple of years. In fact, one study suggests that as many as 15.2 million families in the United States now find themselves with mortgages that are higher than the values of the homes in which they live. That is an astonishing and deeply, deeply disturbing figure.

Meanwhile, housing inventory remains high. Home sales bottomed out earlier this year, and foreclosures continue to ravage communities across our Nation. As part of the economic recovery package, we created an $8,000 first-time homebuyer tax credit, replacing an unsuccessful and overly complex loan program with one that is already having an impact, and I want to congratulate my colleague again from Georgia. He was the one who pushed that idea. I was glad to join him in that effort back a number of months ago. But for Johnny Isakson, I am not sure that idea would have been incorporated as part of that recovery plan, so many Americans owe you a debt of gratitude, Johnny, for that.

The homebuyer tax credit has already been used by nearly 2 million first-time homebuyers. In addition to helping middle-class families achieve the dream of home ownership, the tax credit has helped to stabilize housing prices and the market at large. The credit is set to expire in 5 weeks, as we all know. But the work of stabilizing the housing market will not be done, as we also know. We still need to use every tool at our disposal to try and fix this problem.

So our first witness, Senator Johnny Isakson, and I have proposed extending the tax credit through the end of next June as well as expanding it so that more middle-class families can take advantage of what I believe has been an effective program. But the utility of the homebuyer tax credit will be maximized only if it operates in tandem with an effective program to protect struggling homeowners from foreclosure as well. And our second witness, Secretary of Housing and Urban Development, Shaun Donovan, will discuss with us some of the steps the Administration is taking to prevent foreclosures as well as other steps we can take to stabilize the market and to strengthen communities for all families.

The success of the housing market is not only important to homeowners, of course. On our third panel, we will be joined by four stakeholders in the area of housing policy: David Crowe from the National Association of Home Builders, Jay Brinkmann from the Mortgage Bankers Association, and Ronald Phipps from the National Association of Realtors, and from my home State of Connecticut, Diane Randall, who is the Executive Director of the Partnership for Strong Communities. Those witnesses will offer us a variety of perspectives on how the housing market affects those who build, sell, and finance homes as well as those who rent their homes and rely on our low-income housing stock.

Throughout, we should keep in mind just who the most important stakeholder is, and that is, of course, the hard-working families in our country who want and deserve their piece of the American dream. Whether they are renting, hoping to own a home, or looking to use their equity to build a more secure financial future for themselves and their families, the American people need a stable housing market, and it is up to us here, obviously, to make sure we can rely on one.

Let me say something about Diane as well, Diane Randall from my home State of Connecticut. She is doing tremendous work in our State fighting for affordable housing, but these days her job could not be tougher. I was reading her testimony last evening, and she will testify that nearly half of the renters in Connecticut are spending over 30 percent of their income on housing alone. She says, "For many of these folks, managing the family budget is a high wire act, deciding among the priorities of food, health care, transportation, and clothing." Those statements could be made, I suspect, by her counterparts in almost every State across the country where the stock of rental housing has not kept pace and, therefore, you are seeing a tremendously high percentage of family budgets where people cannot afford to get into a home pay for rental housing.

Anyway, I think she and others like her have hit the nail on the head, and that is the kind of devastating problem that we face, that we are faced with today, and that is why this hearing is so important. I thank many of my colleagues who are here already to participate in it.

With that, let me turn to Senator Shelby for his opening comments, and then, Johnny, we will get to you and your opening comments.

By the way, a rare thing occurred here. My colleagues should know this. We ask witnesses always to submit their testimony 24 hours in advance. I do not ever recall a Member of Congress actually submitting their testimony 24 hours in advance, and Johnny Isakson submitted his testimony, as our colleague, 24 hours in advance—a rarity around here. So, Senator, we really appreciate your complying with Senate rule.

Senator ISAKSON. Good staff work.

Chairman DODD. Staff work. Good staff work.

Go ahead, Richard.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman, and thank you for calling this hearing.

Given the undeniable role that the housing market played in the economic crisis, the Committee, I believe, must continue to monitor this significant sector. Earlier this month, we met to discuss the current state of the housing GSEs and what the future may hold for those entities. As I said then, I do not believe we as a Committee can address the regulatory shortcomings fully that contributed to this crisis without also addressing the future of the GSEs. I still believe that is the case. But before we can do that, I think we will need to understand precisely how existing housing policies shaped our housing market and whether major changes need to be made.

I think one must never forget, however, that Congress cannot and does not operate in a vacuum. Our actions have consequences. To the maximum extent possible, they should be intended. In order to achieve that goal, we must insist on having a solid factual basis for every step we take here.

Senator Isakson will testify today regarding extending the $8,000 first-time homebuyer tax credit. And while I believe this credit was like a better use of funds than much of last year's stimulus bill, you know, I think before we extend any portion of any bill, some basic questions need to be answered.

For instance, some have estimated that as much as 85 percent of qualifying purchases would have been made without the credit, leading to a true new home purchase subsidy of $43,000. This is a vastly larger figure than the $8,000 credit envisioned during the debate.

Now, I did not come up with those numbers, Senator Isakson. Simply put, Brookings estimates that only 15 percent of qualifying home sales were actually spurred by the tax credit. Then they take the overall cost of the program, divide it by only the number of homes in that 15 percent. This gives them a figure per house for just the 15 percent of homes they view to be a new purchase. That figure which they come up with, Senator, $43,000, is what they estimate to be the true subsidy of each new home purchase. We might want to look at those numbers together.

Additionally, will this be net tax relief? Or will the cost of the tax credit we are talking about come at the expense of another sector of our economy? A credit that is born from a reduction in Government spending will have a vastly different impact than a credit paired with a corresponding tax increase on other Americans.

This is merely one of the many policies, I believe, Mr. Chairman, that we and Congress and other Presidents have enacted to promote additional home ownership. There is no doubt that these policies have artificially, at least temporarily, inflated the value of homes across the country and maybe spurred some interest. But I believe we must recognize, Mr. Chairman, this and understand that much of the decrease in home values was simply a deflation of the bubble created in part by our own housing policies underlying all this.

Many of these policies are now under the supervision of Secretary Donovan, who will be here later, and carried out through the Federal Housing Administration. Last month, as we all know, the FHA announced that its capital reserve ratio will fall below the congressionally mandated floor of 2 percent. At that time, Americans were assured that the FHA would not need a bailout. Is that still the case? We will ask Secretary Donovan that.

What is the true financial status of the FHA? We need to know that. What policy changes can we expect if the FHA is unable to raise the necessary capital?

Mr. Chairman, these are just a few of the questions I think that need to be addressed here, and hopefully we will get some answers today. Thank you for the hearing.

Chairman DODD. Thank you very much.

Senator Isakson, we welcome you to the Committee. Let me just say, going over your testimony last night, Johnny, I knew you had been involved in this area—I mean, we have Members come up and talk and testify about subject matters, and I do not question at all their sincerity or their commitment to the issue. Rarely do we have a colleague come up and testify on a subject matter where you have spent more part of your adult life dealing with the very issue, and I did not realize how long you had been involved in the real estate industry and market. So I congratulate you for that expertise.

Senator SHELBY. Since he was 5 years old.

Chairman DODD. Well, early on, so thank you for coming to the Committee, and we are happy to receive your testimony.

STATEMENT OF JOHNNY ISAKSON, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator ISAKSON. Well, thank you, Chairman Dodd and Ranking Member Shelby and other Members of the Committee. I appreciate the opportunity to be here. Quite honestly, I have never been on this side of the dais before. It is really a treat. And I am not learned enough to write for Brookings or do analysis for Heritage, but I have 33 years of experience in the business actually doing it. And I do have some comments, I think, that are relevant to the housing market. That is exactly right.

You know, I started in 1967 in the housing industry, and the average sales price that year for me was $17,900, all FHA and VA houses. In 1968, the first recession that I experienced took place in housing when the FHA 235 no-down-payment sweat equity program collapsed and foreclosures proliferated around the country.

In 1974, I was a branch manager for a company when the biggest housing crisis prior to this one act took place, and the solution to that housing crisis was a tax credit. Congress passed a $2,000 credit for anyone who bought and occupied as their principal residence a standing vacant house. There was a 3-year supply of standing vacant inventory on the market at that particular period of time.

Later on, I became president of that company in 1981 when we had the triple misery index—double-digit inflation, double-digit unemployment, double-digit interest rates. In fact, I actually sold houses with 16.5 percent interest on the houses and negative amortization on the loans to get the payments to an affordable level.

Then finally, in 1990–91, after the collapse of the savings and loan industry and the creation of the RTC, I was in the business running that company and went through those difficult times. They were all bad, but they were nothing like times are today.

In 1995, I was asked to serve on Fannie Mae's advisory board, so I have some experience in what happened at Fannie Mae in the late 1990s. And I retired from real estate in 1999 and came to the Congress of the United States of America.

In my 33-year career, I experienced four difficult recessions, but nothing like the collapse we have today. Our Nation is facing a total collapse of new residential construction and development, and this fact, combined with the unemployment rate and the highest sustained foreclosure rate since the Great Depression, is having a terrible effect.

I would like to refer to the first chart. Put that first one back up, if you would. This is all from Smart Numbers, which is a company in Atlanta that does all the analysis for the lending industry and the real estate industry. But in the metropolitan Atlanta 23-county MSA, you see that beginning in the latter part of 2006 and accelerating, if you see the orange bar, that is the median price decline of housing over the last 3½ years. That last level is the first quarter of this year where the average price of houses was down 27 percent. Mr. Chairman, in my State, prices are down between 20 and 40 percent.

And if you will put the next chart up, I will give you one example of what is happening to housing in Atlanta and in most major MSAs around the country. This is a house that sold in 1993 for $216,000 in Clayton County, Georgia. It resold a couple of times in between, but after 533 days on the market, on the 22nd of April of this year, it sold for $136,500. And that is a house that 15 years earlier had sold for $216,000, to give you some idea of the Draconian drop in terms of housing values.

Why is this happening, you might ask. Well, it is happening for two very important reasons. One is the unemployment rate. There are people losing their jobs and having their houses foreclosed on. But, quite frankly, it is happening because the incentive to stay in a house does not exist nearly like it used to.

Mr. Chairman, if someone bought a house in 2002 in Atlanta, Georgia, with standard financing, 90 or 95 percent, statistically the odds are their house is worth less than what they paid for it. That means people are looking at a monthly payment, they are looking at the value, and they are finding it easier to walk from that investment and let it be foreclosed than stay and manage the house.

This is the *Marietta Daily Journal,* which is my home county, and I brought this from Friday, and I am not going to enter it in the record because it wastes too much Government money printing it. But there are 68 pages of foreclosures in one county in metropolitan Atlanta, 1,157. When you read the foreclosure addresses, it is not the subprime locations. It is not the lower-end housing. It is mainstream America. It is the move-up marketplace where these houses are now being foreclosed on, and that, quite frankly, is a crisis.

I would like to enter for the record an article that appeared in the *Atlanta Constitution,* Sunday's paper, the title of which is "My $290,000 home is worth what?" it is about a family who bought a house, paid $290,000 for it 10 years ago, remodeled it, had it reappraised—or refinanced, and it appraised for $115,000. This is the type of experience people are seeing all across the country which is causing a serious erosion in confidence.

Quite frankly, Mr. Chairman—and I think you know this—most people's equity line of credit is the equity in their mortgage. And money market accounts and secured equity lines of credit are where most people have sent their kids to college, have financed substantial purchases. That value is not there anymore. With credit cards down, with housing values down, Middle America is really stretched, and it is stretched to the core.

I am asked oftentimes, "Well, Johnny, how long do you think it is going to take to get out of this? You went through four of these." My answer, reluctantly, is, "Five years or longer, unless Washington does something."

One is the tax credit. I appreciate the comments of the Chairman. I appreciate the Chairman's support for the $8,000 credit and for its extension now. I believe it is important, as we look at the current termination on November 30th, to consider what is going to happen if we do not extent that credit. What is going to happen is you are going to go into the 3 worst months of the year in housing sales—December, January, and February—with the only incentive out there for a normal sale to take place is gone.

Now, I am not a believer in extending the tax credit forever. In fact, its scarcity or its sunsetting is actually an incentive to drive people to the marketplace. But it needs to be extended and it needs to be broadened in the following ways:

One, it should be broadened to any homeowner who buys and occupies as their principal residence for 3 years, as long as their joint family income is no more than $300,000. That covers most of the move-up market, and it brings a lot of Americans to the marketplace that are sitting on the sidelines today.

It will have the effect of stabilizing home values, and then on their own velocity as business returns, they will be able to build back.

If we do not do the housing tax credit, in my personal opinion, and extend it through midyear next year and take away the first-time homebuyer means test and raise the income qualification, we will have a dramatic and awful situation in the United States of America from which recovery is going to be even more difficult than we have experienced already.

There is a second thing we need to do as well, and with all due respect to the FDIC and the tremendous stress that they are under, the Draconian interpretation of FASB Rule 114 in mark-to-market and community banking is having a terrible effect in terms of liquidity, in terms of credit availability, to potential developers and potential borrowers around the country. And, unfortunately, many of the AC&D loans—the acquisition, construction, and development loans—to build subdivisions, which are main portfolios on the asset side of the balance sheet of most community savings and loans, or most community banks, are being driven down by mark-to-market, so much so that the bank is constrained in its capital, has to raise its loan loss reserve, in some cases recognizes losses that really have not existed.

In 1975, right after the 1974 crisis, the same thing took place. And after a short period of time of massive foreclosures on these acquisition and development loans, the banking community turned and started to make their debtors their partners. Now, granted, bad loans should be foreclosed on, but in real estate, over time you can work your way out of many situations, and I think it is critically important that we try our best to work our way out of the lot inventory that stands out there today rather than foreclosing on it and bankers becoming the owners and the operators, which historically they have done a very bad job of doing.

I would like to show you the third chart to make this point, and then I will close. This is a little bit misleading because it looks like things are improving, but these are the 23 MSA counties in the metropolitan Atlanta MSA, and the bars reflect the number of developed lots on the market, unsold in those markets. Bartow County, which is the highest one, has a 360-month supply of developed lots. Mr. Chairman, that is almost 30 years. The biggest counties in metropolitan Atlanta—Fulton, Gwinnett, Cobb—have supplies of 6 to 12 years. The average of the metro market, when you put them all together, is a 10-year supply of developed lots, unsold, sitting vacant. That is the loans that I am talking about, and that is where the partnership between the bank and people that have the loan and the developer who has the debt can hopefully help us to build out of them rather than have the effect of the short sales taking place on those lots, which further depreciates the value of housing.

I appreciate very much the opportunity to be here, and I have tremendous respect for this Committee, the Chairman and Ranking Member, and all the other Members. Senator Corker, I am very aware of his experience in the real estate industry, and I look forward to answering your questions. But I will tell you this: History is a great teacher. There are things in the past this country has done that worked, and there are things that did not work. The housing credit of 1975 brought this country from the second worse housing recession ever. The extension of this credit I think will be the foundation to do so as well. And when we turn the corner and stabilize the bottom in terms of home values, employment will improve, lots will begin to be absorbed, and our economy will get back on its footing, and we will get back to the prosperity that all of us hope America enjoys sooner rather than later.

Mr. Chairman, I appreciate the opportunity to testify.

Chairman DODD. Senator, thank you very, very much, and very eloquent testimony, again, based on a lot of personal knowledge over the years, which is very valuable, I think, to the Committee.

A couple of just quick points I wanted to raise with you, if I could. One is about the move-up market, and I am worried in a way because we were talking before the Committee started the formal hearing this morning, and it occurs to me that the first-time homebuyer—and, again, I am painting with a broad brush here, but that first-time homebuyer, usually it is a stretch when they are buying that home the first time. So the likelihood that they are going to go out and furnish that home or do major repairs to it, in many cases you are just trying to get in there. You are living on a futon or you are in a bare-bone deal because you got that house and you live in it and you are trying to make ends meet.

It is that move-up market where you start to get what I call sort of a ripple effect that is always so important in housing, and housing and autos being such major parts of our recovery historically, but those people then buying those carpets, buying the furniture, getting that carpenter or whatever, adding on an extension to the home, is more likely to occur in a move-up market than it is in a first-time homebuyer market. At least that is an impression I have, and I wonder if you would pick up on that point, whether or not there is a legitimacy to that point about the move-up market, which is what we are talking about here, going beyond the first-time homebuyer to that move-up market.

Senator ISAKSON. Well, the Chairman makes an excellent point. If you look at the sales to the first-time homebuyers, they are generally at the lower end of the market price range. They are at the entry-level pricing in housing, somewhere around \$150,000 to \$200,000 in most metropolitan markets. But the move-up market is absolutely dead. I will tell you a couple of stories.

Recently, a Pulitzer Prize-winning writer from Atlanta was transferred to Washington. She is a very good friend of mine. I had lunch with her a week ago. She complained that she had to rent her house in Atlanta and rent a house in Washington because she could not sell her house in Atlanta because it was in that move-up price range of \$300,000 to \$400,000.

Mr. Chairman, I hate to bring this up, but it is the best example I can think of. When UPS left Connecticut and came to Atlanta, Georgia——

Chairman DODD. Thank you, Johnny, for talking about that.

[Laughter.]

Senator ISAKSON. It came to Atlanta, Georgia, a number of years ago——

Chairman DODD. Don't you have a better example than that one?

Senator ISAKSON. I knew it would hit home, but it works both ways. But the point I want to make is I handled that relocation for the UPS Corporation. They could not make that move in the climate today because the houses in Connecticut would not have sold; therefore, the people moving could not have bought in Atlanta. And there are moves out of Georgia to other parts of the country where the same thing is true.

The corporate relocation market is basically dead. Companies do not know where the bottom is, so they are scared to offer their transferee, who they are trying to move to wherever they are—Hartford or wherever—a buyout on their house because they do not know where the bottom is. The banks will not finance it. The lines of credit are nonexistent for corporate relocation. So the heart and soul of the American housing market is still sitting on the sidelines.

Chairman DODD. Yes. I thank you very much.

Senator Shelby, any comments?

Senator SHELBY. Yes, I just want to commend him for his testimony and giving us his 30-something years of experience in the business.

Senator, we all know—and, gosh, you know it better than we do, probably—that the housing crisis is real. It is not getting better. You know, you might read the Case-Shiller Index, but overall it is not getting better everywhere, and we have got to do something, but we have got to score all this, and we have got to see what it does. Because if we do not do something, we are damned; and if we do something, we might be damned. So let us figure it out right. And I know you will.

Senator ISAKSON. Well, in response to that, and I will get my staffer to submit it for the record, but we have a CBO score on the extension that Senator Dodd and I have proposed. That score is $16.7 billion if the tax credit is extended until June 30th. And I am perfectly willing to find pay-fors in the system to pay for it, but I would make this point quite clear: Nobody argues that the tax credit has worked. I mean, that is why there is an interest in extending it.

Senator SHELBY. Absolutely.

Senator ISAKSON. Of all the trillions of dollars the Federal Reserve has spent, of all the hundreds of billions of dollars Congress has appropriated, the one thing we can reliably point to that has made a positive change for the country is the tax credit. And it is the smallest expenditure of all those things that we have made. So, relatively speaking, I think it is important for us to find the way to finance it because I think it is our way out.

Chairman DODD. Well, I do not disagree——

Senator SHELBY. We are all going to be better off if we can get housing back moving again.

Chairman DODD. And I do not disagree, if we can find a pay-for, I am all for it, because we have seen over the years we have had a lot of tax cuts in the past where we have not had offsets for them as well, where they have made a value. This one is so important, in my view, that it deserves special consideration.

Senator Tester.

Senator TESTER. Yes, Senator Isakson, welcome. If you could pull back into your database, you said in 1974 there was a $2,000 tax credit for vacant houses. Could you give me an idea if we are talking about the same thing here? Because it appears to me to be that would be a little more confining. And did that work? And how long did it last for?

Senator ISAKSON. Well, it is a great question, Senator Tester. And Bob Corker will remember the Butcher brothers and some of the liberal banking that took place in the 1970s. What happened was a 3-year supply of new construction on the market. If you had a pick-up truck and a hammer, you could get a construction loan, whether you were qualified to build a house or not. And metropolitan Atlanta was one of the poster children for just an entirely overbuilt market. That was the problem in most of the country. It was not resales, so that is where the tax credit was focused. And it was for a year. It was for the purchase of any standing vacant house, not an occupied house.

Things have changed a lot. There are not a lot of new houses sitting on the market now. They have been sold, foreclosed on, taken over. The plethora of houses on the market today are residential resale houses that families live in, in Montana and Georgia, that they cannot sell for what is owed on them. That is the problem. And the further complication of that problem, they have lost their equity, or substantially most of their equity, which means they have lost most of their net worth, and they have lost most of their ability to borrow. It is the single biggest compounding effect on the consumer confidence level of anything that is going on, and until we turn it around, there is not going to be consumption necessary to have a vibrant economy.

Chairman DODD. Senator Corker.

Senator CORKER. I will be very brief. I know that this issue will be debated, and I know pay-fors will be looked for, and I just want to say we have had Senators testify on various committees. I do not think I have ever witnessed one that is more grounded in knowledge and with greater clarity. And I just want to say to Senator Isakson that the people of Georgia have to be awfully proud, and I thank you for your great testimony today.

Senator ISAKSON. Thank you.

Chairman DODD. Thank you very much.

Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair.

One thing I wanted to ask you about is you noted in your comments that you do not support an extension of a credit on a permanent basis, and I just wanted to ask you a little bit about that. Many, many years ago, when I was working for Habitat for Humanity and working with low-income families, when they would buy a house, they would often get no value out of the home mortgage interest deduction, which was a major subsidy for the purchase of a home, because they earned very little money and they were buying very modest houses. And so the interest did not exceed the standard deduction, or if it did, it did just barely.

And so here we had a program that at that time was a $70 billion a year program—this is probably 20 years ago—and low-income families were getting virtually no help to buy homes. And I thought at the time, Boy, it would make sense to have a tax credit as a base for home ownership in America, because then we would be helping all families, not just more affluent families buying larger houses.

Is there any case to be made for a permanent extension at some lower level of a tax credit for first-time homebuyers?

Senator ISAKSON. That is a good question. There might be a case in a narrow focus, but I personally think you would lose all the value of the tax credit if it became a permanent accepted credit in the general marketplace. One of the benefits of the tax credit is the certainty that it is gone at a date certain. You are going to hear some testimony in a minute from a couple realtors who will tell you that right now in America every contract for the purchase of a house that is written has a contingency in it, and it says, "This contract is contingent on this property being able to close by November 30, 2009." The reason for that is, if it goes past that, the tax credit goes away, and they do not get the incentive. So the sense of urgency of having a sunset is very important in the marketplace.

But in answer to your question, it might be targeted at the low end. In certain cases it might make a difference, and that might be something to look at in terms of helping people, as Habitat has helped people get into houses. But I would not in general favor a tax credit that became an accepted norm in terms of housing. You need a normal marketplace that is ebb-and-flowing with demand and supply, where knowledgeable buyers and willing sellers are out there in great numbers, which we do not have today. But it is something to consider at maybe the low end or in a targeted special market. But I would not say across the board, no.

Senator MERKLEY. Let me ask you one other question about the model that is being put forward. As I understand it, the vision that you are suggesting would expire—the tax credit would expire June 30, 2010——

Senator ISAKSON. Right.

Senator MERKLEY. ——which is going to be here so quickly, and so we will be in the middle of next year. I think we are in a long recovery. A long recovery will have a lot of triple-option loans that are kicking up and driving foreclosures next year. We have got it on the commercial side. We have got a tremendous number of 7-year balloon loans that are going to be—companies are going to have difficulty rolling over. So I think we are still going to be deep in the woods, if you will, in the middle of 2010.

Will it really be feasible at that point to have a significant tax credit disappear in the middle of the year, or would it be better to have it at some more modest level and extend it through the balance of 2010?

Senator ISAKSON. Well, I learned a long time ago in Government that legislation is about the art of the possible, and I think the art of the possible is better than the improbable. It is improbable that this body or that this Administration would support an extension of longer than June 30 or greater than $8,000. I have done a lot of talking with the Administration and economists and with a lot of you all, and so it is the art of the doable and the art of the possible.

But let me make a point here that is so great. Real estate is an interesting dynamic, and once you have a confidence level in values, you will recover relatively quickly. And by a confidence level in values, what I mean is a buyer feels comfortable about the price they are paying and a willing seller is able to accept it because it is competitive or it is fair.

We don't have that situation right now. You have willing sellers who are just getting out, walking away. And you have knowledgeable buyers who aren't quite certain where the bottom is yet and they are sitting on the sidelines, and this is particularly true in the move-up market.

So I do think the tax credit extended to June 30 will accomplish three things. Number one, it will take us through the 3 worst seasonal months of the year in real estate sales historically, and that is December, January, and February, number one.

Number two, we will enter the best 4 months of the year, which are March, April, May, and June, which is the spring market, with some velocity and some movement, and values will have stabilized, so people will come back to the marketplace.

What is going to happen on November 30 of this year is the market is going to die a sudden death because the only impetus that exists is a credit for a narrow band of buyers, being the first-time homeowners, and with still the uncertainty as was put in by this article that I entered into the record, you are not going to have people coming back. But if we can extend it through that June 30 date, go into the spring market of next year, I think you can stabilize the values at the bottom and the market will bring the values back once people have a confidence level in those values.

Senator MERKLEY. Thank you very much for sharing your expertise with the Committee.

Senator ISAKSON. Always happy to have my neighbor here. Thank you.

Chairman DODD. And that point you just made, about coming to those 3 best months, I think are very, very valuable, and that is why I think leaving that June 30 deadline, if you can get something in that gets us really an engine moving in those 3 months, it can really help, as well.

Senator Bunning.

Senator BUNNING. Thank you. Good to see you, Johnny.

Senator ISAKSON. Thank you, Jim. Congratulations on the Phillies winning.

Senator BUNNING. Boy, oh boy. How they won was more important.

[Laughter.]

Senator BUNNING. Let us get back to the housing market. The original plan that you proposed was a $15,000 tax credit for new and existing homes, is that correct?

Senator ISAKSON. That is correct.

Senator BUNNING. And we were able to do only the $8,000 new-only housing——

Senator ISAKSON. Well, it is new or resale, but it is first-time homebuyer only.

Senator BUNNING. It is first-time homebuyer. But that really limits the market.

Senator ISAKSON. Correct.

Senator BUNNING. Remember, what did you call it, the step up?

Senator ISAKSON. Move up.

Senator BUNNING. Move up. The move-up market. Those are not necessarily first-time homebuyers. Those are obviously people that were in their house and are looking to move up in the marketplace.

The proposal you have before the Congress presently is a renewal of the $8,000 tax credit. Is that for move up and new home buyer?

Senator ISAKSON. Yes, sir. What I have done is Senator Dodd and I and Lieberman and others who were sponsors of it, we removed the first-time homebuyer qualification or means test, so it is for any buyer——

Senator BUNNING. Any buyer.

Senator ISAKSON. ——as long as they are going to occupy it as their principal residence for at least 3 years. It is not for investors. It is not for speculators.

Senator BUNNING. No, no. This is somebody who wants to live.

Senator ISAKSON. And also, the current tax credit, you are limited to an income for an individual of $75,000 or a couple filing jointly, $150,000. We raise that limitation to $300,000 for a couple filing jointly to accommodate the incentive for the move-up market.

Senator BUNNING. OK. Well, I think it is absolutely necessary, and being in finance as I was for 30-some years, if you don't have a stable housing market, and the equity and the wealth or whatever you want to call it that is in the housing market for the people who own those houses, you don't have a stable financial situation. And you are absolutely right. We have to stabilize the homebuyers' market, and in so doing, we might even stabilize the credit markets, because those are a direct result of the homebuyers' market not being stabilized.

And if we can do that and find the bottom, and I don't care where the stock market is, because we are still a long way from stabilizing this economy, if we can do it with that kind of incentive, rather than throwing Federal Reserve money and TARP money and all the other money we have thrown at this economy to try to stabilize it, this stabilizes it at the bottom, the basic economy that we have to stabilize, or else we are not going to be able to come out of this thing in a normal fashion like you did in 1974 or 1975 or whenever.

We have a business cycle that takes time, and this one is a lot deeper than most of them, and I hope and pray that we are able to do this in a reasonable fashion, and if necessary, pay for it, like we did on other occasions. We have to find pay-fors to do things for the American people.

So I wish you good luck with your legislation, John, because I think it is the basis on which we will start forward. Thank you.

Senator ISAKSON. Well, I thank you, and there is one thing that you said that should be underscored. There is a direct absolute correlation between home values and consumer confidence, and one of the reasons you have a declining retail marketplace right now and the problems you are seeing in the retail industry, shopping centers, commercial loans, is because we have got a very low level of consumer confidence, and stabilizing housing and building those equities back will bring that back quicker than anything.

Chairman DODD. Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman. I would just say, returning again this week from Colorado was a reminder that for our working families, this economy is still nowhere near appearing to get better and I think proposals like the one Senator Isakson is making are critical to moving support. I just want to thank you for being here and sharing your expertise. It is wonderful to hear from somebody who actually knows what they are talking about, so thanks for being here.

Senator ISAKSON. Thank you very much.

Chairman DODD. Senator Johanns? You may want to stay here all day, getting all these compliments.

Senator JOHANNS. You are getting a lot of compliments, but well deserved.

As I thought about the charts that you put up there, Senator, it occurred to me that we could build those charts in just about any market in the United States, really, in any market in the United States. And it is hard for me to imagine that you get recovery, economic recovery, unless you start to see some lift in the housing market. So I really don't have any questions for you, but I did want to indicate I like what you are doing. I am very anxious to work with you to try to get this done. I believe it is a step in the right direction. Quite honestly, I wish we could do a little bit more, but I appreciate the reality of the economic circumstances we are dealing with also on budget issues, but I would be willing to help in any way I can to try to get this to the finish line.

Senator ISAKSON. Well, thank you very much. I appreciate all the kind comments, and I will add one closing remark. I neglected in my testimony to mention one other change that we put in this amendment. Senator Shelby and Senator Bunning both, I think, will be interested in this. The original tax credit, if a veteran or a member of the Armed Services used the tax credit but they had to sell the house within the 3-year period of time of eligibility, they had to pay it back proportionately. We waived that provision for any member of the Armed Services who is deployed overseas, if they are forced to sell because of that deployment. It is a small number of people, but they are the number one people in my heart and we don't need them penalized just because they are defending our country.

I also want to thank the Committee, thank the Chairman and the Ranking Member. It has been an honor to be here today and I enjoy serving with each and every one of you.

Chairman DODD. Thank you, Senator. The cosponsorship of this bill is available to members, and Senator Isakson will welcome anyone who wants to join us in this effort. We hope to get it done in the next few days.

Senator ISAKSON. Thank you, sir.

Chairman DODD. Thank you, Senator, very much.

Let me welcome to our dais once again the Secretary of Housing and Urban Development, Shaun Donovan, who has done a terrific job under very, very tiring—trying circumstances. Tiring circumstances, too, I might add. As many of you know, he previously served as the Commissioner for the New York City Department of Housing, Preservation, and Development. His experience covers both public and private sectors and he does a remarkable job.

Mr. Secretary, we welcome you once again to the Committee. I know you have got a lot of ground to cover. I am going to ask you if you want to take eight or 10 minutes in your opening statement so we can get as much of it. All the other material you have will be included in the record.

STATEMENT OF SHAUN DONOVAN, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary DONOVAN. Good morning, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for the opportunity to testify at today's hearing on the state of the U.S. housing market and the progress the Obama administration is making to stabilize it, as well as other Administration efforts to provide relief to homeowners and neighborhoods suffering from the effects of the foreclosure crisis.

Certainly, we meet at an important moment, as indicators continue to show signs that the housing market is stabilizing. Nationally, home price indexes have been on the rise for the past several months, as reflected in 18 of the 20 metropolitan markets covered by the Case-Shiller Index. Inventories of unsold homes remain at high levels, but have been receding. In selected markets, realtors now report that many homes are selling for more than their asking price and new home sales are at their highest level since September of 2008.

With respect to foreclosures, according to Realty Track, foreclosure activity in September fell for the second straight month by 4 percent. This is somewhat encouraging progress, but foreclosures remain at near record levels. Quite simply, there are still too many people losing their homes. And with delinquency rates on multifamily property mortgages having moved up sharply since mid-2008, while property values continue to fall, it is clear these numbers do not tell the whole story.

Nationwide, in the second quarter of 2009, vacancy rates for rental properties at the higher end of the market rose to nearly 10 percent, while a shortage of affordable rental housing persists for low-income families. This imbalance threatens families, neighborhoods, and the lending institutions on whom these communities depend.

That is why the Obama administration has made stabilizing our housing markets a top priority from its first day in office. The comprehensive approach the Administration has taken has allowed interest rates to hover around or below 5 percent for over 6 months, allowing first-time homebuyers to enter the market and helping some 3 million homeowners refinance, putting as much as $10 billion of annual purchasing power in the hands of American households.

At the center of the Administration's response to the housing crisis is Making Home Affordable, a comprehensive program to stabilize the housing markets by providing affordable refinance and modification opportunities for at-risk borrowers. Earlier this month, the Administration announced that servicers had exceeded the goal of beginning 500,000 trial modifications by November 1, nearly a month ahead of schedule, reflecting the fact that the monthly pace of trial modifications now exceeds the monthly pace of completed foreclosures.

And we are committed to improving Making Home Affordable performance. On October 8, Administration officials and servicer CEOs met to discuss improving servicer efficiency and responsiveness to borrowers during the modification process. At our urging, servicers agreed not to initiate foreclosure proceedings against any borrower that has submitted a HAMP application. In situations where a borrower is in the foreclosure process at the time a HAMP application is received, servicers agreed not to complete the foreclosure until a decision on the application has been made.

This month, the Administration announced new streamlined FHA application documents, providing another resource to make the process easier and more straightforward for borrowers. The Administration is also working to develop a Web portal that will provide a centralized application point for HAMP applications, allowing borrowers to upload all application documents, see that documents have been received and are complete, and receive ongoing information about application status until the application is approved or denied.

In addition, I am announcing that we have finalized the Hope for Homeowners program guidance to lenders. In keeping with changes made by this Committee and Congress, this is a critical first step toward providing an additional option to underwater distressed borrowers seeking to save their homes and preserve equity through principal write-down and refinance. As the program goes online, we will closely monitor its progress and continue working with Congress to ensure its success going forward.

The Federal Housing Administration is also playing a central role in the housing market and our recovery right now, not only insuring a third of the home purchase mortgage market, but also protecting another half-a-million families from foreclosure in 2009 through its loss mitigation programs. As it did during the Great Depression and the Oil Patch Crisis of the 1980s, FHA is again stepping up to ensure housing markets function when the private sector alone cannot do so.

In the current environment, FHA is essential not only to low-income buyers, but also to middle-income homeowners as well. More than three-quarters of FHA's borrowers this year have contributed more than the minimum 3.5 percent downpayment, and more than 40 percent have made a downpayment of greater than 5 percent.

Further, we have seen the average FICO scores of borrowers increase dramatically, from 633 two years ago to 693 today.

I do want to address concerns about FHA. In light of the severe decline in housing prices and performance of the economy, FHA expects higher net losses than previously estimated on outstanding loan guarantees which, combined with stresses accounted for in prior reviews, will drive its capital ratio reserve below 2 percent. However, based on current projections and absent any catastrophic home price decline, FHA will not need to ask Congress and the American taxpayer for any bailout.

Indeed, because of the quality of loans FHA is making today, the independent actuary expects this drop to be temporary and to return above 2 percent within the next 2 to 3 years. That is because FHA sticks to the basic, 30-year fixed-rate traditional loan products with safe underwriting requirements, only insuring owner-occupied residences, and never ensuring exotic or no-doc mortgages. It is also because we have stepped up our vigilance in protecting taxpayers, with increased standards for FHA lenders and appointment of FHA's first-ever Chief Risk Officer. And we are committed to further improving portfolio analysis and management, tightening risk controls, overhauling targeting and monitoring practices, and working with you to modernize FHA's information technology systems.

At the same time we take steps to ensure FHA remains fiscally healthy for the long term, yesterday, the Administration announced it is providing assistance to State and local Housing Finance Agencies. HFAs have been reliable sources of flexible, affordable mortgage money for lower-income first-time buyers, making 2.6 million families homeowners for the first time and adding another 150,000 homes to our affordable rental housing inventory each year.

Last year, through HERA, Congress provided HFAs with $11 billion in new housing bond authority to finance affordable single-family and multifamily mortgages, and expanded HFAs' ability to, for the first time, refinance borrowers that are distressed, as well. To maintain the viability of FHA lending programs jeopardized by the economic crisis, the Administration has developed a set of programs, including a new issue bond program and a temporary credit and liquidity facility program for existing bonds, including a range of risk sharing features and a pricing structure that encourages FHAs to find alternative private market solutions.

In addition, I am also aware of the strong support in Congress for doing more to support the housing market, including extending the first-time homebuyer tax credit beyond 2009. At the same time, I am mindful that these proposals can be expensive, especially at a time of significant budget deficits. I can assure you that the Administration is committing to working with Congress to fashion the most effective homebuyer incentives, mindful of both their benefits and their costs to the American taxpayer.

Let me conclude by saying that while the measures I have discussed are key elements to addressing the housing crisis, there are other ways we can help the housing market recover, as well. Indeed, with some estimates finding that almost half of all foreclosures are caused in part by financial issues stemming from medical costs, health care reform is essential to ensuring loan modification efforts stick.

And, of course, we look forward to working closely with this Committee to modernize our financial system and create a Consumer

Financial Protection Agency that will protect American families who buy financial products and services every day, from mortgages to credit cards. We must set clearer rules of the road for consumers and banks alike. This is a top priority for the Administration, as I know it is for you, as well, Mr. Chairman.

And so thank you for the opportunity to participate in today's hearing and for your continued leadership, Mr. Chairman. Whether it is our Choice Neighborhoods Proposal, to link neighborhood revitalization more closely with early childhood education, an issue on which you have long been the leading voice in Congress, or your Livable Communities Act, to help towns and regions across the country better integrate their housing, transportation, land use, and economic development efforts, we are committed to working with you to build a strong, durable foundation for sustainable growth.

Like you, we recognize that a vibrant housing sector is inseparable from a balanced housing policy that supports home ownership and provides affordable rental opportunities for every American, that it is essential to creating a geography of opportunity in America where our children's choices and futures are never limited by the zip code they grow up in.

As always, the Administration stands ready to explore with Congress additional ways we can work together to make this shared vision of prosperity and opportunity a reality for every American. With that, I am happy to answer any questions you may have.

Chairman DODD. Thank you very, very much, Mr. Secretary. We appreciate your strong efforts and those of the staff at HUD who are working, I know overtime and through weekends and others to try and address these very complex and, as Senator Isakson, who you heard testify a few minutes ago, the most difficult economic situation dealing with housing, certainly in any of our lifetimes. You have to go back to the Great Depression era to talk about a time as difficult as this one. So we welcome your commitment and those who work with you at your agency.

Let me just pick up, if I can, on the tax credit idea and ask you to address that. I listened to you and read your testimony about the statement you made of balancing the interest, obviously, the benefits as well as the costs involved. But you have heard Senator Isakson and those of us up here talk about this. We are coming up pretty quickly now on the date, and obviously those clauses written are into these contracts contingent upon what happens after November 30.

I wonder if you might share some additional thoughts about your views on this issue, in light of the importance of that move-up market and what it can mean, given the fact that housing historically has been such a strong agent of recovery in our Nation, and given the present condition of housing stock and the difficulties the buyer and seller are having to come together. What are your thoughts on this?

Secretary DONOVAN. First of all, let me say that I would agree with Senator Isakson. There is clear evidence that the tax credit has provided a benefit to housing markets. The real issue, and I think the difficulty in really focusing on what precisely the definition of a housing tax credit might be in an extension is that to truly understand the costs, we will not know that until Americans have filed their tax returns. And so we feel it is very important within the Administration that we gather as much data as we possibly can in advance of that before we make a final decision about whether the tax credit should be extended, and if so, exactly what that shape should look like.

Chairman DODD. Is that going to be possible now in the next couple of weeks?

Secretary DONOVAN. Chairman, I was about to say that we understand the urgency of this situation, and we believe that within the next few weeks, we will have additional data that will allow us to sit down with you and to finalize a decision about proceeding with an extension, if we should do so, and if so, what that shape should be. I understand the urgency of the situation. We continue to hear—I hear this. My FHA Commissioner continues to hear this every day from lenders. We understand that urgency. We believe it is critical to have the information necessary to make a fully informed decision about the costs, given the importance of this decision.

Chairman DODD. I appreciate your—and I am going to try and move along here, so we get a chance with the number of Members here on this, but I appreciate your comments about FHA. Obviously, we are all very interested in your very optimistic outlook that no Government money, taxpayer money, will be necessary to bail out FHA. You are confident of that position?

Secretary DONOVAN. First of all, let me say, this is not my opinion alone. We have an independent actuarial study which is done each year, and it is in the process of being finalized and we will be providing it shortly to Congress with all of the details.

Let me be clear. I continue to be concerned that we need to do more in FHA around risk assessment, around making sure we have the systems and the processes in place. My relatively new FHA Commissioner, Dave Stevens, has taken a very strong position with making sure that we have only strong lenders, responsible lenders that are involved in the FHA programs. We recently announced some changes to strengthen that portion of our risk and oversight management. We suspended a very large lender, TBW, recently, took strong action there.

So I don't want to portray the concern as if I do not have concerns about the strength of FHA. But let me say very clearly, what we have seen, first of all, is that FHA has been absolutely critical to stabilizing this market. Some estimates are that—you have heard a lot today already about the importance of first-time buyers in this market. Our evidence today shows that approximately half of all first-time buyers are entering the market using an FHA loan. We have been critical on that front.

And the other thing that the actuarial study will show is that the loans that we are making today are some of the safest loans that FHA has ever made. Given the fact that our FICO scores, our credit scores, have gone up substantially, given the fact that we have—these are—after the dramatic declines that we have seen in the housing market and have begun to see increases in prices, we believe that these are very safe loans that we are making today that are both contributing to the recovery, but also providing a return to taxpayers.

And so we believe strongly that while there are changes that need to continue to be made at FHA, FHA is a strong contributor to the market and must continue to provide the kind of support to make sure that the fragile recovery that we are seeing at this point continues.

Chairman DODD. I appreciate that. I am sure we will get some additional questions on FHA.

Let me jump quickly to the foreclosure issue, as well, and I know and I applaud the fact the Administration has now gotten some 500,000 families into trial loan modifications, and I say trial loan modifications. But certainly the 1.5 million that we are talking about that can possibly get some help in all of this, that is positive news. But I think most of us up here still worry about borrowers who are underwater. We have heard that in our opening comments and testimony, as well, the 15.2 million people in this country who have mortgages that exceed the value of their homes, and obviously that is a huge number and a potential number that could move into this foreclosure area.

I am just wondering whether or not payment modifications will be enough, or do we need principal forgiveness? I know this has been an ongoing debate, but many feel as though if you could do something on principal forgiveness, making it possible for that value, the equity to be able to increase and exceed the value, then you would have people more willing to stay in their homes. And I know this has been a debate. I know the Chairman of the Federal Reserve has argued for principal reduction and forgiveness as a way of trying to really encourage that, avoiding the walk-away problem, people throwing up their hands and just saying, I have had it. This doesn't make any sense and I am leaving. Where are we on that possibility?

Secretary DONOVAN. This is an important debate, as you say, Mr. Chairman. You have been eloquent about this, that this has been an important debate within the discussion around the foreclosure crisis.

What I would say, first of all, is that, to date, we continue to find that there is not any widespread evidence of walk-aways from—people who are underwater but can afford their mortgages. In other words, we continue to find, and we believe the data continues to support, that the most significant problem is the problem of affordability. If you can afford to stay in your home, you will do so.

And I think if we think of this not just as thinking about a housing market, but we think about the importance of home to a family, that it goes beyond just an economic investment. It has so many other important pieces that it brings with a neighborhood—access to schools, to friends, to neighbors. It makes sense, not just in economic terms, but in real human terms, as well, that we would not see large numbers of homeowners, if they can afford to stay in their home, walk away, and, frankly, if they begin to see some expectation as the market turns around that there is a bottom there, and I think we have begun to see those signs in the last few months.

Having said that, I do believe that it is important that we have some options for certain circumstances for principal forgiveness. That is why moving forward, as you have consistently said, with Hope for Homeowners, the ability to move forward with that program, I think, is an important element, and the principal reduction that we are providing through the Making Home Affordable program. We have incentive payments that encourage folks to stay in their homes and be successful long-term by reducing their principal over time if they are successful in their payments on the modification, as well. So we think those two elements are an important piece, but broadly speaking, focusing on affordability is the right answer.

Chairman DODD. Thank you very much.

Senator Shelby.

Senator SHELBY. Thank you.

Mr. Secretary, you testified that—and I will use your words—"Based on current projections and absent any catastrophic home price decline, FHA will not need to ask Congress and the American taxpayer for extraordinary assistance. There is no need for any 'bailout'." Your words.

FHA Commissioner Stevens has made similar statements. While trying to reassure the American public that FHA will not need a bailout, however, both you and Commissioner Stevens seem to qualify your assurances. Perhaps you should, you know.

Tell us what you mean by "extraordinary assistance," and is there a chance that you might request an additional appropriation below the threshold? What bothers me is that FHA—not what they are doing. I hope what they are doing, as you pointed out, they are underwriting, they are doing things prudently and doing right for the American people. But they are under the 2 percent, right? That is a dangerous level. You know, the 2 percent was mandated by Congress. It might be—and I am not saying it is the end of the world. We want to keep FHA going. You have that obligation to make it work well as the Secretary.

What do you mean by "extraordinary assistance"?

Secretary DONOVAN. Well, there will be significant detail in the actuarial report which will show a look at even substantial declines in housing prices beyond what we have already seen that show that FHA's reserves never dip below zero. In other words, it would never need an injection of funding beyond what it currently has in its reserves.

Let me be clear—so there is significant detail about that, and even under our base case, to be conservative, we have assumed some continued decline in house prices, close to 10 percent. And so even with that, what you see in the projection—and I think this is very important. The 2 percent is a secondary reserve fund. There are two reserve funds that are held within FHA. Today they hold more than $30 billion, which is equivalent to almost 4.5 percent reserves. So that is today. The 2 percent is done based on an assumption that if FHA literally shut down business today, made no more loans, and it assumes losses over 30 years, a much more stringent requirement than any bank or traditional reserve. So even under what is assumed to be a relatively conservative scenario, we are still looking at FHA reserves never going below $25 billion, and even under larger declines.

Senator SHELBY. So you are pretty confident you are going to be OK. Is that what you are saying here?

Secretary DONOVAN. None of us can ever predict exactly what is going to happen in the future. I would like to be more secure about FHA systems. There are a range of things that you have talked about that we are doing. But what I will say is independent actuarial reviews of this have said, first of all, that we will not need extraordinary assistance. But second of all, and I think even more importantly, loans that we are making today are highly profitable for the American taxpayer, that these are good loans that we are making. They are safe loans. They are written with underwriting basics, as I have described in my testimony, and that FHA continues to be important to this economic recovery.

So I believe it is very important that we continue to monitor FHA's risk, but not take any undue or hasty actions that would hurt this fragile economic recovery that we are experiencing.

Senator SHELBY. If we did not pass—Senator Isakson is still here, I am glad, to hear your testimony. If we did not pass the tax credit, would houses go into a tailspin, a downward tailspin? Some people say they would.

Secretary DONOVAN. My own view is that there are a number of different dynamics happening in the market, and many of those are regional dynamics. I believe in general that the tax credit, as I said earlier, has been a positive force in the market, and that the end of the tax credit would have some negative implications for the market. But I do not believe, based on all of the other actions that we are taking—for example, whether it is keeping interest rates low, the concerted actions that we have taken, FHA continuing to be an important force in the market—I do not believe that a catastrophic decline would be the result of the end of the tax credit.

Again, exactly how big a decline, there would be some negative impact, but exactly how big that impact is, is hard exactly to say, but I think catastrophic is unlikely.

Senator SHELBY. Mr. Secretary, do you believe, though, that central to a recovery of our economy, housing has to play a central role?

Secretary DONOVAN. I would say not only do I believe that is true, but I believe the actions of this Administration, the decisive actions that we have taken this year, have shown that we do believe housing is a critical part of a recovery.

Senator SHELBY. What actions are you talking about?

Secretary DONOVAN. I would just reiterate what I have discussed in my testimony, which is, first and foremost, concerted actions to keep interest rates at a level that has not only allowed millions of homeowners to refinance——

Senator SHELBY. I thought the Federal Reserve did that, not the Administration.

Secretary DONOVAN. There are also actions taken by the Treasury as well as the important actions of FHA to make sure that mortgage capital remained available, widely available to homeowners in the country, at reasonable rates.

Senator SHELBY. OK. I know my time is getting up, if it not already up, but I have a question that I need to get into.

In your testimony, Mr. Secretary, you state that it is critical to HUD that financial regulatory reform, which we are considering, create a consumer protection agency that will, to use your words, "protect American families who buy financial products and services every day."

Were the problems that you believe require the creation of a consumer protection agency, something new, the result of regulators not enforcing existing rules? Or did regulators not have necessary authority to protect the consumers in the first place? In other words, if more authority is needed, specifically what new statutory powers do regulators need? Some people have argued and said the regulators had the power, they just did not use it. The Fed had power. Obviously, Senator Dodd has questioned them closely on that. They did not use it. To create a consumer protection agency—and I know you are the Secretary of HUD; you are not the Treasury Secretary or the President. But to do this, you are getting into new ground that we have never gotten into before.

Secretary DONOVAN. What I would say is—and you talked earlier, Senator Shelby, about the importance of understanding the history of the crisis that we have been through.

Senator SHELBY. Absolutely.

Secretary DONOVAN. We recently delivered a report to this Committee that showed the very central role that a set of unregulated, nontraditional financial institutions making what were, frankly, irresponsible loans contributed to the crisis that we had. And I believe it is both the problem of a lack of regulatory oversight over certain kinds of financial institutions that is part of the problem that needs to be solved by the consumer financial protection agency, as well as the coordination of existing regulation.

The Balkanization, if you will, of oversight I believe was a significant issue as well.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much. And I would just say, before I turn to Senator Reed, on that point obviously, you know, we had them on the books, some of these regulations. Historically, safety and soundness, an important function, always trumps consumer protection. And that has been a major problem, and we have got to address that, in my view, so I agree with your point.

Senator Reed.

Senator REED. Thank you, Mr. Chairman. Thank you, Secretary Donovan. I also want to thank Senator Isakson for his very eloquent and very profound testimony. Thank you, Senator.

One of the points that Senator Isakson brought up is the fact that what we are seeing now is a shift away from subprime, poorly underwritten loans, to loans that were fairly well underwritten, but the individual borrower has lost his or her job. And the HAMP program generally requires employment as one of the gateways to eligibility.

I know when Secretary Apgar was here in July, he talked about some discussions that were ongoing about how we could go in and help people who were temporarily out of work or in some way did not have the employment to qualify. Can you elaborate on what has been done?

Secretary DONOVAN. Senator, let me just make one important clarification to what you have said. Unemployed homeowners are eligible for the HAMP program, and, in fact, there are significant numbers of unemployed homeowners that we have already helped through the program.

There are really two ways that we take into account unemployment. One is that we will allow any kind of unemployment benefits or others to be counted toward income in terms of underwriting a modification. So it is not that there is no income at all that is counted. Second of all, we will allow up to 90 days of a complete cessation of payments for a borrower, a stay of payments to allow them to get through a temporary period of unemployment. So I do think that those are benefits.

What I would say in addition, based on the input that you, Senator Merkley, others, and Chairman Dodd have given us, we are looking at the issue of whether it makes sense to go farther trying to coordinate those with extension of unemployment benefits and others so that the timeframes, the current 90-day, whether that window should be longer.

So I think that there are things we can do in terms of changes to the program that could be helpful that we are looking at, as we discussed the other day. But I do want to be clear that we have helped a significant number of unemployed borrowers through the HAMP program. It is really a question of whether there are changes that can be made that can go even farther.

Senator REED. Thank you, Mr. Secretary.

Another aspect of the HAMP program is that, as I understand it, there is a significant number of trial modifications, but fewer numbers of permanent modifications. Can you comment on that?

Secretary DONOVAN. Simply just to make sure it is clear to the Committee how the process works, we begin modifications for a 90-day period, and then at the end of the 90-day period with some potential for extensions we convert them to permanent status. The vast majority of the modifications that we have made thus far have not reached that 90-day point, and so the fact that there are not a lot of permanent modifications at this point is not a surprise. It is simply a matter of timing. Over 90 percent, I believe, are still within that 90-day period.

We have seen some issues around documentation and other things as we reach the permanent phase, and so one of the important things that we have done, recently released, is a simplification of documentation, removal of need for signatures and other things that we felt were not critical to ensuring the integrity of the program. So we have made some streamlining changes that should allow the conversion process to move more smoothly.

But it is an issue we continue to be focused on with the lenders.

Senator REED. This transition to permanency is not automatic. The individual has to be current in their payment and still have the same——

Secretary DONOVAN. That is correct. We want to make sure it is working. We also, frankly, want to make sure that we do not repeat the mistakes that led us to these problems in the first place.

If a modification is going to be sustainable, if we are going to bring it into the program, we want to make sure that we have verified income, that we have gone through the steps that are necessary to make sure both that it is a sustainable modification but also that the homeowner actually deserves the kind of relief that the program was set out to provide.

Senator REED. And a quick question, as my time is rapidly expiring. We anticipate resetting of ARM loans significantly this year, which could possibly complicate everything we have talked about this morning. Can you briefly comment on that? Do you anticipate this as a challenge? Are you prepared for this? Are there programs that are in place to anticipate it?

Secretary DONOVAN. We have been modifying some number of these option ARM loans that are starting to ratchet up, particularly in high numbers next year. So they are eligible for the program. What we have been doing is looking more carefully at whether there is a consistent pattern where it will be difficult, given how low some of the payments are, because they are adjustable rate, whether there will be enough of a benefit in the program to be able to help large numbers. Based on that look, it is possible we may make some changes to the program to respond to that.

But at this point, we do not see significant numbers of those borrowers, because their payments are so low today, that are in distress because their payments need to be brought lower. It is really a question of when they reach the resets, and that is what we are looking at to make sure we understand whether there is going to be an eligibility problem for them. At this point, we do not see a large problem happening today.

Senator REED. Thank you.

Chairman DODD. Thank you, Senator, very much.

You know, Senator Isakson, I apologize. If you would care to join us here on the dais, you are more than welcome to sit up here. It was not very courteous of me.

Senator ISAKSON. I am enjoying the view. Thank you.

Chairman DODD. You like the view from down there better?

[Laughter.]

Senator SHELBY. He has been elevated—downwards.

Chairman DODD. Well, you are more than welcome to join us on the dais if you would care to do so.

Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. And, Mr. Secretary, thank you for your testimony.

I was struck by the comment that you made that you are making the best loans you have ever made right now or in recent times. Senator Isakson in his outstanding comments talked not only about foreclosures but also what is happening at our community banks around the country, and he alluded to an accounting issue. I would say that that is compounded greatly by regulators, creating a self-fulfilling prophecy. So here you are out making loans that are the best loans you have ever made. Community bankers around our country have the ability right now probably to make the best loans they have made in a decade, and yet regulators are creating a self-fulfilling prophecy.

I wonder if you would tell us about whether you find that frustrating because it exacerbates the problem or whether you think that basically things are OK in that regard.

Secretary DONOVAN. Senator, maybe you could say a little bit more about the specific——

Senator CORKER. Well, I think what is happening is loans are continually being criticized, so community bankers are continuing to withdraw credit when today is probably the best time to be making loans at the bottom of the market. And I am wondering if you are seeing that affecting you in any way as it relates to your own mission.

Secretary DONOVAN. I think there is no question that there have been important discussions and interactions in the Administration around some of the regulatory issues. Let me just say, first of all, that I am not an expert on some of these regulatory and accounting issues, and I do not want to go too far in terms of expressing an opinion on particular pieces of it.

What I would say is that a significant part of what is important to happen—this is true on the multifamily side as well as the single-family side—is that we get accurate assessments of the valuation of loans, but not go too far. And so our focus within the Administration has been to ensure that we are getting accurate views but not overly conservative views of the valuation of loans today.

I also would say I believe a significant part of the problem is not just accounting. It is also access to capital. And that is why I think many of the other actions the Administration has taken through TARP, through some of the other resources, as well as the announcement that we made yesterday around housing finance agencies, here you have a group of very important lending institutions that have had very good track records, very low default rates—in fact, today better than prime mortgages—and yet have been restricted in their access to capital because of what has happened more broadly in the capital markets.

And so this is an example of where I think we can effectively help to create a market. HFAs today account for about 10 percent, almost 10 percent of all loans to first-time buyers. They are a very important part of the housing recovery. And our support to them, at what we believe will be no cost to the taxpayer, can help to make sure that there is adequate capital available.

So I do believe the accounting rules are important, but I think access to capital as well is critical.

Senator CORKER. I came into this world probably, the public service arena, not in business but civically being involved in helping folks in my home town being able to afford housing. And so I come from a background of trying to help that happen for people who otherwise that would not have happened for.

Has this whole situation, though, philosophically, affected you in any way as we look at the fact that we here in Washington have had policies that basically made everyone in America feel that they should own a home? We have seen trillions of dollars of losses take place on homeowners' and citizens' balance sheets. And should this in some way affect our underwriting in the future? Much of what we are looking at as it relates to reg reform is really just rearranging the deck chairs. I am still not sure that we have hit at some of the key points in our financial regulation that we should be hitting at.

But I just wonder if philosophically we in America ought to look at different underwriting standards trying to get people to own homes where basically they are just renting them because they have no equity in it. I wonder if you might want to talk to us a little bit about the Danish model, talk to us a little bit about just the way we have gone about this, and I am wondering if this has sort of shaken people who do what you do on a daily basis and caused you to think a little differently about the way we go about this in the future—because, by the way, if we just rearrange the deck chairs, Johnny Isakson, who is probably the most eloquent spokesman of this, in another decade will be up here talking to us about another crisis that has occurred in real estate if we do not change the underwriting.

Secretary DONOVAN. Well, Senator, that is an important—and it is a question we could probably spend an entire hearing talking about and addressing, because I think there are many different aspects to housing policy that, given the crisis that we have been through, we do need to take a look at.

I do believe very strongly that we need to make sure that rental housing, in addition to home ownership, is a valued option for Americans. I think too often that we have felt that home ownership is the only option that should be valued, and really we have to have a more balanced housing policy.

The other significant point I think I would make is—and I referred to this, but maybe if I could focus on it a little bit more, in my testimony—that one of the things this crisis has done is to remind us the importance of the basics in underwriting and thinking about whether it is home ownership or more broadly about real estate. Frankly, we got to the point in this country where we were making loans to people we knew they could not afford, whether it was not checking incomes, providing incredibly low rates up front which we knew were going to step up, and if they were not unaffordable today, that they would be unaffordable within just a few years. And we need to make sure that we have—and I believe a regulatory system is very important in doing this—that we do not have a system that is making loans that we know people cannot afford. And that includes, given the complexity of our system, ensuring that there is real skin in the game, not just on the homebuyer's side but also throughout the chain, whether that be a mortgage broker who we make sure is responsible, whether it is the securities that are sold down the line and who holds the risk for those securities. There is a whole chain of places where we have to infuse responsibility back into our system. And that is where I think—one of the things, frankly, that disturbs me about some of what is being written about FHA today and comparing it to subprime loans, nothing could be further from the truth.

During the boom, there is a reason why FHA shrunk to less than 2 percent of the market: because we continued to focus on fully underwritten, fully documented, 30-year fixed-rate loans, not exotic products. And that is why we were doing almost no business during that time. We have continued to focus on those things, and I think it is important that we remember that we get back to basics.

One last thing I would say on this is I think it is very important that we not confuse responsible lending and underwriting with whether or not low-income people can have access to the American dream of home ownership. When I was housing commissioner in New York, we created or preserved 17,000 units of home ownership. By the time I left, there were only five foreclosures among those 17,000 units. Why? Because we made sure people could afford them up front. We made sure they were trained for the responsibilities of hospital.

I believe strongly that home ownership is still a laudable goal, but we have to get back to responsible, commonsense underwriting in the way that we make these products. And I have talked about a set of things that we can do to make sure that happens.

Chairman DODD. Thank you very much.

Just on that point that Senator Corker raised, I think there is unanimity in that thinking up here. Obviously, what happened in so many cases, where there were good underwriting standards, the problems did not exist. A lot of our community bankers across the country had very little problems in this area. And where we did not, obviously the problems exploded on us. It almost seems we have no memory on these things because it comes back over and over again and people just seem to believe these things are going to continue to escalate and you can do the zero down and zero payments for a year, and you end up in the mess you are in. So I appreciate the point, Senator Corker.

Senator SHELBY. Mr. Chairman, could I——

Chairman DODD. Certainly. Go ahead.

Senator SHELBY. I just want to pick up on something I thought Senator Isakson brought up, and I think you have got to correlate this into housing. People's confidence comes from—the average person—what they believe their house is worth, you know, home equity. Our next wave of concern is not housing. It is going to be commercial properties around, retail businesses, people are not buying. And if we do not restore confidence in housing, they are not going to be buying a year-and-a-half or 2 years from now, and we are going to exacerbate, I believe—I think that is what Senator Isakson was alluding to earlier, and I think, Mr. Secretary, although you are not in the commercial business *per se,* it is all related to some extent, I think.

Secretary DONOVAN. I agree.

Chairman DODD. Senator Tester.

Senator TESTER. Thank you, Mr. Chairman.

A couple things. Welcome, Secretary Donovan.

Secretary DONOVAN. Good to see you.

Senator TESTER. You listed a number of programs in your opening statement that the Administration is doing. Has the Administration taken a position on this particular amendment as far as the income limits and extending it out to June 30th?

Secretary DONOVAN. The income limits within the home ownership tax credit?

Senator TESTER. Yes. This will extent it not only to first-time homebuyers but to everybody, a $300,000 cap, and to June 30th. Has the Administration taken a position on that?

Secretary DONOVAN. We have not. As I said earlier, we believe that within a few weeks we will have sufficient data to be able to sit down and get to a conclusion on it. We understand the urgency of it, and we would like to do that very quickly.

Senator TESTER. You have been in the housing business for a while yourself, and I guess my question is: With this tax credit, are we installing confidence in the system, or are we artificially inflating the price of houses?

Secretary DONOVAN. I believe that given the decline that we have been through, I think the likelihood that the credit is inflating the market beyond what it would otherwise be is very, very low. I do not believe that that is the overriding concern here about whether we are inflating the market in some way that is unhealthy for the long-term future. I believe it is much more a balance.

As I said earlier, the tax credit has provided real, tangible benefits to the market. It is a question of understanding more fully the costs to the taxpayer of those benefits and whether the credit should be extended based on those costs and shaping the exact form of it.

Senator TESTER. The tax credit goes to the homebuyer, and I am not going to quiz you on mark-to-market, but I am going to use it as an example because Senator Isakson brought it up about recognizing losses that do not exist.

I have got a nice house. I am making $150,000, $200,000 a year so I can make my payments. It is the bottom of the market. Why would I ever sell? Any comments on that?

Secretary DONOVAN. I believe that one of the real negative impacts—and I agree with Senator Isakson on this—is that there are lots of folks stuck in homes who have not been able to move or to go to other jobs because of the impact. One of the things that I think is very important that we do—and we have been working with the servicers to do this—is to make sure that short sales can happen much more easily. In other words, even in a situation where someone wants to sell, where their mortgage is higher than the value of their house, they have been unable to short of going through the full foreclosure process. It does not make sense for——

Senator TESTER. Isn't there a situation—doesn't that situation exist almost entirely with folks with low incomes?

Secretary DONOVAN. No. In fact, given the price declines that have happened in California, they have been concentrated in a certain number of markets where there were actually relatively high-priced homes compared to the national average.

Senator TESTER. From a regional perspective.

Secretary DONOVAN. I do not think this is a problem that is facing just low-income Americans. I think it is facing middle- and even some upper-income Americans.

Senator TESTER. How well has the program worked, the original program, in rural America? Do you have any sort of numbers that would indicate whether it has worked well or not?

Secretary DONOVAN. The tax credit program?

Senator TESTER. Yes, the original one for first-time homebuyers.

Secretary DONOVAN. Generally speaking—we do not have detailed numbers. As I said earlier, without getting the actual tax returns filed, it is very hard to get detailed geographical information.

What I would say generally is that in rural areas we have seen less of a decline—there was less of a bubble. There has been less of a decline, and we have fewer homes changing hands in rural areas than we do in suburban and urban areas. And so, therefore, my educated guess would be that we have less of an impact in rural areas relatively speaking, but that there would be some real variation across the country.

Senator TESTER. I have heard from a number of lenders and appraisers and realtors and home buyers that there is a frustration with the Home Valuation Code of Conduct. While certainly a worthwhile intent, the HVCC is problematic in certain parts of the country, specifically in lightly populated States like Montana, in which appraisers may be chosen who aren't familiar with a market area. There were new rules forged, and I am sure you are very, very familiar with them, with an agreement between the New York State Attorney General and the two secondary mortgage market companies.

Have you heard of problems about the HVCC and compliance with the HVCC? And do you think Congress should weigh in on that issue, which was basically a byproduct of the deal between the AG and two GSEs?

Secretary DONOVAN. Not only have I heard often about issues with HVCC, we have actually taken some action on that.

Senator TESTER. OK.

Secretary DONOVAN. We recently, through FHA, clarified what I think were some of the unintended consequences of the HVCC.

Senator TESTER. All right.

Secretary DONOVAN. Very briefly, we had certain companies that were assigning appraisals that I think there was somewhat of a misperception in the market that they needed to be used and that that had led to a lot of, frankly, less qualified nonlocal appraisers——

Senator TESTER. Correct.

Secretary DONOVAN. ——being used based on the HVCC. What we have done in FHA is not only clarified that you don't need to use those referral companies, but, in fact, we have increased our standards on local knowledge to ensure that the appraisals that are being done are based on real, intimate knowledge of what is happening in that local market, not an appraiser that may be coming from a different city or even a different State to do the appraisal.

Senator TESTER. When did you do that?

Secretary DONOVAN. I don't have an exact date in my mind, but within the last weeks.

Senator TESTER. OK. Thank you very much. Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator, very much.

Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

I have so many questions, I don't know where to begin. First of all, on the GSEs and the housing market, what do you think the future of the GSEs will be, especially Fannie and Freddie?

Secretary DONOVAN. We have begun a process within the Administration to look at that. We have laid out a set of options this past summer and we are——

Senator BUNNING. Secretary Donovan, the GSEs have been in trouble for 4 years. If you are just looking at it now, it is too late, because we are going to own 100 percent of them——

Secretary DONOVAN. Well——

Senator BUNNING. ——before you act.

Secretary DONOVAN. Senator, I would say that there have obviously been substantial concerns and problems at the GSEs, but today, they are playing a very important role——

Senator BUNNING. We own them. That is why.

Secretary DONOVAN. They are providing today, or helping to provide, about two-thirds of all the mortgage financing today in the country.

Senator BUNNING. Secretary, you know that the United States taxpayers own them. So it is taxpayers' money.

Secretary DONOVAN. I understand, and I believe that this Administration has taken responsible actions to ensure both that the housing market stabilizes and that the losses within the GSEs don't get even worse from the decline that we have had, and to put them on a path toward having a more stable, more responsible housing market in the future. So I understand——

Senator BUNNING. Do you want to answer my question? What do you think is the future of GSEs?

Secretary DONOVAN. We have, as I said, begun a process within the Administration to come to a decision about what the future of the GSEs should be, but I——

Senator BUNNING. When do you expect to make a decision?

Secretary DONOVAN. We have said publicly that we expect to put out a set of recommendations early next year, at the time that we publish our budget. But I want to reemphasize that it is—we cannot lose sight of the important role that the GSEs are playing today in the recovery of the market. Without their role today, I think it is fair to say that there would not be mortgage capital available broadly, and it would certainly not be available at the rates that have been available to allow the housing market——

Senator BUNNING. It is the taxpayers' money.

Secretary DONOVAN. I understand that, and——

Senator BUNNING. So we are financing our own bailouts through GSEs through the taxpayer, period. That is all there is to it. I mean, so if you want to continue doing that, I think you are making a big mistake. You have got to get either the GSEs owned by private capital or you have got to do it 100 percent.

Now, the Administration has known that the housing credit was going to expire November 30 of this year for how long? Since the beginning, since we passed the law. Why haven't you made a decision on that prior to this time?

Secretary DONOVAN. As I explained earlier, we believe it is critically important, as I believe we have heard from this Committee, that we understand as fully as possible the costs of that extension——

Senator BUNNING. Don't you think the people up here do, too?

Secretary DONOVAN. I agree. There is, at this point—and we have been talking regularly to lenders in the market about the timing of the extension, and we understand that a decision needs to be made within just a few weeks to be able to ensure that those buying houses understand whether they are going to be eligible for the credit. And I am committed—the Administration more broadly is committed to getting to that decision within just a couple weeks to make sure that the market doesn't become interrupted.

On the other hand, we believe it is critical, as I have said before, that we understand as much as possible about what the costs are. That data is not easy to gather because it is——

Senator BUNNING. We feel that we—or we would not have made the proposal that has been made if we didn't feel that it were just absolutely necessary to keep the housing market from falling out of bed if we didn't continue this.

One other thing you brought up—you brought this up in response to a question by Senator Shelby on the Consumer Protection Agency—you said, unregulated financial institutions caused this problem. I want you to know, in 1994, we handed the Federal Reserve—we handed them the power to regulate all banks and all mortgage brokers on the loans that they make. That is all of them. In 1994, they didn't do a thing. They didn't do a thing in 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, all the way up to 2008. Then they wrote some regulations on mortgages. Fourteen years later, after we gave them the power to regulate mortgages, they decided maybe some of those sophisticated mortgages, those no-interest mortgages, those balloon mortgages are not too good for the marketplace.

So it isn't a question of having the power to regulate, it is the question of the power to regulate being used by those that we gave them to. Now, why would we write a new protection agency if they are not using the power we gave to the Federal Reserve to start with?

Secretary DONOVAN. Senator, as I said earlier, I believe strongly that we had a set of institutions that were not traditional financial institutions, that were not subject to the——

Senator BUNNING. Did you just listen to what I said?

Secretary DONOVAN. I did, Senator.

Senator BUNNING. What did I say about the Federal Reserve? We passed a law that said, you are responsible for every bank that makes a mortgage and you are responsible for every mortgage broker that makes a loan. Now, do your job. Well, they didn't do their job, and now you want to create a new institution because the Federal Reserve didn't do their job. I say you are wrong in creating a new institution. We should insist that the Federal Reserve does their job, and we can make it, our take the power away and give it to someone else. But every time you talk about taking power away from the Fed, they want more.

So I am telling you that you have, in my opinion, very little chance of getting a Consumer Protection Agency past this Committee. Maybe they will pass it, maybe they won't, but we have given the power to regulate mortgages a long time ago to the Federal Reserve and they didn't do their job. Thank you.

Chairman DODD. Thank you, Senator.

Let me just say, in a sense, and I want to get to Senator Merkley, my good friend from Kentucky makes the case—in fact, I have given the speech that Senator Bunning did probably a thousand times, the 1994 Act and why nothing happened and why it should have happened. And my concerns are exactly those expressed by Senator Bunning and the argument for the Consumer Protection Agency.

The fact of the matter is, when they had the authority, they never did anything with it, and that has been the problem with too many of the regulators that had the authority. They never did anything. Hence, the argument of creating an agency, in effect, that has the authority and the power to do something about people walking in their door.

So in a sense, his argument was one I thoroughly endorse and support, having made it many times, but I come to a different conclusion than he does, that, in fact, the very argument he makes creates the case for why we need a Consumer Financial Protection Agency.

Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you, Mr. Secretary.

One of the things you noted in your testimony was that in order to facilitate loan modifications, you are going to have a Web portal up and running in a few weeks, I think by about December 1, approximately, 6 weeks from now, and that this will allow folks to file their applications electronically and to post their documents.

You also note in your testimony that it is going to be divided into a couple of phases. Will the first phase of the Web portal allow folks to file their application electronically and post their documents, or will that come in phase two?

Secretary DONOVAN. I believe it will allow that in the first phase. We are still deciding on the final amount that we are able to get into that first phase, but that is certainly one of the things that we are aiming for in the first phase.

Senator MERKLEY. Well, I really want to compliment you and the Department for pushing forward with that portal. Just this weekend, I was at a gathering of loan modification agents and the public and this issue of being able to know that—for folks to be able to know that their application had been received, to be able to know that the documents that they had filed to support it had been received and were available and not to be in limbo, almost blind, if you will, in their conversation for months at a time will be a tremendous step forward. So thank you for pushing forward with that.

Secretary DONOVAN. Thank you.

Senator MERKLEY. You noted in your comments that because you have a responsible loan design in the FHA program, that foreclosures, it really minimizes the number of foreclosures. Does the FHA program specifically exclude loans that have prepayment penalties or that have any form of yield spread premiums attached to the transaction?

Secretary DONOVAN. Yes, it does.

Senator MERKLEY. Thank you. And that is an expectation that will continue into the future?

Secretary DONOVAN. Absolutely.

Senator MERKLEY. I want to ask you the question that I asked to Senator Isakson a little bit earlier, and that is back when I was working with lower-income Americans, many of them when they bought a home didn't get much significant help from the home mortgage interest deduction because their salaries were low and they were buying very low-end starter houses, and so the amount of interest didn't necessarily exceed the standard deduction. I believe that that home mortgage interest deduction now costs about $100 billion a year, somewhere around that. Is there an argument to be made for an ongoing tax credit for first-time homeowners in order to recognize and assist the lower-income Americans who are becoming homeowners in a significant fashion?

Secretary DONOVAN. In fact, as a candidate, Senator Obama talked about the need to ensure that the mortgage interest deduction was available to lower-income families, that it was—because of the deductions available to—the standard deduction available to many low-income families, that they weren't benefiting in the same way. So I do think that it would be valuable to look at the mortgage interest deduction and make sure that benefits a broad spectrum of Americans, obviously recognizing the cost and looking at how broadly that might be expanded. But I do think, as the Senator advocated during the campaign, that that would be an important thing to look at.

Senator MERKLEY. Well, I certainly would applaud your Department to look at that. I recall a study that looked at home ownership for low-income families that concluded it had perhaps the most powerful externalities of virtually anything that we have in Government policy. Children were stabilized, did far better in school. Families were stabilized. They got involved in their communities in more significant ways because they felt like they had a stake in the community. And there were just many, many features. The likelihood of the family being involved in crime dropped. The tax contributions increased. In just measure after measure, home ownership for low-income families had a very positive impact.

And I preface this all on the basis of when responsible loans were utilized, not the kind of phony financing that really meant that home ownership wasn't a stabilizing factor, and by that, I am going back to the exploding interest loans, the subprime loans, the triple-option loans, and so forth were not so helpful.

Do you anticipate that the Administration might come forward in the middle of this debate with a specific proposal on how to strengthen home ownership for lower-income Americans, kind of following on with the theme that President Obama struck during his campaign?

Secretary DONOVAN. Well, first of all, Senator, let me just say that I appreciate your raising that point. As I said earlier, I think one of the misperceptions that I want to make sure is clarified out of the crisis that we have seen is that home ownership is a valuable goal and that it is a valuable goal for Americans aspiring to be in the middle class, not just for those already in the middle class. So I think it is very important that we not lose focus of that. And I have seen very personally, as you, I am sure, did with Habitat for Humanity, that lower-income Americans can be not only successful as homeowners, but it can be a critical part of building wealth for them as they move up the economic ladder. So I think that is a very important lesson.

I also believe that that is one of the reasons, not only about taking future action, whether it is the HFA policies that we announced yesterday, whether it is the continuing importance that FHA plays in the market, that there is a set of things we have done to make sure that home ownership remains available for lower-income Americans with exactly the kind of responsible products that we have talked about.

Beyond that, I do think that there are a set of things that we can do. Importantly, I think the kind of assistance that we are providing through Making Home Affordable, but also through programs like the Neighborhood Stabilization Program, where we are ensuring that, particularly in low-income communities that have been hit hard by foreclosures, that if we can begin to use some of those what are vacant and now abandoned homes as an asset to open up home ownership to lower-income Americans, that that can be an important role. In fact, Habitat for Humanity has been very interested and has begun using those Neighborhood Stabilization funds to not only build new construction, but, in fact, to renovate homes and make them available to lower-income Americans.

So I think there are a set of things that we could do and I would look forward to talking to you more about some of the details of those.

Senator MERKLEY. Thank you very much.

Secretary DONOVAN. Thank you.

Chairman DODD. Senator Merkley, thank you very much. I was in with Senator Merkley a few days ago in his State. We had a wonderful meeting with consumers in his State and people who had gone through a lot of difficulties, Mr. Secretary, like we have in all of our States. I want to commend Senator Merkley for his leadership in his State and on this Committee. He has been consistent in his concerns about this issue from the day he arrived here, so we thank you very much, Senator, for that.

Secretary Donovan, we thank you. We have kept you here a while and we appreciate it very much and appreciate your hard work——

Secretary DONOVAN. Thank you. Good to be with you.

Chairman DODD. ——on these issues. Obviously, we will be looking fairly soon, if we can—we would obviously like to hear from the committee on the tax credit idea. Many of us up here, as you know and heard up here, feel very strongly about moving forward on this, but obviously, we always welcome the counsel and advice of the Administration, any Administration, and what your thoughts are on these matters. I know Senator Isakson shares that view, so we are interested in hearing what you have to say about that, as well. So thank you for being with us.

We will leave the record open. There may be some additional questions that Members who could not make it here this morning would have for you. I would urge you to respond to those when you get the chance.

Let me turn to our third panel quickly, if I can, here, and some very fine people who have come to join us today. I have already introduced, in a way, Diane Randall, who is the Executive Director at the Partnership for Strong Communities, an organization she has led for 5 years in my home State of Connecticut. She does a tremendous amount of work dedicated to providing affordable housing to hard-working, low-income Americans, and we thank her for joining us.

We want to welcome Ron Phipps, the First Vice President of the National Association of Realtors. Mr. Phipps has been a Realtor for 30 years, almost equaling the time that Johnny Isakson spent in the field of the real estate business. He is with Phipps Realty and only about 45 minutes away from where I live, in Warwick, Rhode Island, so we thank you, Mr. Phipps. My mother was from Westerly, Rhode Island, and I went to Providence College, and my in-laws and my sisters-in-law live in Narragansett and Providence, as well, the Bonnano family, that I suspect you know, as well.

Jay Brinkmann is the Chief Economist and Senior Vice President for Research and Economics at the Mortgage Bankers Association, and we thank you, Jay, as well for being with us, and patiently sitting here this morning. I hope you found it interesting, the conversation.

And last, I welcome to the panel Dr. David Crowe, who is the Chief Economist for the National Association of Home Builders, and we thank you, David, for joining us, as well.

Let me begin in the order that I have introduced you, and if I can—did I miss someone? Diane Randall, I introduced. She is from Connecticut, as well, and does a great job in our State as the Director of our low-income Partnership for Housing.

So let me thank you, and Diane, we will begin with you. I would ask you to try and keep your remarks to about 5 minutes apiece. That way, we will get to some questions for you. Obviously, all of your testimony and statements, we welcome and will include as part of the record. That is true of all my colleagues here, as well, for any opening statements or thoughts they have. But welcome to the Committee, Ms. Randall.

STATEMENT OF DIANE RANDALL, EXECUTIVE DIRECTOR, PARTNERSHIP FOR STRONG COMMUNITIES

Ms. RANDALL. Thank you very much, Senator Dodd, Senator Shelby, and the entire Banking Committee, for the opportunity to testify today. My name is Diane Randall. I am the Executive Director of the Partnership for Strong Communities, which is a Connecticut-based organization dedicated to solutions to homelessness, the development of affordable housing, and the creation of vibrant communities. I am also a member of the Board of Directors of the National Low-Income Housing Coalition, which works on solving housing problems for low-income people in our country.

For millions of Americans, many of them vulnerable by disability or age, the opportunity to own a home, even with a very generous home ownership tax credit, is beyond their reach. For these Americans, the American dream is a safe, secure, affordable, rental home.

The opportunities for Congress to intervene with solutions for the low-income rental market are immediate and can have dramatic benefits, not only for the Nation's economy, but also for people who need the security of an affordable rental home. Indeed, one of the lessons from this housing crisis is that efforts to fix only the home ownership market is not an adequate housing policy for our Nation, our States, or even our local communities.

It is important also to understand that there is no such thing as the Nation's housing markets. There are thousands of markets, each with its own needs, and it is critical that Congress provide States and localities with the tools and resources that can be tailored to address conditions in those different markets.

Let me give you a snapshot of our State, Connecticut. It is a wealthy State that nonetheless has deep pockets of poverty, with an unemployment rate of 8.1 percent, which while less than the Nation's 9.7 percent unemployment rate shows no signs of declining. As Senator Dodd mentioned earlier, nearly half of our renting households pay more than 30 percent of their income for housing. For many of these folks, it means that there is no money left over at the end of the day for their children to have music or dance lessons or even have a night out at the movies.

Connecticut's suburban and rural towns have very little supply of multifamily housing, especially affordable housing. In order to afford a two-bedroom rental home, a family would need an annual income of nearly $45,000, which is more than the median wage of almost half the occupations in our State.

The percentage of Connecticut homes valued under $200,000 shrunk from more than 65 percent of the total in 2000 to less than 20 percent in 2008. Even if they could muster the downpayment and receive a tax credit, low-income households have few opportunities to become homeowners due to the very high housing prices and limited supply.

Across the country, the same story is played out. The National Low-Income Housing Coalition has culled information from the American Community Survey showing that while some renters in every category pay more than 30 percent of their income for housing, 86 percent of renters who are earning less than $20,000 a year pay over 30 percent of their income for housing. In other words, the poorer you are—and recent reports indicate that throughout the country, household incomes are declining—the greater your challenge in finding a home you can afford.

Americans with growing rent burdens in rural, suburban, and urban communities include people with disabilities, veterans, the elderly, and families with young children. People with disabilities who rely on Social Security income as their sole source of income continue to be some of our Nation's poorest citizens. The monthly SSI income payment in 2008 of $637 a month is supplemented by almost half of the States. In Connecticut, that brings an individual's income up to $805 a month, but it would require a person to pay 116 percent of this income just to afford a one-bedroom apartment.

Many of those with low incomes are also at an increased risk of experiencing homelessness, particularly during these difficult economic times. Connecticut's 2009 Point-In-Time Count of Homelessness, which is a 1-day look at the number of people using emergency shelters and out on the streets, does not include families doubled up with friends or family. It challenges some of the traditional challenges about homelessness. In fact, it demonstrated a shift that homelessness is growing at a faster rate in suburban and rural towns than in our urban centers. It is a finding that is consistent with many national studies.

Has the current housing crisis increased the availability of rental housing for low-income households? Quite simply, that is not the case. The loss of regular income experienced by millions of Americans, whether through unemployment, reduction in work and benefits, or crises related to mortgage and foreclosure problems, pushes more lower-income households to look for affordable rentals. This pressure on the low-income rental market, in turn, drives up rents for these homes.

The market for rental housing for low-income households is not the same as the market for those who have higher incomes and an increased ability to pay more. Although recent reports indicate that rental prices may be declining in some markets, these reports are coming primarily from large rental buildings that primarily rent to higher-income segments of the population.

There also appears to be an influx of troubled properties in the rental market, as homeowners try to rent property they can no longer afford themselves.

Finally, I want to just say a few words about the loss of existing public housing. We estimate that there has been a loss of almost 200,000 units of public housing stock, which is mostly for low rental, and that there is an immediate need to preserve rental housing stock in the next decade.

My testimony indicates some of the benefits of a low-income housing rental market working. Those obviously inure to the education of children, to the stability of households, and to the health and well-being of people with disabilities and the elderly.

I just want to thank Congress for the steps that you have taken, particularly through the ARRA Act, in terms of the Homeless Prevention and Rapid Rehousing Program, and the Tax Credit and Assistance Program to bolster the low-income housing tax credit market. They are very important.

Again, my testimony names a number of things that you could do immediately, including remedies to the Section 8 program, which assures that we fully fund the Section 8 Tenant Rental Assistance Program. We believe it is incredibly important and valuable to include new rental assistance vouchers that could be used both for Tenant-Based Vouchers as well as for Project-Based Vouchers, to enact SEVRA, to fund the National Housing Trust Fund, which would be one of the first major initiatives, and again, Senator Dodd and this entire Committee have been great champions of that. That would provide a permanent source of financing for the development of affordable rental housing.

We are very partial to the Frank Melville Supportive Housing Act, which serves people with disabilities, and hope you will pass that. It has bipartisan support. And again, to enhance the Livable Communities Initiative that Senator Dodd has championed.

Thank you very much.

Chairman DODD. Thank you very much, Diane. We appreciate your testimony and your presence here today.

We will begin with you, Mr. Phipps.

STATEMENT OF RONALD PHIPPS, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. PHIPPS. Good morning, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for inviting me to testify today.

My name is Ron Phipps. I am a practicing licensed real estate broker from Warwick, Rhode Island, and the 2009 First Vice President of the National Association of Realtors. My family has been actively involved in residential real estate and appraisals for four generations. It is an honor to be here on behalf of the 1.2 million fellow realtors.

The latest housing data suggests that the $8,000 first-time homebuyer credit has been effective. Sales have increased to annual rate of 5.1 million units. Housing inventories, while still higher than ideal, are down to an 8-month supply. Additionally, the decline in housing values and prices has slowed.

Housing sales are important for the overall economy. One economist estimates that for every 1,000 home sales, $112 million of economic activity and more than 700 jobs are created. While the focus is on the statistics, it is important to remember that each one of these transactions is purchased by a household. These are people and families just like yours and mine.

While the facts are encouraging, the current situation in the housing market is very fragile. We face serious challenges for successful, sustained housing recovery and economic revitalization.

First, the lack of private capital, specifically in the jumbo markets, made it difficult if not impossible to obtain mortgage loans. This has increased the number of foreclosures and short sales as people cannot refinance.

Second, the FHA does not have the resources to do its job. The Federal Reserve reported that one-half of home purchases and one-quarter of refinances were backed by the FHA or VA at the end of 2008. The FHA is working on technology that averages 18 years. That is, the technology is 18 years old.

Last Friday, I had clients, Mary and Dan Cerissi, who closed on their first house with 3.5 percent down. Dan is a police of course, in Narragansett. Mary is a school teacher. She teaches seventh grade English. Without the $8,000 credit and the FHA, they would not have been buyers. They would not have purchased their first home. It is a very valuable tool that we need to keep in place—both tools. Remember, statistics are families. Each one of these is a family.

Third, the new Home Valuation Code of Conduct, while well intentioned, has delayed the appraisal process and significantly increased the cost for consumers. Earlier, there was a question about have people seen problems with it. We surveyed our members, and 70 percent of them have had problems with appraisals, not just value but the process.

Fourth, short sales are still a mess. They are delayed and denied due to unreasonable price expectations, lost documents, full voicemail boxes, insufficient or untrained staff. Last spring, one of my clients, an officer in the Navy, was relocating, being transferred to Jacksonville. He was underwater in his mortgage. After putting his house on the market, we received an offer. We contacted the lender to get a response on the short sale. It took 6 weeks to get any response, and the buyer had moved on. When the lender finally responded, the message was direct: “We don’t care. PMI will figure it out. And, by the way, they are going to say no.”

Frustrated, the naval officer went to his family and borrowed the money from them in order to close with another buyer and report to his new post.

Fifth, the Federal Reserve’s unwinding of the MBS program is critical to the housing market and the overall economy. A significant increase in rate would result in a derailing of the housing recovery. Incidentally, the commercial real estate market is worse. The mortgages are due now. They will not be renewed or extended, and there is no source for money. It is the perfect storm, and the net result may be the loss of the entire commercial fleet.

Today we come to you urgently. We need to act now.

First, we need the $8,000 first-time homebuyer tax credit extended and expanded. It is responsible for 350,000 to 400,000 additional sales this year. Each sale generates approximately $63,000 in economic activity. We appreciate the $10 billion cost, but the direct benefit of this is to Americans, and the multiplier effect cannot be ignored. We need this done now. The average closing takes 45 days. We are at threshold. If you do not act immediately, then sales will wane. We are writing offers literally in our office today that are contingent on closing by the 30th of November or the sales agreement is null and void, meaning the transaction goes away. It will not happen. And that is when people qualify for the $8,000.

Second, NAR urges you to make GSE and FHA mortgage loan limits, higher limits, permanent. They expire on the 31st of December. Action is required now.

Finally, realtors believe that the Federal Government must continue to play a role in mortgage markets. The secondary market must meet two key goals. First, we need to ensure that the housing market works at all times, regardless of the economy; and, second, we need to provide mortgages to all qualified homeowners for sustainable home ownership.

It has been an American tradition for communities to work together and help people in need. When a barn burned, the neighbors would rebuild it. We are asking for you to work with us, not to build a bar but, rather, to build homes—homes for American families. I cannot overstate the immediacy now. You need to act on the extension today. Now, now, now. In 2 weeks, 3 weeks, or when the reports come in, it is too late. We will be in wane period, and we really need the activity now.

Thank you.

Chairman DODD. Well, thank you very much, Mr. Phipps. And we hope the next time you testify you would be more certain about what you would like to see happen.

[Laughter.]

Mr. PHIPPS. I tend to equivocate.

Chairman DODD. Mr. Brinkmann.

STATEMENT OF EMILE J. BRINKMANN, CHIEF ECONOMIST AND SENIOR VICE PRESIDENT FOR RESEARCH AND ECONOMICS, MORTGAGE BANKERS ASSOCIATION

Mr. BRINKMANN. Good morning. Whenever I am asked when the housing market will recover, I explain that the economy and the housing market are inextricably linked. The number of people receiving paychecks will drive the demand for houses and apartments, and the recovery will begin when unemployment stops rising.

Since September 2008, we have lost 5.8 million jobs in the U.S., many more than the previous year. Job losses of this magnitude put incredible strains on all of our systems, especially housing.

What is different about this recession is we entered it with an already weakened housing market. In past recessions, it was unemployment that increased delinquencies and weakened demand for housing. Prior to the onset of this recession, however, the housing market was already weak, and due in part to the heavy use of loans like pay option ARMs and stated income loans by borrowers for whom these loan products were not designed, together with rampant fraud by some borrowers buying multiple properties and speculating on continued price increases, this led to very high levels of construction to meet that increased demand—demand that turned out to be unsustainable. When that demand disappeared, a large number of houses were stranded without potential buyers. The resulting imbalance in supply and demand drove prices down, particularly in the most overbuilt markets like California, Florida, Arizona, and Nevada—markets that had previously seen some of the Nation's largest price increases.

The nature of the problem has shifted. A year ago, subprime ARM loans accounted for 36 percent of foreclosures started, the largest share of any loan type despite being only 6 percent of the loans outstanding. Now, prime fixed-rate loans represent the largest share of foreclosures initiated. Perhaps more significantly, almost 40 percent of all prime fixed-rate foreclosures are in the States of California, Florida, Arizona, and Nevada. So even though those States consistently had about two-thirds of the foreclosures on pay option ARMs, stated income ARMs, *et cetera,* they now also have a disproportionate share of the prime fixed-rate problem.

It is difficult to overstate the degree to which those four States continue to drive the national mortgage delinquency numbers. The national quarterly foreclosure rate reported by the MBA for the second quarter of this year was 1.36 percent. However, in the four States I mentioned, it was 2.34 percent, roughly 10 times the rate we saw in those States during the boom years. Without those four States, the national foreclosure rate would be about 1 percent, or roughly double the rate we saw for the rest of the country during the previous boom years.

Unfortunately, the consensus is that unemployment will continue to get worse through the middle of next year before it slowly begins to improve. While we have seen certain good signs, like stabilization of home prices and millions of borrowers refinancing into lower rates, we still face major challenges. Perhaps the most immediate challenge is what will happen to interest rates when the Federal Reserve terminates its program for purchasing Fannie Mae and

Freddie Mac mortgage-backed securities in March. The Federal Reserve has purchased the vast majority of MBS issued by these two companies this year and in September purchased more than 100 percent of the Fannie and Freddie MBS issued that month. The benefit has been that mortgage rates have been held lower than they otherwise would have been without the purchase program, but there is growing concern over where rates may go once the Federal Reserve stops buying and what this will mean for borrowers. While the most benign estimates were increases in the range of 20 to 30 basis points, some estimates of the potential increase in rates are several times these amounts.

The extension of the Fed's MBS purchase program to March gives the Obama administration time to announce its interim and perhaps long-term recommendations for Fannie and Freddie in February's budget release. All of this, however, points to the need to begin replacing Fannie Mae and Freddie Mac with a long-term solution. MBA has been working on this problem for over a year now and recently released a plan for rebuilding the secondary market for mortgages. MBA's plan envisions a system composed of private, nongovernment credit guarantor entities that would insure mortgage loans against default and securitize those mortgages for sale to investors. These entities would be well capitalized and regulated and would be restricted to insuring only a core set of the safest types of mortgages and would only be allowed to hold *de minimis* portfolios. The resulting securities would in turn have a Federal guarantee that would allow them to trade similar to the way Ginnie Mae securities trade today. The guarantee would not be free. The entities would pay a risk-based fee for the guarantee, with the fees building up an insurance fund that would operate similar to the Bank Insurance Fund. Any credit losses would be born first by private equity in the entities, any risk-sharing arrangements with lenders and MI companies, and then only when these entities failed would the insurance fund come into play, and only if that fund then failed would the Federal guarantee be called upon.

We believe this proposal represents an important improvement over the present structure in a number of areas. We are eager to discuss it with Members of the Committee as well as other proposals detailed in the written testimony, especially the extension of the homebuyer tax credit.

Chairman DODD. Thank you very much for that, and thank you for the suggestions on the GSEs. I welcome that. We had a hearing on the GSEs a few weeks ago, and obviously it is a concern for all of us up here. But we all recognize, I think most of us do, the value they are playing right now in terms of stabilizing the market, but we also recognize that we have got to reform this fundamentally, and how we do that is still open to some debate. But we welcome the suggestions made by the mortgage bankers. Very helpful.

Mr. Crowe, we thank you as well, David, for being with us.

STATEMENT OF DAVID CROWE, CHIEF ECONOMIST, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. CROWE. Thank you, Chairman Dodd, Ranking Member Shelby, and Members of the Committee.

The current housing recession is the worst since World War II. Starts are down nearly 80 percent from their peak in January of 2006, from 2.3 million down to 488,000 on an annual basis. The inventory of newly constructed homes reached a record high of almost 12 months. And, finally, home prices have declined in every quarter since the beginning of 2008, which undermines housing wealth and also aggravates foreclosures.

These price declines did improve affordability, and that should have translated into an increase in housing sales and starts. However, this has not occurred as strongly as history would suggest because consumer confidence is still so deeply shaken. Further, access to mortgage lending and challenges in appraisals continue to reduce the pool of eligible homebuyers, thereby keeping housing demand at a reduced level and encouraging a damaging negative feedback cycle.

While there are glimmers of hope that the 3-year decline in housing may have recently stabilized, there remain other significant obstacles to recovery, including: an excess inventory being fed by more foreclosures; continued downward pressure on house prices; an increase in unemployment; and a lack of financing for builders.

One factor playing a proven positive role is the $8,000 first-time homebuyer tax credit. NAHB estimates conservatively that this credit fostered at least an additional 200,000 home sales and resulted in an increase of 187,000 jobs. These impacts are consistent with recent increases in the NAHB's Housing Market Index, a measure of builder confidence, which languished at historically low levels in late 2008 and early 2009. The HMI improved from its low through September, but its most recent report did lose ground.

The impending expiration of the tax credit seems to be the primary reason for this retreat in builder confidence. Consequently, to propel the fragile recovery in the U.S. housing market and to promote economic growth, NAHB urges extending the sunset date to December 1, 2010, and enhancing it to include any purchaser of a principal residence.

We estimate that this proposal would increase home purchases by almost 400,000 in the next year, increase housing starts by about 82,000, create more than 347,000 jobs, yielding $16 billion in wages and salaries, $12.1 billion in small business and corporate income, and almost $12 billion in Federal, State, and local taxes.

Expanding the tax credit to all buyers will address the inability of the existing credit to stimulate the move-up market. NAHB survey data reveal that only 27 percent of the builders sold a new home to a move-up buyer who was in turn able to sell their old home to a first-time homebuyer.

Home sales data from Census also confirms the success of the credit for the starter home market, but not necessarily for the move-up market. Increases in sales for homes priced below $300,000 were evident, while those above $300,000 were very weak. All of this suggests the great stimulus potential in expanding the tax credit to all buyers of principal residences.

It is important to note that the production of new housing remains far below a sustainable level as the market works off all of the excess inventory. NAHB is still forecasting only 560,000, 570,000 housing starts for 2009 and perhaps 716,000 for 2010—a long way from the sustainable production level of 1.8 million. While this gulf persists, we are losing jobs.

NAHB surveys also reveal that as the housing market recovers, financing of the production of those houses will be very challenging. More than 60 percent of the builders surveyed reported worse conditions in obtaining production credit from the last time we asked, which was last quarter. Removing this barrier will be critical for housing and job creation.

I thank you and I welcome your questions.

Chairman DODD. Thank you very, very much, Mr. Crowe, and we appreciate your comments here this morning as well. Let me thank all four of you for your patience here in listening to all of this and the importance of these issues.

I wonder if we might quickly have the three of you comment on some of the comments by Ms. Randall when she talked about the rental housing. Obviously, what we are talking about here is the tax credits for home purchases. But I think we all recognize as well there has been a paucity or lack of stock in rental housing, and, therefore, you see the kind of rates we have in Connecticut, where 30 percent of an income is necessary to afford a rental unit.

I wonder—and the area that the three of you while specialize, obviously, in sales and so forth—what your comments and thoughts would be on rental stock.

Mr. CROWE. Senator, I would be glad to start. The home builders build rental housing just as much as they build owner-occupied housing, so they are deeply concerned about the lack of affordable rental housing, and we have fostered many programs and lobbied for many additions to the current programs, including the low-income housing tax credit, which has added a significant stock of affordable homes to Americans. But we share that concern. We are simply here to tell you that the housing market in general is way out of equilibrium, and the consumer is really the dictator of our success right now. If we can stimulate the consumer back into the marketplace, we can get this market moving, and then the entire economy.

Chairman DODD. Mr. Brinkmann, any comments?

Mr. BRINKMANN. Sure. One of the things we are pushing for is an increase in the FHA limits for multifamily, because we believe a lot of the return of rehabilitated units and that for affordable housing will come from these other units, and that just has not kept track with increased costs. And when you look at where the supply of money is for the type of financing, as David mentioned, that is going to be through the FHA program for the foreseeable future.

Chairman DODD. Mr. Phipps.

Mr. PHIPPS. Senator, the only thing I would add is that we actually handle rentals within the office. We are a small firm. We are a dozen people. It is not just the lack of supply, but the landlords are reading the papers as well, and they have been much more rigorous in their expectations on the financial qualification of who is renting. So we have got a convergence of two major problems: a lack of supply that is affordable and an unwillingness of landlords or owners to rent to people who have been just displaced by a foreclosure or a short sale. So you have got a huge human cost, and then there is a premium. They will say, "Well, I will rent, but you have substandard credit. What I want to do is have you pay a premium," which is the antithesis of what they really do need. So they pay a higher rent in order to rent market space simply to have shelter.

So it is—it is a mess. It is just ugly.

Chairman DODD. Yes. Diane, would you comment on the—I do not know if you have any thoughts on the tax credit. I realize your business and what you focus on is the other side of the equation. But what are your thoughts on this idea—you heard this morning Senator Isakson and others here talk about this—the value of providing some financial support for the move-up market?

Ms. RANDALL. Thank you, Senator Dodd. We look at actually future development, and we also understand that it is important to be able to have a move-up market because that is where we see some activity, and it opens up opportunities for first-time homeowners as well.

Our organization has not taken a formal position on this tax credit proposal. I think that what we are hopeful is that as we look at this challenging situation that has been so ably described by so many people this morning is that we just look at a balanced approach to this and assure that we are not—that as much as we try to help create a fix for homeowners, we are creating a fix for renters as well.

I would hope we could do both, but I also understand your position as Congress to try to do the balancing act on the budgetary side of what this will mean.

You know, I do think it is incredibly important that, as has been described here, we understand that home ownership provides asset building and wealth building for households and families, and we certainly support that initiative as being one that we all strive for. But we are very concerned that there are a number of people for whom home ownership simply will be out of reach if we do not try to address that.

Chairman DODD. Well, not only that, but I think there is also—and Senator Corker raised this point, and others have as well. I happen to be one who thinks home ownership does so many positive things, in neighborhoods, communities, in families, obviously, wealth creation, long-term stability, all the values that are associated with it. But I think we also need to remind ourselves as well that it is not necessarily right for everybody, and we ought not to be shoving people through a door here to get there. You see the kind of problem that happens when we tell everybody they can all do this, when they cannot, obviously, for various reasons. You end up in the mess we found ourselves in.

So we need to be able to provide affordable, decent shelter for people who either do not want, cannot afford, or should not be necessarily in that market at this point given their circumstances so they are not left on the side. So striking that balance I think is something we all agree on. I appreciate your comments on that.

I am going to turn the gavel over to Senator Merkley of Oregon here to preside while I have to run off to another meeting myself, but I thank you all very much for your testimony, and I thank Senator Merkley as well, and Senator Shelby and Senator Bunning as well for hanging around for this, too. Thanks.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Phipps, in your testimony, you state that affordable housing goals must be reasonable and, your words, "should not provide incentives for the institution that are inconsistent with sustainable home ownership." I think this is an important point. Ensuring proper underwriting standards and not exposing consumers to mortgages they cannot afford, cannot pay, that does not provide home ownership. You know, it provides problems, because ultimately I think the most important consumer protection we can do, because if you put people in something that they cannot walk with, you know, cannot sustain, we are asking for problems, and we have seen a lot of those today, have we not?

Mr. PHIPPS. We have, Senator, and I think the words speak for themselves. There is a human cost in addition to the cost to financial institutions, to society in general.

Senator SHELBY. Absolutely.

Mr. PHIPPS. People who entered into the instruments based them on a couple assumptions: that prices would go up, that their income would go up, that they would be able to sell the house. So there were inherent assumptions. They acted in what I am going to describe as blind faith, but they acted with the best of intention.

That said, it is important that the housing that we put people in is affordable. It is funny——

Senator SHELBY. That is affordable for the people to pay and to own it.

Mr. PHIPPS. Right.

Senator SHELBY. If you cannot pay, you will never own anything, right?

Mr. PHIPPS. Correct. And if the mortgage instrument was so sophisticated that initially the payment was really low and then it had escalator clauses that it was not sustainable, then that was not a good instrument for the people to be in. So at the end of the day, there needs to be common sense. You need to figure out what you can afford, either buy or rent based on what you can afford, and not anticipate huge increases in salary, a huge increase in the market, *et cetera.* You need to be able to sustain the house. That is helpful.

Senator SHELBY. Doesn't that go back to basic, fundamental, sound underwriting standards for all of us?

Mr. PHIPPS. I think it does. The problem, Senator, is that the underwriting requirements now have become reactionary. They are overreactive. I spoke in Maine 2 weeks ago. You need to document all of the money that is gift money in the underwriting process. An agent came up to me from northern Maine and said, "Ron, you will not believe this." And I need to tell you, realtors are used to unbelievable stories about underwriting lately because every one of us has a lot of them. She said she was working with a first-time homebuyer. The first-time homebuyer was getting ready to close.

They had $6,000 available to put down on the transaction. The underwriter wanted to know where the money came from. They had just gotten married. There were 80 guests at the wedding. They were given $6,000 by the 80 guests. The underwriter wanted gift letters from the 80 guests.

Senator SHELBY. That is crazy.

Mr. PHIPPS. That is ridiculous. And what it causes us to do is be creative because what they did is they regifted the money back to the parents, and the parents both gave two gift letters. That is silly. We have lost common sense in the process.

Senator SHELBY. That is too much.

Dr. Brinkmann, do you have a comment on this?

Mr. BRINKMANN. Yes, I would say that sometimes when—the 50 letters perhaps is their interpretation of some new regulation or interpretation from whether it is Fannie, Freddie, FHA, because after the fact, if something goes wrong with that loan, they will come back to the lender and say, "Well, you did not have full documentation, and you have to buy it back." So there is a defensive——

Senator SHELBY. But that is a literal, strictly literal interpretation, is it not? And maybe more than that, if you can get more literal. OK.

Mr. Phipps, Mr. Crowe, and Dr. Brinkmann, all of you cited the unemployment rate, which we have talked about, as a major factor behind foreclosures in our troubled housing market and what it could do in the next quarter and the next quarter and the next quarter. This was also touched on by Secretary Donovan.

Given the importance in any economy, especially ours right now, of employment levels to the housing market, isn't it vital that Congress take up pro-growth economic initiatives designed to encourage businesses to expand and create jobs? We are talking about housing now. But housing creates a lot of jobs, too, and create jobs in particular. In other words, we are all concerned about the rising unemployment. I think if we have a recovery—we are always praying for one—that it will be probably a jobless recovery.

Do you agree, do all three of you agree that a robust job market is the best protection against foreclosures, that and good underwriting to begin with? Mr. Brinkmann.

Mr. BRINKMANN. I would say that absolutely, ultimately the solution is going to be with the growth of the jobs market, that a lot of these programs that we look at, we can shift some demand from the future to now to try and rebuild consumer confidence efforts. But when you look at the magnitude of the loans of the houses we have out there on the market now, the magnitude of the loans that are in serious delinquency right now and when those volumes come in, ultimately it is going to take a recovery in the economy. And what we have seen recession after recession is it is taking longer and longer for the jobs to recover after they get into that recession.

Mr. CROWE. I would just add to that, one of the benefits of this first-time homebuyer tax credit, and hopefully extended to all buyers, is more jobs. Not only does home building create jobs in the home-building industry, but it creates jobs in the manufacturing sector; it creates jobs in the mortgage banking sector and the real estate sector. All of those products that go into a house have to be made, and they are made somewhere across the entire country, so the job benefit actually spreads itself out much beyond wherever that home is located.

Mr. PHIPPS. Senator, the only thing that I would add is that in addition to good underwriting standards, we need to stabilize prices. The majority of the problems will go away if housing values——

Senator SHELBY. Wait a minute. You said stabilize prices. Doesn't the market basically stabilize prices?

Mr. PHIPPS. It would if there were not such impediments to the markets.

Senator SHELBY. OK.

Mr. PHIPPS. And we can talk about what those are, and I identified some in my testimony, but the underwriting requirements, the new appraisal requirements, those become impediments to price stabilization, the lack of response from short sales within 2 weeks.

Senator SHELBY. OK.

Mr. PHIPPS. Thank you.

Senator SHELBY. GSE reform, I talked about it earlier. Some of you were here. Dr. Brinkmann, in your testimony, you state that ambiguity surrounding the Federal Government's support for long-term securities issued by Fannie and Freddie, your words, "partially caused credit spreads to increase significantly earlier this year."

Does some uncertainty about the future of the GSEs—and there is uncertainty there—impact other segments of our financial markets and our national economy? And if so, does this mean that the GSE reform should be included as part of any financial regulatory reforms considered by Congress this year? In other words, I do not know—if we are going to get into regulatory reform, GSEs seem to be a central part of this for the long-term viability of our housing market.

Mr. BRINKMANN. Senator, I will answer the second part of your question first, is that we think it needs to be done. We think we have some good ideas. Clearly, I think it is an extremely complicated issue and our concern——

Senator SHELBY. Thank you very much.

Mr. BRINKMANN. ——to the extent it gets tied up with the rest of the regulatory reform. But as to how it fits itself into the work schedule and coverage. But we are here with an idea as to how it should be addressed.

In terms of what the ambiguity of failing to deal with this is that it continues to become expensive, because the uncertainties—if you look at the nature of the instruments that are sold, these are long-term nominal duration MBS of 30 years, even though the expected life is shorter than that, and then what is the actual extent of the support behind it? So investors are looking at that and saying, well, until there is some clarification, the days of the benefits of implicit guarantees are long gone.

Senator SHELBY. Sure.

Mr. BRINKMANN. The investors say, we have to know, is it there or is it not, and we are going to price accordingly, and I think the longer we go with this ambiguity, we are going to have problems.

Senator SHELBY. Certainty is always better than ambiguity, isn't it?

Mr. BRINKMANN. Yes, sir.

Senator SHELBY. Thank you, Mr. Chairman, for your indulgence.

Senator MERKLEY [presiding]. You bet.

I want to turn to Diane Randall and ask you to comment a little bit on how the changing tax credit market for affordable housing tax credits has impacted the ability to construct new units.

Ms. RANDALL. Thank you very much. I will refer to my experience on the Board of Directors for the Connecticut Housing Finance Authority, where we are the administrating agency for our State's allocation of low-income housing tax credits. As I referred to in my testimony, the support that Congress gave through the ARRA legislation to address the tax credit markets is incredibly important and valuable and has allowed us, in fact, to do a little bit more this year.

The challenge that we have, I think, with regard to—and again, as I said, every market is different. We find that our tax credits are doing a little bit better in the lower Fairfield County, closer to New York, the more rural counties, and as we try to do more housing using tax credits that is deeply targeted or housing that is serving a more vulnerable population, it is a much harder market to use.

We do think that it is very important that we continue to have a robust housing tax credit program, because at this point, it is really what I call the workhorse of affordable housing, multifamily development for low-income populations. So anything that we can do to assure that that is extended, I think is very important.

Senator MERKLEY. Am I right in thinking that the market for tax credits dropped by about 20 percent or something close to that?

Ms. RANDALL. I believe that is probably correct. I know that the raise on the tax credits has changed dramatically. At one point, I mean, even 2 years ago, we were getting almost a dollar for every tax credit. It has gone down in some places to below 70 cents, and that has been very difficult to do more of that. And I think the other opportunity here is the use of—we are looking in Connecticut at trying to use the 4 percent tax credits in conjunction with some of the tax-exempt bonds. But again, even using those two together still makes it challenging without some kind of subsidy to underwrite these deals, to preserve the existing affordable housing we have.

Senator MERKLEY. Let me turn to the Section 8 rental vouchers. I believe in your testimony, you called upon not only stabilizing the ones we have, but adding a couple hundred thousand more. How did you get to that number, or what is the number you are recommending, and what drives that vision for increasing Section 8?

Ms. RANDALL. Well, Section 8, as you know, has been an incredibly successful program in serving elderly people and people with disabilities and families who are vulnerable and who are very low-income, and I think the consensus of a number of national organizations who have worked on this is that just in terms of an absorption rate, we would like to see the program continue to grow, but you can't flood vouchers into a market. So there needs to be some process by which that happens.

One of the interesting conversations I was involved in just last week in Connecticut was about how to use more Housing Choice Vouchers to project base with particular development, so that it is both doing a development process in terms of multifamily and using it with some of the programs. For example, there was a question about whether Housing Choice Vouchers would be able to be used with a Neighborhood Stabilization Program to assure that the target of addressing some housing for people who are homeless could be met. Again, in our State, without a Project-Based Voucher, it is extremely difficult to create a rental unit for a family below 30 percent of area median income.

Senator MERKLEY. Mr. Phipps, I wanted to turn to you. You had made comments about the appraising process and the troubles that that has created. I believe Secretary Donovan mentioned earlier that the Administration is issuing a new set of rules. Have you had a chance to look at the Administration's adjustments and will those address the issues you are concerned about?

Mr. PHIPPS. Senator, I would preface this conversation by saying my grandfather was an appraiser, my mother was an appraiser, and my wife is an appraiser, so while I may not be as intimately familiar with them as I should be, I assure you that the people involved with me remind me regularly.

We believe that what Chairman Donovan identified goes the direction. The practical application in the field right now, it is still just not working, and between the AMCs—frankly, the appraisals themselves are fine. It is what happens to them when they are in the system. We have underwriters, credit managers, and people then reviewing the appraisers and going back to the appraisers and saying, why did you use this appraisal? Why didn't you do that one?

Sally Corbin, one of my competitors in East Greenwich, had an appraisal last week. They had three offers on a house on Hemlock Drive, three offers, all within $2,000 of price. The appraisal came through. The appraisal came in $400,000 and the transaction fell apart. The reason wasn't that the appraiser wasn't directed. The appraiser had influence saying this is still a distressed market. So we are dealing with what distressed means in terms of an application for value.

We are looking at lots of problems with the AMCs. There is just—I would be delighted to provide lots of specific case studies for you and lots of documentation, but it is aggravating and further deteriorating value, because people are willing, ready, and able, and qualified to buy the houses and the appraisal comes back below value.

Senator MERKLEY. Thank you very much. I would certainly be interested in seeing the additional material you are referring to. That would be very helpful.

Senator Bunning.

Senator BUNNING. Thank you. Mr. Phipps, Mr. Brinkmann, Mr. Crowe, your organizations all were flying very high—very, very high, in fact—the Homebuilders, 1.8 million units, the Mortgage Bankers Association were thriving with their newly acquired credit and away they wrote mortgages, and the Realtors were selling houses so fast, they couldn't keep up with them. Now, somewhere along the line, we hit a big snag, and I want to start with Mr. Brinkmann.

Since low downpayment mortgages have performed very poorly and the housing bubble was inflated by purchases by those who had little or no money down to buy homes they couldn't afford when they should have been renting, what do you think is an appropriate downpayment going forward?

Mr. BRINKMANN. Senator, downpayment, of course, is one of the factors that is considered, so you would also have to look at, well, what is the income relative to——

Senator BUNNING. Well, I think——

Mr. BRINKMANN. ——so a newly minted——

Senator BUNNING. Let us assume all others. In other words, I am trying to get to the basis by which you sell a house or the basis by which a house is sold, or the basis on putting Mr. Crowe back in business again so he can build some houses. So what do you think, a 30-year mortgage—when I bought my first house, it was 30 percent. You had to have 30 percent down and then I could get a 30-year mortgage at 5¼ percent. That is a long time ago. I can get the same mortgage right now, going through a lot of rigmarole, with 4.7 percent for a 30-year mortgage, 4.75, maybe. So what do you think is appropriate?

Mr. BRINKMANN. Senator, my background before this was actually in credit modeling.

Senator BUNNING. OK.

Mr. BRINKMANN. One of the factors that we would see was that downpayment was important once a loan then went into default, but the key driver of putting that loan in default was a loss of income, so that it offers protection to the lender. It is important, but there have been successful low downpayment mortgages out there.

I think when we look at what caused ultimate problems of the past, it was not necessarily just the low downpayment or people that literally had zero in the house. That was the problem, that they were expected to put up something. But it was also the misstatement of income, the either lack of understanding of——

Senator BUNNING. It took me 26 pages worth of paperwork to get a mortgage.

Mr. BRINKMANN. And how that is——

Senator BUNNING. That wasn't enough——

Mr. BRINKMANN. ——the borrower, whether or not that borrower knew or didn't know that if they continued to make this minimum payment every single month, they were digging themselves into a hole that they may not be able to get out of——

Senator BUNNING. Right. That is because they didn't put enough money down on the house and the house devalued by 30 percent. I mean, those were things I don't think you or you or you or anybody in this room anticipated. So you are telling me that I should have anticipated it, or you should have?

Mr. BRINKMANN. There were a number of things that I think I should have anticipated, I think the industry should have anticipated, and I think the breakdown that we saw was that some of these loan types, whether it is low documentation, whether——

Senator BUNNING. All of the above.

Mr. BRINKMANN. ——all the various things worked for a small sliver of borrowers. But there was a breakdown of sort of the macro credit view of how much were these kinds of loans driving the entire market and what was going to happen when the——

Senator BUNNING. And the collateral——

Mr. BRINKMANN. ——and what——

Senator BUNNING. When they collateralized the loans——

Mr. BRINKMANN. When they——

Senator BUNNING. ——it just added, too. Nobody knew who owned the loan.

Mr. Phipps, what do you suggest to restart the private secondary mortgage market without guaranteed Government guarantees?

Mr. PHIPPS. Senator, we have a group of Realtors and economists actually meeting later this week here in D.C. to identify choices. We believe that a sustainable source for mortgages needs to be identified. The current situation is challenging, and as a result, we are actively engaged in identifying what those other alternatives are. Literally this week, I think Wednesday and Thursday of this week——

Senator BUNNING. It sounds like Mr. Donovan's explanation about the new proposed legislation that they didn't know was going to expire by November 30. I don't think that is a very good answer.

Mr. PHIPPS. Actually, Senator, the group has been meeting for almost a year at this point and we are meeting again. We are trying to come up with some specific recommendations, and we have identified and articulated principles that we can provide you with copies of as to what we——

Senator BUNNING. I would appreciate that very much.

Mr. PHIPPS. Thank you.

Senator BUNNING. Mr. Crowe, when will the housing market be able to stand on its own without Government subsidies?

Mr. CROWE. When the consumer decides to come back into the marketplace, Senator.

Senator BUNNING. When will that be?

Mr. CROWE. I don't think we will be back to what I would consider to be full equilibrium until——

Senator BUNNING. When are we going to build 8,800,000 homes again?

Mr. CROWE. Late 2012.

Senator BUNNING. Late 2012. And what will the unemployment rate in the United States be by that time?

Mr. CROWE. It may take that long before it is back down to what we would consider——

Senator BUNNING. We are at 11-and-a-half percent in Kentucky going to 13. Michigan is at 15 percent going higher. The United States is at 9.7 going to ten. When will it all stop?

Mr. CROWE. That is why it will take so long for the housing recovery to occur, because we don't——

Senator BUNNING. In other words, the Government subsidies are going to have to continue until that time?

Mr. CROWE. No, I didn't say that.

Senator BUNNING. Well, that is the question I asked.

Mr. CROWE. No. We are asking for a 1-year extension. We feel like that is enough to get the ball rolling, to get the buyer back in the market——

Senator BUNNING. Until the end of 2010?

Mr. CROWE. To the same date, 2010, until December 1, 2010.

Senator BUNNING. That is all I have for now. Thank you.

Senator MERKLEY. Thank you very much, Senator.

Before we shut down the hearing, I wanted to ask a question, Mr. Brinkmann, in regard to your testimony about the mortgage credit guarantee entities. As I understand it, you are presenting that as the replacement for the GSEs, and as I was reading your testimony, I wondered how many of these entities you envision, whether it is two or is it 25, and also, you note that they should be implicitly or explicitly—the acquisitions should be, or the securities should be guaranteed by the Federal Government. Can you just address whether that doesn't just put us back in the same place we were in terms of the type of risks that might be taken by the entities?

Mr. BRINKMANN. Yes, sir. I think the key differences are, first of all, in terms of how many. Two is too few. Twenty-five is probably too many. Our vision is for a sufficient number so that no one of which is too big to fail, that if there is too much credit risk taken, the others can step in, absorb what is lost without creating systemic risks to the economy.

The other issue is toward what is exactly guaranteed in this. We think that certainly the equity, but also any of the debt sold by these entities would be explicitly not guaranteed by the Government, that the nature of the Government guarantee be made explicit. It would only be for the MBSs that were issued, and it would be very much a backstop to other forms of covering these losses, so that if a loss occurred, you would first go back to the equity in the institution, you would go back to any risk sharing arrangements that existed with the lenders, you would go back to the insurance pool that would be established, and only in the event that you actually ate through all those other sort of private label layers would then the Federal support come in.

Would Federal support have been my first choice in a structure like this, and I would have to say no. I would prefer to actually have tried to think of a model that excluded it. The problem is, the reality in the international markets today is that if we would need to attract the capital internationally that is going to be needed to support the housing market in the U.S. as we had in the past, they are looking at, OK, is the Government standing behind it, because are they providing adequate and sufficient regulation of these entities to ensure us that if something goes wrong, then ultimately it is the U.S. Government that is on the hook and not us.

Senator MERKLEY. So to restate that and make sure I understand your point, you are saying, rather than have an implicit guarantee, it is better to make it explicit that such a guarantee is essential to the acquisition of the appropriate levels of international capital and it should be explicitly structured in a fashion in which investors know that they are on the hook first?

Mr. BRINKMANN. Yes, sir, and I would add to that and explicitly paid for, that this would not be a free good, but that it would be something that these entities would pay for, for the guarantee as well as paying into the fund and——

Senator MERKLEY. Premium penalties——

Mr. BRINKMANN. Yes, sir.

Senator MERKLEY. ——or premium fees. Well, thank you very much, and thank you to all of the witnesses for your presentations. We appreciate it a great deal.

The record will remain open for a couple of days for Members to provide questions for the record and for you all to have a chance to provide responses.

The hearing is hereby adjourned.

[Whereupon, at 12:22 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR JACK REED

Thank you, Mr. Chairman, for convening this important hearing. We know that the housing market lies at the core of the current economic crisis. If we want to stabilize the economy, we must be sure we also address the root of the problem.

Of utmost importance is the current foreclosure crisis. After the Bush administration's failure to respond to the burgeoning crisis, the Obama administration's Making Home Affordable program was a step forward. Seventy-eight percent of loan modifications tracked by the second quarter Mortgage Metrics Report led to reduced payments for homeowners, up from 54 percent.

However, we must do more and move aggressively to ensure that qualified homeowners get access to existing initiatives. I still hear troubling reports from Rhode Islanders of long waits and unnecessary obstacles to obtaining loan modifications. Consumer advocates have also reported examples of homeowners being offered modifications that don't comply with the Home Affordable program and homeowners being denied a modification without clear justification. The process can and should be more transparent.

There are other signs that we must do more. Realty Trac reports that foreclosure actions are still on the rise. Job losses will likely only drive those numbers up—even among well underwritten loans. Indeed, in the second quarter, foreclosures for prime mortgages continued to outpace efforts to help families remain in their homes. With unemployment at an alarming 13 percent in Rhode Island and rising across the Nation, the issue of how we help unemployed homeowners is of growing importance. The Preserving Homes and Communities Act, which I recently offered along with my colleagues Senators Durbin, Merkley, and Whitehouse, includes a plan to help homeowners experiencing a temporary loss of income remain in their homes. This is an issue that needs to be addressed.

In addition to the problems in the commercial real estate market, it is also reported that a wave of option adjustable rate mortgages will reset in the next 4 years. One estimate puts the number of mortgages in question at one million. Already, 10 percent of payment option ARMS are in the process of foreclosure, three times the 2.9 percent rate for all mortgages. We need to ensure we are moving into action to respond and prevent future crises.

Recent reports point to modest signs of improvement in the overall housing market. Nationally, prices in the second quarter showed the first quarterly increase in 3 years. The Mortgage Bankers Association projects home sales will rise in 2010. However, many of these transactions are foreclosures or short sales. Higher priced homes are moving more slowly, and there's still a significant inventory. And it's unclear how many homes in the foreclosure process will eventually be on the market.

Stabilizing the housing market is the key to economic recovery, and we must continue to use all of the tools at our disposal to ensure that homeowners get the relief that they need. Furthermore, we have to be vigilant in anticipating—and preparing for—the other challenges that await.

I also want to welcome Ron Phipps of Rhode Island who will testify at today's hearings not just about my State's problems but the range of issues facing our housing sector. I know that Ron's testimony will help ensure that this Committee hears from the frontlines of the foreclosure crisis.

PREPARED STATEMENT OF JOHNNY ISAKSON, A U.S. SENATOR FROM THE STATE OF GEORGIA

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, I appreciate the invitation to speak this morning on the state of the housing market in America.

I began my career in residential real estate in 1967 as a real estate agent specializing in FHA and VA home sales with an average price of $17,900. In 1968, I experienced the first of four housing recessions I would face during my 33 years in the business. That first housing recession was brought on by the failed FHA 235 no-down-payment program.

In 1974, I was a branch office manager for Northside Realty in Atlanta when our country experienced what at the time was the worst housing recession our Nation had ever faced. That recession ended in 1976 after Congress passed a $2,000 income tax credit for the purchase of a single family home in 1975. That tax credit effectively reduced a standing vacant 3-year supply of housing to less than a 1-year supply.

In 1981, I was President of Northside Realty, and experienced my third housing recession. Interest rates rose to 16.5 percent, and for the first time ever lenders made negative amortization loans to make monthly payments affordable.

In the late 1980s, the savings and loan crisis caused institutional failures across the Nation, and the Resolution Trust Corporation was created. This brought on the housing recession of 1990–91, and mortgage-backed securities became the primary source of capital to fund residential conventional loans. This is when Freddie Mac and Fannie Mae became dominant in housing finance.

In 1995, I was asked to serve on the advisory board of Fannie Mae. In 1999, I was elected to Congress and stepped down as President of Northside Realty, which had grown into a residential brokerage company with 1,000 agents, 25 offices, 11,000 annual home sales and volume exceeding $2 billion dollars.

During my 33-year career in real estate, I experienced many challenges and difficult markets, but never anything like the current housing market in America. Our Nation is facing a total collapse of new residential construction and development. This fact, combined with the highest sustained foreclosure rate since the Great Depression, also has placed our community banking system under enormous stress.

America's families have lost trillions of dollars in home equity as home values have fallen, and in some markets, continue to fall today. Second only to unemployment, this fact has the single greatest impact on consumer confidence. In my home town of Atlanta, home values have declined 10 to 40 percent, depending on the neighborhood or the county.

While the current crisis began with the failure of subprime mortgages, today it continues with the failure of loans that a year ago were performing quality assets. Why is this happening, you might ask? In part because of rising unemployment, but more because as values decline below the mortgage balance owed the positive incentives of home ownership vanish. Historically, foreclosures on residential home mortgages were rare because families would do anything to protect their home and their equity. But when the equity disappears and the prospected for recovery are bleak, the incentives are gone.

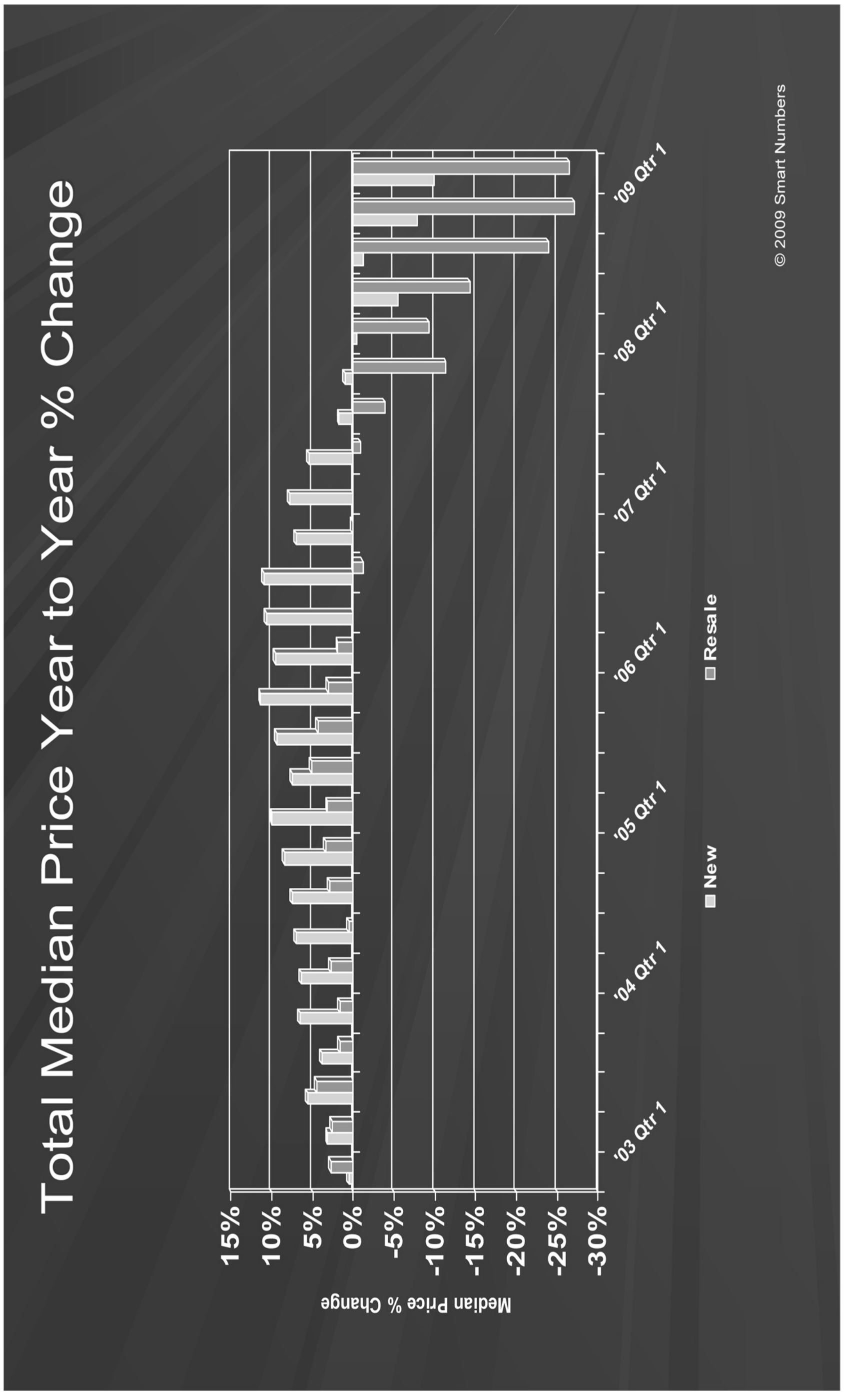
That, Mr. Chairman, is the problem America faces today. I am frequently asked by my constituents back home, “When do you think housing will recover?” My answer is reluctantly, “Without some policy changes in Washington, 5 years or more.”

There are two actions we can take now that will make a positive difference in the rate of recovery of America's housing market. The first is to extend the existing homebuyer tax credit that expires on November 30th, and to make it available to all buyers who purchase a home for their principle residence and whose joint income is $300,000 or less. In my opinion, the extension should be through June 30, 2010. I believe this will provide the stabilization necessary for home values to begin to return. Most importantly, it will thaw the current freeze in the move-up market, which must recover if we are to return to a viable market.

Second, I believe the FDIC must revisit its Draconian interpretation of mark-to-market rules in terms of real estate development loans and other similar assets. It also should look to its real estate development borrowers not as liabilities but as potential partners. Sure, some of these real estate loans are bad and losses should be recognized, but many of these loans could be worked out over time, benefiting the bank and the developer. By the way, this was what happened in 1975. Combined with the housing tax credit, these two actions brought America's housing market back from disaster.

Mr. Chairman, prior to this current recession, I had lived through four major housing recessions and four recoveries. History is always a good teacher. America should repeat that which worked and remember that which didn't.

Thank you.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Median Price % Change
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New
Resale
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Clayton County
FORECLOSURE
Sold 4/22/2009 $136,500
Lake Spivey
Country Club
Property History
Home sold new in 1993 for $216,000
Sold 6/24/2005 for $343,000
Sold 9/22/2005 for $440,000
Sold 1/12/2006 for $480,000
Listed 11/6/2007 $334,400
Reduced to $274,900
Expired 11/30/2008
Re-listed after foreclosure at $251,900
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Total Days on Market
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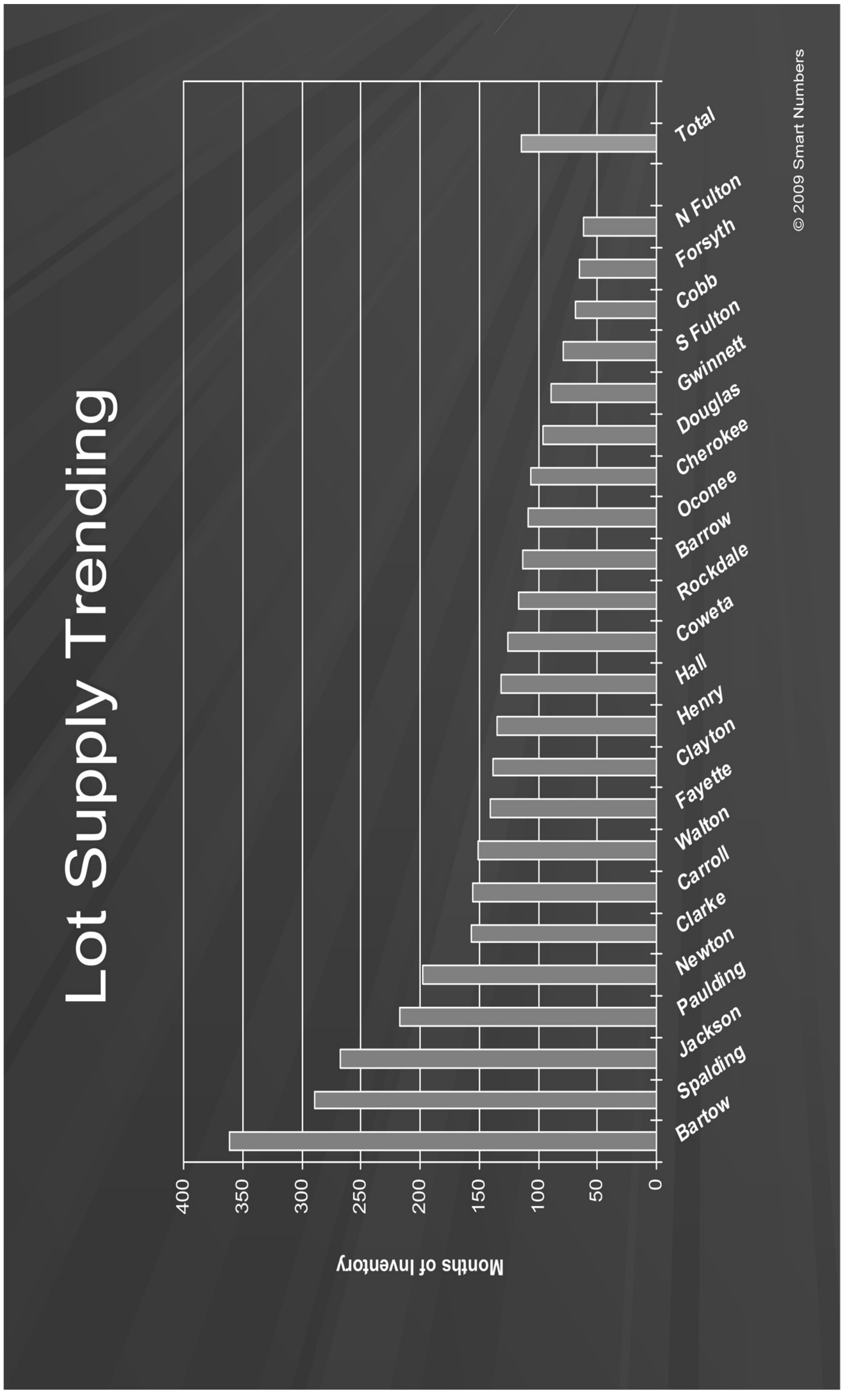
Lot Supply Trending
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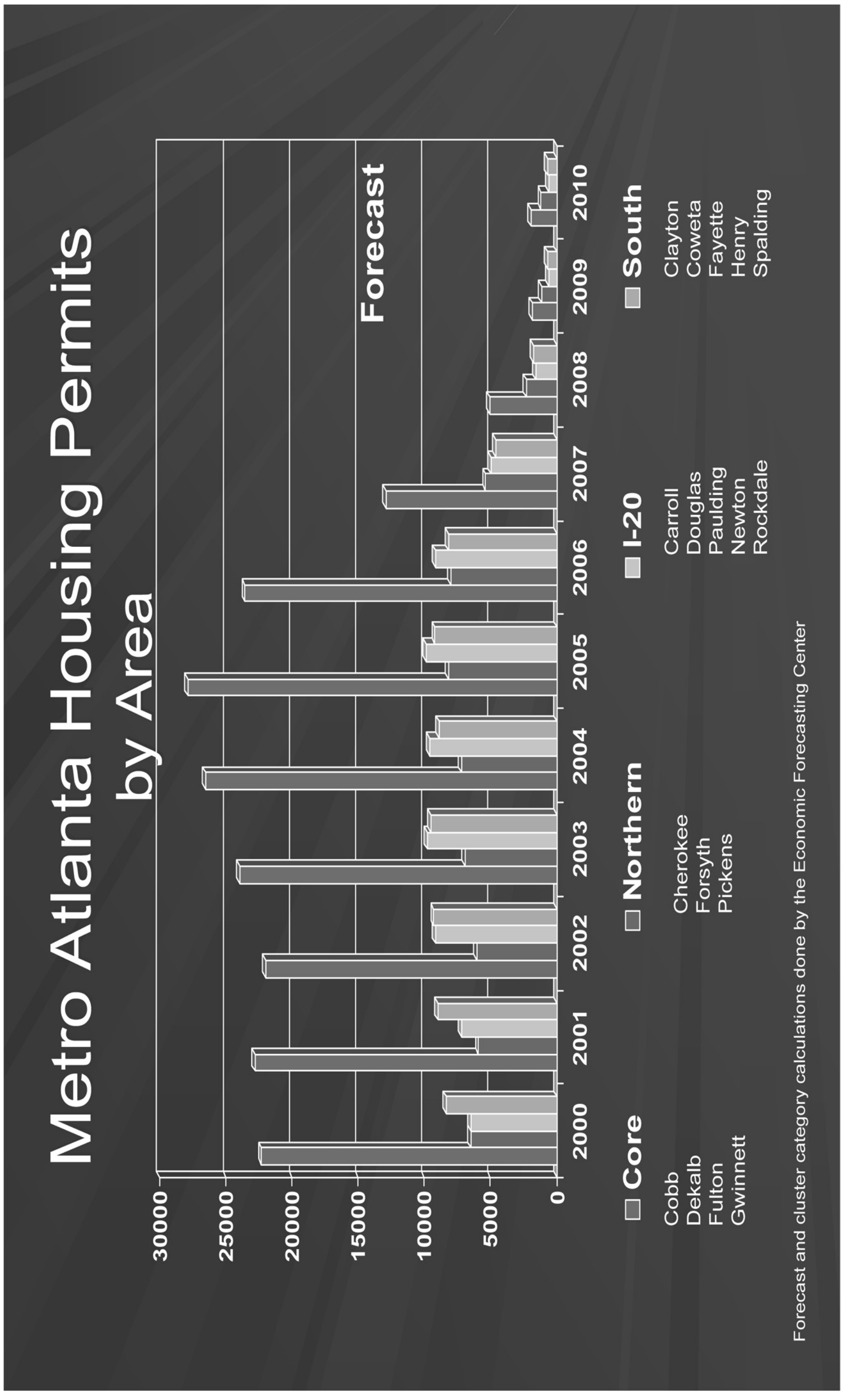
Metro Atlanta Housing Permits
by Area
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20000
15000
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2010
Forecast
Core
Cobb
Dekalb
Fulton
Gwinnett
Northern
Cherokee
Forsyth
Pickens
I-20
Carroll
Douglas
Paulding
Newton
Rockdale
South
Clayton
Coweta
Fayette
Henry
Spalding
Forecast and cluster category calculations done by the Economic Forecasting Center

PREPARED STATEMENT OF SHAUN DONOVAN

SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OCTOBER 20, 2009

Good morning, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for the opportunity to testify at today's hearing on the state of the U.S. housing market and the progress the Obama administration is making to stabilize it, as well as other Administration efforts to provide relief to homeowners and neighborhoods suffering from the affects of the foreclosure crisis.

Today, I would like to summarize the conditions of the housing market and discuss how our efforts—particularly Making Home Affordable (MHA)—are impacting the market, as well as outline the essential role the Federal Housing Administration (FHA) plays in ensuring the viability of our housing market and some of the steps we are taking to shore up its fiscal health for the long-term.

Housing Market Conditions

Certainly we meet at an important moment, as indicators continue to show signs that the housing market is stabilizing. In September, according to RealtyTrac, foreclosure activity fell for the second straight month, by 4 percent. Nationally, home price indexes have been on the rise for the past several months, as reflected in 18 of the 20 metropolitan markets covered by the Case-Shiller index. Inventories of unsold homes remain at high levels, but have been receding. In selected markets, realtors now report that many homes are selling for more than their asking price and new home sales are at their highest level since September 2008.

However, with the rental market showing increasing signs of distress, it is clear these numbers do not tell the whole story. Delinquency rates on multifamily property mortgages have moved up sharply since mid-2008, while property values continue to fall. Nationwide, in the second quarter of 2009 vacancy rates for rental properties rose to nearly 10 percent. This softness was sparked in part by an influx of new supply arising from the conversion of condominiums into rental properties and home foreclosures adding to the available housing stock, and it continues today as multifamily housing and other commercial real estate are among America's weakest market sectors.

This is a source of considerable concern at HUD, as growing vacancies and increasing delinquencies threaten not only the families and neighborhoods who live in these properties but also the lending institutions, particularly smaller regional and community banks, that have financed them and on whom these communities depend.

Further, this softness doesn't necessarily mean that housing is more affordable at the low end of the economic spectrum where recent hits to income have been the biggest. Indeed, the number of people facing high rental cost burdens remain extremely high in light of weaker incomes and higher rents due to increasing demand for the most affordable housing. In fact, the number of families earning between and $20,000 and $50,000 who now pay more than a third of their income for housing has increased by 20 percent in just the last 3 years. So, it's clear that the need for rental assistance for the most vulnerable families continues.

The connection of these indicators to what we're seeing in our overall economy is clear. The annual rate of real growth in the economy during the second quarter of this year was a decline of 0.7 percent—a significant improvement from the first quarter, when real GDP decreased 6.4 percent. Decreasing investment in residential construction reduced overall GDP growth by 0.67 percentage points compared to a reduction of 1.33 percentage points in the first quarter of 2009. What that means is that as the housing sector has begun to stabilize, our economy has as well—but we still want to see more progress from both.

That is why the Recovery Act is so important. Slowing the rise of unemployment—a leading cause of foreclosures—and creating jobs is critical to helping stabilize the single-family market, helping families meet their mortgage payments, and stimulating home sales. But it's also important to families at the lower end of the economic spectrum where the unemployment rate remains extremely high—according to the Current Population Survey, more than double what it is for upper income families, at least partially offsetting any gains these families might have realized by the softer market.

Making Home Affordable: Progress to Date

Mr. Chairman, from its first day in office, the Obama administration has made stabilizing our housing markets a top priority, with a particular focus on preventing foreclosures and mitigating the impact that foreclosed and abandoned properties have on neighborhoods, communities and the broader economy. Working with the

White House, Treasury Department, and other key Administration agencies, HUD has played a central role in these efforts.

One result of the comprehensive approach the Administration has taken is that interest rates have hovered around or below 5 percent for 6 months—allowing first-time homebuyers to enter the market and helping some 3 million homeowners refinance, putting as much as $10 billion of purchasing power in the hands of American households annually. For a family in a median-price house of $200,000, an interest rate saving of one percent on a 30-year mortgage rate saves that family $1,200 a year. That's money that goes to homeowners all over the country.

At the center of the Administration's response to the housing crisis is the Making Home Affordable Program, a comprehensive program to stabilize the housing markets by providing affordable refinance and modification opportunities for at-risk borrowers. The initiative includes the following two key components:

1. *The Home Affordable Modification Program (HAMP):* HAMP is providing up to $75 billion dollars, including $50 billion of funds from the Troubled Assets Relief Program (TARP), to encourage loan modifications that will provide sustainable, affordable mortgage payments for borrowers. Importantly, HAMP offers incentives to investors, lenders, servicers, and homeowners to encourage mortgage modifications.
2. *The Home Affordable Refinance Program (HARP):* HARP expands access to refinancing for families whose homes have lost value and whose mortgage payments can be reduced at today's low interest rates. It helps to address the problems faced by homeowners who made what seemed like conservative financial decisions 3, 4, or 5 years ago, but who have found themselves unable to benefit from the low interest rates available today because the value of their homes have declined below that of their existing mortgages.

MHA has achieved clear success in a relatively short time period and there are indications that the housing market is stabilizing. Since the launch of the program in March, [64] servicers—representing more than 85 percent of the market—have signed contracts with the Administration. On October 8th, the Administration announced that servicers had exceeded the goal of beginning 500,000 trial modifications by November 1, nearly a month ahead of schedule. Moreover, the monthly pace of trial modification are now exceeding the monthly pace of complete foreclosures which indicates that we've reached a turning point in our modification efforts.

This program is not only the largest single program of its kind, but unlike many previous loan modification efforts, the MHA program generates true affordability by ensuring that participating homeowners pay just 31 percent of their monthly income towards mortgage expenses.

In addition, since February there have been more than 3 million home loans refinanced, both as part of the HARP and more broadly as a result of historically low interest rates. By extending the HARP program to individuals with up to 125 percent loan-to-value (LTV) ratio, we assist underwater borrowers who were previously unable to take advantage of the refinancing program, particularly in areas of the country that have seen larger than average drops in home prices.

In addition to these MHA programs, earlier this year the Administration supported low mortgage rates more generally by increasing support for the Government-Sponsored Enterprises (GSEs), Fannie Mae, and Freddie Mac, through an expansion of Treasury's Preferred Stock Purchase Agreements with the GSEs. To this effect, under HERA authority, we have committed up to an additional $200 billion in support to the GSEs, and Treasury has purchased over $200 billion in Agency securities on the open market.

Improving Servicer Accountability, Transparency, and Responsiveness

Despite the significant progress under MHA, we recognize that more needs to be done to improve the responsiveness and accountability of servicers participating in the program so that additional homeowners facing, or at risk of, foreclosure are contacted and assisted in a timely manner. As the Chairman is well aware, many borrowers who are interested in modifying or refinancing their mortgages under MHA have experienced difficulties in contacting the servicers of their loans or obtaining information from the servicers. Others, having made contact with servicers, have found it difficult to shepherd their applications through the process, with instances of lost application materials, changing personnel and delays in response times.

Indeed, HUD has played a lead role in pressing the servicers to do more. We have put pressure on servicers to ramp up their efforts. For instance, Treasury Secretary Geithner and I sent a strong letter to the CEOs of all participating servicers on July 9, calling upon them to devote more resources to the program, and requiring each servicing entity to designate a senior official to serve as a liaison with the Administration and work directly with HUD and Treasury on implementation of all aspects of MHA.

At a meeting on July 28, servicers committed to significantly increase the rate at which they were performing loan modification and agreed to the set a goal of beginning 500,000 trial modifications by November.

On October 8th, Administration officials and servicer CEOs met to assess the progress under MHA and discuss improving servicer efficiency and responsiveness to borrowers during the modification process. The discussion also included working with servicers to set more exacting operational metrics to measure the performance of servicers, including evaluating the time between applying for a modification and receiving a final decision and average time to pick up incoming borrower calls. The HAMP guidelines require all borrowers to be screened for HAMP eligibility prior to any foreclosure sale. If a consumer is deemed eligible for HAMP, the servicers have agreed to explore mechanisms for reducing foreclosure fees that accrue during the foreclosure process.

We have made significant progress in reaching implementation objectives outlined during our July 28 meeting, including:

- Administration began publicly reporting servicer-specific performance under the program on August 4. While this data shows a wide range in servicer performance, we are already seeing evidence that the "peer pressure" being created by a publicly available scorecard has motivated servicers to ramp up their efforts.
- Administration will require servicers to report on more exacting operational metrics to measure the performance of the program.
- On July 28, the Administration asked Freddie Mac, in its role as compliance agent, to develop a "second look" process pursuant to which Freddie Mac will audit a sample of MHA modification applications that have been declined. This "second look" process began on August 3, and is designed to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification. In addition, the program is examining servicer nonperforming loan (NPL) portfolios to identify eligible borrowers that should have been solicited for a modification, but were not.

MHA Program Improvements

As always, we are committed to improving MHA performance—by ensuring homeowners have the information they need and that servicers have the tools and resources they need to process applications and make these modifications permanent.

On October 8, the Administration announced the issuance of a new Supplemental Directive on streamlining MHA application documents which provides another resource to make process easier and more straightforward for borrowers. The Directive: (i) creates a standard HAMP Request for Modification and Affidavit form that incorporates borrower income and expense information, the existing Hardship Affidavit and portions of the existing Trial Period Plan, (ii) updates and simplifies income documentation and verification requirements, (iii) allows for the conversion of the current trial period plan to a notice that does not require a borrower signature, and (iv) standardizes borrower response timeframes applicable to completed HAMP requests. Pursuant to the supplemental directive, within 10 days of receipt of financial information verbally or in a completed Request for Modification Affidavit, the servicer must acknowledge the borrower's request for HAMP participation in writing. And within 30 calendar days following the servicer's receipt of all required documentation, the servicer must complete its evaluation of borrower eligibility and notify the borrower of its determination in writing.

The Administration is developing an application portal through the MakingHomeAffordable.gov Web site. Over the coming weeks, borrowers will be able to find all the necessary resources to complete a HAMP application, and eventually they will be able to apply on line through the Web site, and check the status of their applications. Borrowers will soon be able to obtain all application forms from the Web site so that they can be sure they are providing the servicer with the required documentation. Soon thereafter, borrowers will be able fill out application documents on line, and submit applications to their servicers via e-mail. Eventually borrowers will be able to obtain ongoing information about application status until the modification is approved or denied. The standardized nature of the portal will help to provide a clearer, more consistent format for processing borrowers and help to successfully move more loans from trial to official modification status.

The Administration understands the concern that many consumers and counselors are not given adequate reasons for rejection from the program. As a result, we have established denial codes that will require servicers to report the reason for modification denials in writing, both to Treasury and to borrowers. Servicers will be required to send borrowers denial letters containing the reason that the modification was not approved in plain language. Moreover, in the denial letters, borrowers will be provided with a phone number to contact their servicer in order to obtain additional details about the inputs used in making the modification decision. This will give borrowers an opportunity to call and verify that that servicers evaluated their application based on accurate and correct information.

Reaching Troubled Borrowers

We have launched a consumer focused Web site, *www.MakingHomeAffordable.gov,* with self-assessment tools for borrowers to evaluate potential eligibility in the MHA program. This Web site is in both English and Spanish and has had well over 34 million page views.

We have worked with an interagency team to establish a call center for borrowers to reach HUD approved housing counselors, so that they are able to receive direct information and assistance in applying for the HAMP program.

Working closely with Fannie Mae, we have launched an effort to hold foreclosure prevention workshops and borrower outreach events in cities facing high foreclosure rates across the country. These foreclosure prevention events include counselor training forums where representatives from Treasury, Fannie Mae, HUD, and other agencies provide information and training to local housing counselors and nonprofit groups, leveraging local resources to expand the reach of the HAMP program. We had visited 10 hard hit markets by October 1, and will continue our outreach efforts throughout the fall and the year to come.

HAMP has made significant progress in reaching borrowers at risk of foreclosure. However, much more remains to be done and we will continue to work with other agencies, regulators and the private sector to reach as many families as possible.

FHA: Essential to the Viability of our Housing Markets

At the same time MHA has helped 500,000 families keep their homes, FHA has protected many more homeowners from foreclosure through its loss mitigation programs. Indeed, last year, more than 500,000 families were assisted through forbearance, partial claim, loan modification, preforeclosure sale, and deed-in-lieu of foreclosure among others. That's in part because servicers of FHA-insured loans are required to notify delinquent homeowners about the options available to help them make their monthly payments and take such steps before initiating foreclosure proceedings. As a result, we expect as many as a half million families will be assisted in 2009 through benefits provided by FHA insurance, bringing the total number of homeowners assisted by FHA to over a million.

In addition, FHA is playing a critical role in the housing market and our economy right now—insuring a third of the home-purchase mortgage market and 80 percent of its purchase loans are for first-time homebuyers. But as this Committee knows, an independent actuarial review is expected to predict that FHA's capital reserve ratio will fall below 2 percent.

Based on current projections and absent any catastrophic home price decline, FHA will not need to ask Congress and the American taxpayer for extraordinary assistance—there is no need for any "bailout." Combined, FHA's Reserve Receipt Account and Mutual Mortgage Insurance Fund hold more than $30 billion in cash reserves.

However, in light of the severe decline in house prices, overall performance of the economy, and future housing price projections, FHA expects higher net losses than previously estimated on outstanding loan guarantees which, combined with stresses accounted for in prior reviews, will drive the ratio below 2 percent.

I should note, however, that the independent actuary expects this drop in the capital reserve ratio to be temporary—and to return above 2 percent within the next 2 to 3 years, even if FHA were to make no policy changes at all. That's because FHA stuck to the basics during the housing boom: 30-year, fixed rate traditional loan products with standard underwriting requirements. It only insures owner-occupied residences and has never insured exotic subprime, Alt-A, or "no-doc" mortgages. It's precisely this responsible approach that has allowed FHA to limit losses during this economic crisis and fulfill its mission of providing safe opportunities for home ownership to those who can afford a home.

Still, we are committed to ensuring the agency takes every step possible to remain financially healthy for the long-term—improving portfolio analysis and management, tightening risk controls, and overhauling targeting and monitoring practices. Indeed, FHA has made more significant credit policy changes in the past few months than FHA has in decades, bringing on new leadership with broader and deeper knowledge and skills and is in the process of hiring a Chief Risk Officer.

And with Congress's help, we are working to modernize FHA's information technology systems, so that it can develop a set of commonly used fraud detection tools and a fully automated underwriting system that helps us focus our attention on the loan files that are most likely to contain serious deficiencies.

Announcements—HFA Assistance and Hope for Homeowners Guidance

While there can be no doubt that the housing market is on the mend, work still remains to build on this initial promise.

I am announcing that that the Administration is providing critically needed assistance to State and local housing finance agencies (HFA's) and their efforts to aid distressed homeowners, stimulate first-time home-buying, and provide affordable rental homes. Since HFAs are key players in making home ownership possible for hardworking families who otherwise would not be able to buy or remain in their homes, this initiative is a logical part of the Administration's overall support for the housing market, which has included the First-Time Homebuyer Tax Credit, and our support for low interest rates and liquidity through the FHA and the GSEs. The two initiatives are designed to address challenges facing HFAs, including lack of Financing for New HFA Housing Bond Issuance and lack of Liquidity to Support State HFA Variable Rate Debt Obligations.

HFAs are located in all 50 States and have been reliable sources of flexible, affordable mortgage money for lower-income first-time home buyers. HFAs have made approximately 3 million families first-time homeowners, and add another 100,000 families each year. HFAs also play a key role in HUD's efforts to promote expanded access to affordable rental housing through the HOME Investment Partnerships Program, Section 8, and the Low Income Housing Tax Credit. HFAs and their partners have produced nearly 2 million affordable rental homes, financing an additional million affordable rental homes with Housing Bonds. At a time when we need it most, HFAs add another 150,000 homes to our country's affordable rental housing inventory each year.

In light of their strong track record and considerable capacity, last year under the Housing and Economic Recovery Act (HERA), Congress allowed HFA to refinance loans and provided HFAs with $11 billion in new Housing Bond authority, to be available through 2010 to finance affordable single-family and multifamily mortgages. Unfortunately, HFAs have not been able to translate these additional resources into expanded housing opportunities in this time of expanded housing need. The health and viability of many HFAs have been jeopardized by the economic crisis. State and local HFAs have experienced a number of challenges, including: a lack of liquidity support, credit and cash flow concerns, and an inability to issue new bonds to fund single- and multifamily loans even though the bond cap was increased.

Given the critical role HFAs play, the Administration, together with the Federal Housing Finance Agency (FHFA), Fannie Mae, and Freddie Mac, has developed a set of programs to maintain the viability of HFA lending programs infrastructure. The new HFA initiative includes both a New Issue Bond Program (NIBP) and a Temporary Credit and Liquidity Facility (TCLF) Program for existing bonds. These programs will generally be available to all HFAs who meet eligibility criteria. To minimize cost to the taxpayer, the HFA initiative includes a range of risk sharing features and a pricing structure that encourages HFAs to find alternative private market solutions as soon as possible.

I am also announcing that we have finalized the Hope for Homeowners (H4H) program guidance which provides instructions to lenders about the program. In keeping with changes made by Congress in the "Helping Families Save Their Homes Act of 2009," this is a critical first step toward revamping an important component of the Administration's plan to stabilize the housing markets—providing an additional option to underwater distressed borrowers seeking to save their homes and preserve equity through principal write-down and refinance. As the program goes online, we will closely monitor its progress and continue working with Congress to ensure its success going forward.

In addition, I am also aware of the strong support in Congress for doing more to support the housing market, including extending the First Time Home Buyer Tax Credit beyond 2009. At the same time, I am mindful that these proposals can be very expensive, especially at a time of significant budget deficits. I can assure you the Administration will work with Congress to fashion appropriate and effective home buyer incentives, mindful of both their benefits to stimulating new demand and their costs to the American taxpayer.

Preventing Another Crisis

Let me conclude by saying that helping to prevent foreclosures through Making Home Affordable is one way to address the housing crisis, but there are other ways we can help the market recover as well. That's one reason President Obama is working to reform our Nation's health care system. With health care costs the leading cause of personal bankruptcies—with some estimates finding that almost half of all foreclosures are caused in part by financial issues stemming from medical costs—reform is an important part of stabilizing the housing market.

And of course, we look forward to working closely with this Committee to modernize our financial system. Critically important to us at HUD is the creation of a Consumer Financial Protection Agency that will protect American families who buy financial products and services every day—from mortgages to credit cards. The need is clear to set clear rules of the road for consumers and banks, including requiring brokers to look out for the interests of hardworking Americans if they give advice about mortgages.

This is a top priority for the Administration—and I know it is for you as well, Mr. Chairman. You have spoken powerfully about the central role consumers play in our economic growth and the need to build a strong foundation of protections for consumers. We agree—and look forward to working with you closely to do that through the creation of a strong Consumer Financial Protection Agency.

Conclusion

And so, thank you, Mr. Chairman, for the opportunity to participate in today's hearing and for your continued leadership—not only on these issues, but all your work to create sustainable communities. Whether it is our Choice Neighborhoods proposal to link neighborhood revitalization more closely with early childhood education—an issue on which you have long been the leading voice in Congress—or your Livable Communities Act to help towns and regions across the country better integrate their transportation, housing, land use, and economic development efforts, we are committed to working with you to build a strong, durable foundation for sustainable, inclusive growth.

Collectively, I hope the initiatives I have described today signal to you and to every family across the country that we believe, as you do, that a vibrant housing sector is essential to creating a geography of opportunity in America—where our children's choices and futures are never limited by their zip code. As always, the Administration stands ready to explore with Congress additional ways we can work together to make this shared vision of prosperity and opportunity a reality for every American.

With that, I am happy to answer any questions you may have.

PREPARED STATEMENT OF DIANE RANDALL

EXECUTIVE DIRECTOR, PARTNERSHIP FOR STRONG COMMUNITIES

OCTOBER 20, 2009

Thank you, Senator Dodd and Members of the Senate Banking Committee for the opportunity to testify today on "The Nation's Housing Markets." I am Diane Randall, Executive Director of the Partnership for Strong Communities, a Connecticut based organization dedicated to solutions to homelessness, the development of affordable housing and the creation of vibrant communities. I am also a member of the Board of Directors of the National Low Income Housing Coalition, which works on solving the housing problems of the lowest income people in our country.

For millions of Americans—many of them vulnerable by disability or age—the opportunity to own a home, even with a very generous home ownership tax credit, is beyond their reach. For these Americans, the American Dream is a safe, secure, affordable rental home. The opportunities for Congress to intervene with solutions for the low-income rental market are immediate and can have dramatic benefits—not only for the Nation's economy but also for people who need the security of an affordable rental home. Indeed, one of the lessons from this housing crisis is that efforts to fix only the home ownership market is not an adequate housing policy—for our Nation, our States, or our local communities.

It is important to understand that there is no such thing as the Nation's Housing Market. There are thousands of markets, each with its own needs, and it is critical that Congress provide States and localities with tools and resources that can be tailored to address conditions in those different markets.

Let me give you a snapshot of the picture in my State—Connecticut—a wealthy State that nonetheless has deep pockets of poverty, with an unemployment rate of 8.1 percent which, while less than the Nation's 9.7 percent unemployment rate, shows no signs of declining.

- In Connecticut, nearly half (48.2 percent) of renting households pay more than 30 percent of their income for housing. For many of these folks, managing the family budget is high wire act, deciding among the priorities of food, healthcare, transportation, or clothing. Forget things like music or dance lessons for the kids or even a trip to the movies.

- Connecticut's suburban and rural towns have very little supply of multifamily housing, especially affordable housing. This results in relatively few rental homes available and affordable to Connecticut's low-income population.
- The "housing wage" for renters in Connecticut has risen to $21.60 hour in 2009 from about $14/hour in 2001. In order to afford a 2 bedroom rental home, a family would need an annual income of more than $45,000, more than the median wage of nearly half the occupations in Connecticut. [1]
- The percentage of Connecticut homes valued under $200,000 shrunk from more than 65 percent of the total in 2000 to less than 20 percent in 2008. Even if they could muster the down payment and receive a tax credit, low-income households have few opportunities to become homeowners in Connecticut due to very high housing prices and limited supply.

Across the country, the same story has played out. The National Low Income Housing Coalition has culled information from the American Community Survey showing that some renters in every income category are paying more than 30 percent of their income for housing. These data demonstrate that as income decreases, the number of renters paying more than 30 percent of their income for housing dramatically increases, with 86 percent of renters earning less than $20,000 a year paying over 30 percent for housing. In other words, the poorer you are—and recent reports indicate that throughout the country household incomes are declining—the greater your challenges in finding a home you can afford.

The Americans living in poverty and facing growing rent burdens in rural, suburban, and urban communities include people with disabilities, veterans, the elderly, families with young children. People with disabilities who rely on Social Security Income as their sole source of income continue to be our Nation's poorest citizens.

- The monthly Federal Social Security Income payment in 2008 was $637 per month. About half of the States provide a modest supplement to this income. In Connecticut, the supplement is $168 per month, bringing the SSI income up to just $805 a month.
- In our State, 34,289 nonelderly adults with disabilities would need 116 percent of their income to rent a one-bedroom apartment, according to "Priced Out in 2008," a report by the Technical Assistance Collaborative.

Many of those with low incomes are also at an increased risk of experiencing homelessness, particularly during these difficult economic times. The need for affordable and supportive rental housing to prevent and end homelessness is critical. Connecticut's 2009 Point in Time Count of homelessness conducted 8 months ago challenges some traditional assumptions about homelessness. The one day snapshot of people who are living outdoors or in emergency shelters demonstrated a shift: homelessness is growing at a faster rate in suburban and rural towns than in our urban centers—a finding consistent with national studies. Findings from the Connecticut 2009 Point in Time Count also show:

- 4,154 people were homeless; 801 of those people were children.
- 32 percent of families were working at the time of the count and 78 percent said they had income from some source.
- 60 percent of adults in homeless families had a 12th grade education or higher.
- 57 percent of adults in families reported no history of hospitalizations for mental illness or drug/alcohol abuse. Yet, 43 percent of Connecticut families had to leave their last place of residence due to problems with rent or eviction.
- The number of individuals who are homeless over the course of a year in Connecticut is estimated at over 30,000.

Has the current housing crisis increased the availability of rental housing for low-income households? Quite simply, that is not the case. The loss of regular income experienced by millions of Americans—whether through unemployment, reduction in work/benefits, or crises related to mortgage/foreclosure problems—pushes more

[1] Housing wage information on all States and additional data on the low income housing market is available at *www.nlihc.org,* National Low Income Housing Coalition. Other resources for information on housing that prevents and ends homelessness and meets the needs of people with disabilities: *www.csh.org,* Corporation for Supportive Housing; *www.naeh.org,* National Alliance to End Homelessness; and *www.tacinc.org,* Technical Assistance Collaborative.

lower incomes households to look for affordable rentals. This pressure on the low-income rental market, in turn, drives up rents for these homes.

The market for rental housing for low-income households is not the same as the market for those who have higher incomes and an increased ability to pay more for housing. Although recent reports indicate that rental prices may be declining in some markets, these reports are coming primarily from large rental buildings that generally rent to higher-income segments of the market.

There also appears to be a recent influx of troubled properties into the rental market as individual owners try to rent properties that they can no longer afford themselves. However, these owners are likely to sell once market conditions turn favorable, adding to instability in the rental market. These properties generally have high maintenance costs, making rents high or making the properties vulnerable to neglect and eventual abandonment if the owners are unable to make enough on rent to cover their costs.

Another problem that exacerbates the low-income rental market is the loss of nearly 200,000 public housing units over the past decade, according to the Center for Budget and Policy Priorities. Additional private sector units were also lost due to poor condition, condo conversions and sales, and demolitions.

Our communities stand at risk to lose thousands of rental housing units over the coming decade if we don't act to preserve the units that currently are home to low-income households. The homes in need of preservation are falling into disrepair, becoming obsolete or need to be recapitalized to extend the affordability. Connecticut faces a huge challenge in preserving our State housing portfolio—over 17,000 units of housing inhabited by low-income elderly and families. Preservation of this housing and other affordable Government assisted housing is drawing heavily on our State's allocation of Low Income Housing Tax Credits, our tax exempt bond cap and the very limited State capital subsidy programs, making it virtually impossible to develop more than 150–200 units of net, new rental housing each year that is dedicated to low income households in Connecticut.

Benefits of Low Income Rental Market Working

Health, education and employment outcomes for individuals with disabilities and families with children are vastly improved when rental housing is affordable and safe for low income people.

- Our aging rental housing stock in the Northeast often has problems with environmental hazards, including lead, asbestos, mold, and dust mites. These factors have sparked significant increases of asthma in urban schools, the leading cause of absenteeism and diagnoses in school-based health clinics according to CT's Department of Education.
- The rate of school stability—students finishing the year in the same school they started in—is 95 percent in Connecticut's affluent school districts, but only 77 percent in its 6 poorest districts. Children who move in midschool year are more likely to underperform, have learning disabilities and exhibit violent behavior. Most (58 percent) cases of mobility—moving from one school to another—are the result of residential moves, often because of affordability or housing quality issues.
- Stable housing reduces public health costs. Connecticut's supportive housing Demonstration Program developed mixed income housing for 282 formerly homeless people in nine different locations in the 1990s. The tenants who have psychiatric disabilities and/or addictions experienced a 72 percent reduction in in-patient Medicaid costs according to a 2002 study published by the Corporation for Supportive Housing. Connecticut has produced nearly 4,400 units of permanent supportive housing, using Federal, State, and philanthropic resources; housing that has helped people get back to work and school and restored property values in communities that benefited from the housing investment.

In Connecticut and in every State, we need Congress to respond affirmatively to the low income housing market; States and communities across the country look to the Federal Administration and Congress to offer leadership on a rational housing policy that assures all Americans have opportunity for a home they can afford.

Thank you for the leadership you have provided—this spring passing legislation that protects renters in foreclosure, and through ARRA establishing a homeless prevention and rapid rehousing program and the tax credit assistance program and tax credit exchange program to keep the Low Income Housing Tax Credit program moving. These steps are very important. Let me suggest in closing a few additional immediate actions you could take to further bolster the low income housing rental market and our economy—to assure the American dream of a safe, affordable home for all.

A Few Modest Solutions for the Low Income Rental Housing Market

1. Fully renew all Section 8 tenant and rental assistance in order to prevent homelessness and assure stability for people who currently have housing choice vouchers.
2. Fund 200,000 new housing choice vouchers a year for 10 years—begin immediately to ramp up new tenant based and project based vouchers over a 10 year period to create long term affordability/stability and mixed income communities.
3. Enact SEVRA—Section 8 Voucher Reform Act that improves the ability to project base vouchers, streamlines the program and improves the funding formula.
4. Fund the National Housing Trust Fund—capitalize at $1 billion immediately; Senator Jack Reed's bill SB1731 offers a viable option to assure that this program which has wide bipartisan support could be operational in 2010. Find a permanent source of funds to increase annual support of the National Housing Trust Fund to $15 billion a year, This new program would require 90 percent of the funds to be used for production and preservation of multifamily rental housing, all serving very low income households, with an emphasis on serving extremely low income households.
5. Enact SB 1481, The Frank Melville Supportive Housing Investment Act—which modernizes the Section 811, Housing for Persons with Disabilities and creates a demonstration program with project-based rental assistance.
6. Advance the Livable Communities Act—an initiative that recognizes and encourages effective community development planning and practice that includes affordable housing, based on the local housing market needs and plans. Incentives and project based vouchers could insure that low income households would have housing opportunities through this initiative.

PREPARED STATEMENT OF RONALD PHIPPS

FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

OCTOBER 20, 2009

Introduction

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, on behalf of more than 1.2 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry thank you for inviting me to testify today regarding the current state of the Nation's housing market.

My name is Ron Phipps. I am a 3rd generation member of a 4 generation family tradition in the Rhode Island residential real estate industry. My passion is making the dream of home ownership available to all American families. As direct result of my passion, I have become very active within the National Association of Realtors® (NAR); holding significant positions at both the State and national levels. Since 2000, I have been President of the Rhode Island Association, an NAR Regional Vice President, and a member of the NAR Executive Committee. Most recently, I was elected NAR First Vice President for 2009.

Current Housing Trends

A review of the latest data strongly suggests that the homebuyer tax credit has had its intended impact of significantly stimulating home sales. From about 4.5 million annualized home sales pace in the few months prior to the stimulus, sales have jumped to 5.1 million in recent months. That is a change of 600,000 additional existing home sales. New home sales have risen from mid 300,000 to low 400,000 over the similar period. The rise in sales has been concentrated in the lower-priced homes largely because first-time buyers are looking to stay, rightly, well within their budget.

Housing inventories, while still higher than a desired level, have been trimmed. The latest 8-month supply of existing-home inventory is much better than the double-digit figures of last year. Home values have likewise moved in an "improving" direction. Broadly speaking, they are down from 1 year ago, but the declines have been less steep in recent months compared to the prestimulus times. The median existing home price as of August was down 12.5 percent compared to a nearly 20 percent decline early in the year. In short, sales have risen and home prices are on the verge of stabilizing.

Housing's Impact on the Economy

At a cost of about $10 billion, should the first-time homebuyer tax credit be extended through the middle of next year, the housing market will likely have recovered nicely with the broader economy on track for a solid robust expansion. The $10 billion price tag is rather modest compared to the $700 billion in TARP funding and $800 billion of the broader economic stimulus package that was passed early in the year. Moreover, the $10 billion cost is a static measure that does not take into account job creation and increased tax revenue from rising economic activity. Actually, if all of the economic dynamic responses are taken into consideration, the home buyer tax credit can be argued as a net positive revenue generator for the Federal Government.

As an example, Arun Raha, the chief economist for the State of Washington, is quoted in the *Seattle Times* as indicating that,

> The tax credit has prompted 7,000 purchases by first-time homebuyers [in the State of Washington]—purchases that otherwise would not have occurred. Every 1,000 home sales generate $112.4 million of economic activity with $71.9 million of it directly from home-sale preparation and the actual real estate transaction. In addition, more than 700 new jobs are created. This is not a balance-sheet bailout, it's real help for our neighbors and communities. One reason for the tangible success and economic impact of the tax credit is that it focuses on first-time buyers, whose purchases spark a surge of home buying that ripples across the economy and into the future. Most of their purchases are homes that someone else has been waiting to sell so that they, in turn, can purchase another house. The Washington Center for Real Estate Research at Washington State University estimates that 65 percent of those who sell their home to first-time buyers subsequently buy another house in the State. The people from whom they bought their home also purchase a new residence, and so on.

There is nothing like economic growth to dent budget deficits. If the economy was already at full capacity, the housing stimulus would simply be moving dollars from one sector of the economy to another. But as is fully visible out on the street, we are nowhere near full capacity. Factory capacity utilization was 69.6 percent in August, compared to an 80 percent rate that should be the case in normal economic times. On the job market front, the country is facing a double-digit unemployment rate rather than the healthy 5 or 6 percent unemployment rate. Therefore, there is a plenty of room for growth and a win-win situation for the housing market and other sectors of the economy.

Outlook

Despite these vast potential benefits to the economy from extending the homebuyer tax credit, valid questions should nonetheless be asked. Is there any pent-up demand remaining? Will the tax credit just go to the people who would have bought a home anyway and thereby will simply pocket the $8,000 check? Well, a compelling case for tapping the financially healthy renter population follows.

In 2000, before the housing market boom, there were 11.5 million renter households who had the necessary income to buy a median priced home at prevailing market conditions. Today, the pool of renters who can buy a median priced home is over 16 million. Just nudging even a small share—say 5 percent—of these financially healthy renters into buying via a tax credit check will mean 800,000 additional home sales. That number is sufficiently meaningful to get the inventory down to the level of home value stabilization. The housing market will then be on the path to a self-sustaining recovery.

The key to any future sustainable economic recovery lies in home values stabilizing or, better yet, a return to a historical home price appreciation rate of 3 to 5 percent each year.

The bubble prices crash landed, but all the excesses have already been removed. In fact, one could legitimately argue that home values have overshot downward. Price-to-income ratio is now below the historical average, and the monthly mortgage payment for a middle income person buying a middle priced home is well below its historical norm.

Housing Challenges

Although the future of the housing market looks bright, that future is extremely tenuous as a number of obstacles must be cleared to ensure a successful recovery.

NAR believes that Congress and housing industry participants must adequately address jumbo mortgages, commercial mortgages, HVCC, the modernization of FHA, short sales, and the unwinding of the Federal Reserve's MBS program to guarantee a smooth economic recovery.

Jumbo Mortgage Issues

For residential borrowers seeking to purchase or refinance homes that are above the existing GSE loan limits, the lack of Government participation has caused a situation similar to that faced by commercial mortgage market participants. A severely reduced amount of private capital in the jumbo market space has constricted the consumer's ability to get an affordable loan, if funding is available at all. For homeowners needing to refinance to a more reasonable mortgage product, the lack of liquidity is all but forcing many homeowners into foreclosure or short sale, which continues to place severe downward pressure on housing and the economy.

Commercial Mortgage Issues

Currently, banks and the CMBS market represent 75 percent of all outstanding commercial real estate loans. However, banks have tightened their credit standards and moved to reduce commercial real estate exposure, while the CMBS market has ceased to function—all of which points to systemic dysfunction. Hundreds of billions of dollars of commercial real estate loans from a variety of sources are expected to mature this year and over $1 trillion in the next few years. However, under current conditions, there is insufficient credit capacity to refinance this wave of loan maturities. With no liquidity, commercial borrowers face a growing challenge of refinancing maturing debt and the threat of rising delinquencies and foreclosures. Without the presence of a GSE to support liquidity and provide capital, the current crisis facing the commercial credit markets is even more profound.

Home Valuation Code of Conduct (HVCC)

The Home Valuation Code of Conduct (HVCC) has been in effect for over 5 months and REALTORS® report many adverse, unintended consequences since its implementation. According to a July 2009 survey of REALTORS®, 76 percent of respondents said the length of time to obtain a completed appraisal report increased after May 1, 2009. More than one third of REALTORS® have lost at least one sale because of a delay in the appraisal process. At the same time, respondents who identified themselves as appraisers said their time frame to submit an appraisal reports decreased and half of these respondents say this impacts the quality of the appraisal report. Finally, consumers are paying more for delayed appraisal reports that may have quality issues.

The Need for FHA Modernization

NAR does support some additional changes for FHA to ensure its continued strength and availability to homeowners.

Technology and Staffing—NAR strongly supports increased funding for FHA to upgrade their technology. FHA operates with technology that is an average of 18 years old. Quickly upgrading the dozens of incompatible systems, such as the 30-year-old COBOL system, to Web-based customer centric applications is necessary for the agency's continued existence and future success. Legislation has recently passed the House, H.R. 3146, the 21st Century FHA Housing Act of 2009, which would provide this authorization. This bill, introduced by Representatives Adler (D–NJ) and Lee (R–NY), will provide a number of reforms to modernize FHA. We also understand funding has been included in the Appropriations bill for HUD, and we urge that funding to be included in the final version of the FY2010 Appropriation for HUD.

We also believe HUD should have the ability to hire the professional staff they need to run what is now such a large and critical component of our housing finance system. H.R. 3146 provides HUD flexibility to hire appropriate staff using the compensation guidelines of similar agencies, such as the Federal Housing Finance Agency or the Federal Deposit Insurance Corporation. The legislation would also permit the hiring of expert consultants to work on specific program areas within FHA's operations. We think these changes are necessary to ensure the FHA is able to work efficiently and effectively with qualified, experienced staff.

Uniform Short Sales Policies

The number of short sales are increasing due to the current economic crisis. Since a short sale generally costs the lender less than a foreclosure, it can be a viable way for a lender to minimize its losses. A short sale can also be the best option for homeowners who are "upside down" on mortgages because a short sale may not hurt their credit history as much as a foreclosure. As a result, homeowners may qualify for another mortgage sooner once they get back on their feet financially.

However, too often, a short sale is a story of delay, unrealistic expectations of the value of the home, lost documents, full voicemail boxes, and insufficient or untrained staff. NAR has been working with lenders and servicers to try and ease the closing of short sales. As you may be aware, the vast majority of short sales never close—even after the offer has been accepted. On May 14, 2009, the Administration announced incentives and uniform procedures for short sales under a new Foreclosure Alternative Program. These guidelines and forms are in the process of being completed, and are expected to be released later this month. NAR was extremely pleased that the Administration heard the concerns of our members that short sales reform is crucial to helping families, who are unable to keep their homes, nevertheless avoid foreclosure.

The new program offers the hope of uniformity, transparency, and speed. But those goals will only be achieved if a large majority of servicers agree to participate and if they apply it uniformly to all eligible families. Completed short sales are not only good for the seller and the buyer, but saves the lender tens of thousands of dollars and benefits the community by keeping the home occupied and maintained. REALTORS® anxiously await implementation of the program and continue to report, every day, problems getting short sales to closing resulting in unnecessary foreclosures.

Unwinding of the Federal Reserve MBS Program

NAR believes that the manner in which the Federal Reserve unwinds the MBS program is critical to the housing and mortgage industries and to the economy as a whole. It will take considerable planning and effort to ensure that phasing out of this program does not lead to a significant spike in interest rates, disruptions to the flow of mortgage capital, and a halt to the fledgling recovery in the housing industry.

To ensure a smooth transition, NAR recommends the following steps:

- The Fed, Treasury, FHFA, and the GSEs should document that recently issued MBSs under the program are performing well and disseminate this information widely and publicly, in order to instill confidence among investors.
- The Fed, Treasury, FHFA, and the GSEs should work with banks and others in the financial industry to bring private investment back into the MBS market.
- The FHFA and/or the Treasury should signal that new agency MBS are, at least in effect, backed by the United States Government.
- If private investment does not return to the market in sufficient amounts to replace the current rate of Fed MBS investment, the Fed should increase the dollar size of the program and extend its term beyond the end of the first quarter of 2010.

Recommendations To Enhance Recovery and Spur Growth

REALTORS® believe that in order for the U.S. housing market and economy to thrive, the housing market requires strong consumer demand and the secondary mortgage market must be safe, sound and contain dependable participants in are economic situations, good or bad. NAR suggests that the following suggestions regarding the first-time homebuyer tax credit, the FHA/GSE loan limits, and "Principles for Ensuring a Robust Financing Environment for Home Ownership" be considered as legislation is entertained to further stimulate and sustain the housing market.

Extend the 1st Time Homebuyer Tax Credit

The $8,000 first-time homebuyer tax credit expires as of December 1, 2009. But the usefulness of the credit diminishes daily if the credit is not extended well before that date. A homebuyer is eligible for the tax credit only if the home is "purchased" before December 1, 2009. That means that buyers have to find a house, complete a contract, satisfy any contingencies, secure financing, and go to closing by November 30. Accomplishing those tasks by November 30 will become more difficult with every passing day. In today's market, it generally takes between 45 and 60 days to go from contract to closing. Without Congressional action now, the market may freeze again—possibly as soon as this month. NAR's research suggests that as many as 350,000 sales this year can be directly attributed to the availability of the credit. The tax credit stimulated market activity. The volume of housing sales has improved steadily every month since the credit was enacted. The credit pulled people from the sidelines and created some momentum that had been absent.

The housing market remains fragile. The market has improved and prices have stabilized in many areas, but the market has not fully corrected. Retaining the tax credit sustains that recovery. Inventory may remain unusually high. The waves of foreclosures attributable to subprime and other improper lending practices are working themselves through the system. Presently, high unemployment rates pose a threat to homeowners and could set another round of foreclosures in motion. If foreclosure rates were to spike again, inventories could become bloated again. Incentives are still needed to keep the market moving.

Home sales continue to stimulate economic activity. The economy will never fully recover until housing markets fully recover. Thus, the stimulus the credit provides is still needed. NAR estimates that every sale generates approximately $60,000 of additional economic activity. And expanding the credit beyond first-time homebuyers would give the economy a much needed kick. We continue to need the homebuyer credit. Congress must act now to be sure that the credit is available through 2010.

FHA/GSE Mortgage Loan Limits

NAR strongly supports making permanent the GSE and FHA mortgage loan limits that are currently in effect. The GSEs and FHA have played a critical role in providing mortgage liquidity as private financing has dried up. The current loan limits are set to expire in just a few months, on December 31, 2009. Last year, when the limits temporarily expired, many communities saw dramatic declines in mortgage liquidity. More than 612 counties in 40 States and the District of Columbia saw their limits fall. The average decline in the loan limits was more than $51,000.

In today's real estate market, lowering the loan limits further restricts liquidity and makes mortgages more expensive for households nationwide. FHA and GSE mortgages together continue to constitute the vast majority of home financing availability today, which makes it particularly critical to extend the current limits. Without the additional liquidity created by maintaining these loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

Principles for Ensuring a Robust Financing Environment for Home Ownership

NAR believes that these principles, which require a continuing role for the Federal Government in the mortgage market, should be used in the development of a model for secondary mortgage market going forward, in order to encourage a safe and sustainable housing market. According to the principles, the secondary mortgage market model must:

1. Ensure an active secondary mortgage market by facilitating the flow of capital into the mortgage market, in all market conditions;
2. Seek to ensure affordable mortgage rates for qualified borrowers;
3. Establish reasonable affordable housing goals so all qualified borrowers, including low- and moderate-income households, have an opportunity to realize the dream of home ownership. Affordable housing goals should not provide incentives for the institution that are inconsistent with sustainable home ownership;
4. Require the institution to pass on the advantage of its lower borrowing costs (and other costs of raising capital) by making mortgages with lower rates and fees available to qualified borrowers;
5. Ensure mortgage availability throughout the Nation. NAR supports indexing conforming loan limits based on increases in median sales prices, including higher indexed limits for areas with high housing costs;
6. Require sound underwriting standards;
7. Require the highest standards of transparency and soundness with respect to disclosure and structuring of mortgage related securities;
8. Ensure there is sufficient capital to support mortgage lending in all types of markets; and,
9. Provide for rigorous oversight.

These principles espouse two major themes. First, the housing market must work in all markets, and at all times, no matter the existing economic condition. As we have mentioned in previous testimonies before Congressional Committees, the housing market has brought us out of nearly all of the major economic downturns, and will continue to do so if we as a Nation protect the housing mission or the GSEs. Pure privatizing of the GSEs without any level of Government support, which would incent them to act as current private investors and flee the market during an economic downturn, would create a major draft on future housing and U.S. economic recoveries.

Second, mortgage capital needs to be available to ALL potential, qualified housing consumers. NAR is not advocating going back to the excesses that we saw during the housing boom, where everyone, practically regardless of their ability to repay the loan, could get a mortgage. On the contrary, the housing goals that the Government imposed on the GSES, when they were reasonable, fostered opportunity for many creditworthy consumers who were in the lower portion of the income spectrum to pursue and obtain the dream of home ownership. Removing the Government's involvement in the secondary mortgage market will offer no incentive for market participants to reach out to lower income, creditworthy consumers which will ultimately deprive them of their ability to own a home, and build wealth that future generations can use to move up the economic ladder.

Retain Strength of FHA

With the collapse of the private mortgage market, the importance of the Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, FHA is one of the primary sources of mortgage financing available to families today. Without FHA, families would be unable to purchase homes and communities would suffer from continued foreclosure and blight. On September 30, the Federal Reserve published its draft explanation of the 2008 Home Mortgage Disclosure Act (HMDA) data. That report shows the critical role FHA is playing in the market. According to the Federal Reserve, by the end of 2008, nearly one half of home purchase loans and one quarter of refinancing loans were backed by either FHA or the VA. In addition, minority borrowers rely heavily on FHA. According to the Federal Reserve, "In 2008, more than 60 percent of home purchase loans and almost 40 percent of refinance loans to blacks were from either the FHA or VA. For Hispanic-white borrowers, nearly 50 percent of their 2008 home-purchase loans and 21 percent of their refinance loans were from the FHA or VA."

FHA has announced that their 2009 audit will demonstrate that their capital reserve fund has fallen below the Congressionally mandated 2 percent ratio. The reason the capital reserves have fallen below 2 percent actually has nothing to do with FHA's current business activities. It simply is a reflection of falling housing values in their portfolio. FHA actual total reserves are higher than they have ever been—with combined assets of $30.4 billion. The audit is also expected to confirm that FHA has "positive" reserves—meaning they have adequate resources to cover all claims and expenses from their portfolio. In addition, the audit will show that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years. It is important to note that there has not been a significant increase in defaults on the part of borrowers, or underwriting problems on behalf of FHA and its lenders. Instead, the decrease in the capital reserve account is a direct effect of the state of our economy and our housing markets.

Given the devastating impact home price declines have had on banks, lenders, and even the Government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae, FHA has performed remarkably through this crisis. Why? FHA has never strayed from the sound underwriting and appropriate appraisals that have traditionally backed up their loans. FHA meets it mission of serving low and moderate income homebuyers, but has never resorted to abusive loans, improper or nonexistent underwriting, or other bad practices. As a participant in the home mortgage process, FHA cannot be immune to the pitfalls of the housing crisis. But solid policies and practices have protected it from the biggest failures.

Today, FHA borrowers have never been stronger. The Federal Reserve report shows that FHA is not the new subprime lender—its FICO scores have increased, and its LTVs decreased. The average credit score for FHA's current customer has grown to 693, and only 7.5 percent of their purchase borrowers this year had FICO scores below 620. Borrowers have more equity, as the percentage of FHA's Loan-to-Value (LTV) ratios above 95 percent fell from 72 percent in 2007 to 62 percent in 2008. FHA's cash reserves are strong, and sufficient to pay claims. We believe FHA is taking the necessary steps to assure it remains a critical source of mortgage insurance for America's homebuyers at all times—good and bad.

Conclusion

The National Association of REALTORS® sees a bright future for the housing market and the overall economy. However, our members are well aware that the future we see rests on the industry's ability to successfully navigate some very serious issues. Congress and the housing industry must maintain a positive, aggressive, forward looking partnership if WE are to ensure that a housing and national economic recovery are sustained.

I thank you for this opportunity to present our view of the state of the Nation's housing market. As always, The National Association of REALTORS® is at the call of Congress, and our industry partners, to help facilitate a sustainable housing and national economic recovery.

PREPARED STATEMENT OF EMILE J. BRINKMANN

CHIEF ECONOMIST AND SENIOR VICE PRESIDENT FOR RESEARCH AND ECONOMICS, MORTGAGE BANKERS ASSOCIATION

OCTOBER 20, 2009

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify on the state of the Nation's housing market. I am Emile J. Brinkmann, Chief Economist and Senior Vice President for Research and Economics for the Mortgage Bankers Association (MBA). [1]

Whenever I am asked about the state of the mortgage and housing market, I explain that the economy and the housing market are inextricably linked. The state of the overall economy and the number of people receiving paychecks will drive the demand for houses and apartments. The recovery of the housing market will be the result of a larger economic recovery, not a driver of that recovery, but there are a number of policy initiatives that can assist in improving the housing market which I will discuss in my testimony.

What is different about this recession, compared to others for which we have data, is the higher rates of delinquencies and foreclosures for the levels of unemployment we are experiencing, particularly in certain States.

Why is that? Perhaps the most important reason is that we entered this recession with an already weakened housing market. In past recessions, it was the loss of jobs and the paychecks needed to make mortgage or rental payments that weakened the housing market. In this recession, the housing market was already weak before the recession even started.

The use of loan products like pay option adjustable rate mortgages (ARMs) and stated income loans by borrowers for whom these loan products were not designed, together with rampant fraud by some borrowers buying multiple properties and speculating on continued price increases, led to very high levels of construction to meet demand that turned out to be unsustainable. When changes in the market caused demand for homes to suddenly shrink, a large number of houses were stranded without potential buyers. The resulting imbalance in supply and demand drove prices down, particularly in the most overbuilt markets like California, Florida, Arizona, and Nevada—markets that had previously seen some of the Nation's largest price increases.

The problem is that when the recession hit and people began to lose their jobs, the equity in their properties may already have been wiped out. In past recessions, they may have been able to sell their home and recover some of their equity, but in markets where we have seen sizeable price drops, that is no longer an option.

Here are a few numbers to illustrate the point. A year ago, subprime ARM loans accounted for 36 percent of foreclosures started, the largest share of any loan type despite being only 6 percent of the loans outstanding. As of June 30, 2009, prime fixed-rate loans represented the largest share of foreclosures initiated. Perhaps more significantly, almost 40 percent of those prime fixed-rate foreclosures are in the States of California, Florida, Arizona, and Nevada. Due to the imbalance between supply and demand in those States, prices have dropped so far that any life event that would normally lead simply to a delinquency—like the loss of a job or a divorce—is now also leading to a foreclosure.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand home ownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: *www.mortgagebankers.org.*

The national quarterly foreclosure rate reported by the MBA for the second quarter of this year was 1.36 percent. However, in the four States I mentioned, it was 2.34 percent, roughly 10 times the rate we saw in those States during the boom years. Without those four States, the national foreclosure rate would be about 1.04 percent, roughly double the rate we saw for the rest of the country during the boom years.

Exacerbating the problem of the oversupply of homes is the potential shadow inventory from mortgages that are either in foreclosure or that may enter foreclosure and "pent up" supply, *i.e.,* households the have been unable to sell due to the frozen housing markets. The current supply of previously owned and new homes on the market is roughly 3.9 million. The number of loans 90 days or more past due nationwide is also about 3.9 million. Some of these mortgages will be successfully modified or otherwise become current, but some of these problem loans will result in additional homes being put on the market. Freddie Mac, for example, estimates that 36 percent of its mortgages that are at least 90 days past due or in foreclosure are already vacant. There is no borrower living in the house to whom a modification plan can be offered. In Florida, 56 percent of this category of properties is vacant. In Nevada it is 45 percent, in Ohio 46 percent, and in Texas 44 percent.

When you see numbers of this magnitude, it is clear that recovery in the housing market will occur when the number of jobs in the economy begins to expand, thus creating the economic demand needed to absorb some of this excess inventory. Only then will we see an expansion in the number of households sufficient to fill the many vacant homes and apartments now available. Unfortunately, MBA's projection, and the projections of many other economic forecasters, is that unemployment will continue to get worse throughout the middle of next year before it slowly begins to improve. The lags between the recovery of the economy and the recovery in employment have grown longer and longer over the past several recessions and we expect this recession to continue this trend.

One problem for the housing market, however, is that there is no guarantee that when the jobs come back, they will come back where the excess single-family and rental housing units are located. For example, employment in Michigan has still not recovered from the 2001 recession. There may well be some areas of the country that stay mired in a housing recession for several years after the rest of the Nation recovers.

In addition, it is important to note that the mortgage lenders doing business today are the ones who did not make the riskiest loans and who had the greatest control over their underwriting standards. These surviving lenders are, by the mere fact that they are still here, the most conservative and the least likely to become very expansionist with their lending policies. These lenders largely did the right thing and were often criticized by shareholders and others for losing market share during the middle of this decade because they did not rush into the riskiest forms of lending. Now they are bearing the brunt of bad publicity and strict supervisory actions from Federal agencies such as the Federal Reserve and the Department of Housing and Urban Development (HUD) and a patchwork of inconsistent State regulations that are the result of the behaviors of their now-defunct competitors. The effect of the regulations and the negative publicity will likely make these institutions even more conservative in their policies.

Another series of challenges facing the mortgage and housing industries in both the immediate and long term stem from the Government's actions to provide stability to the financial markets. Perhaps the most immediate challenge is what will happen to interest rates when the Federal Reserve terminates, in March 2010, its program for purchasing Fannie Mae and Freddie Mac mortgage-backed securities (MBS). The Federal Reserve has purchased the vast majority of MBS issued by these two companies this year. The benefit has been that mortgage rates have been held lower than what they would have been without the purchase program, but there is growing concern over where rates may go once the Federal Reserve stops buying and what this will mean for consumers. While the most benign estimates are for increases in the range of 20 to 30 basis points, some estimates of the potential increase in rates are several times those amounts.

We believe the termination of the program was extended to March in order to provide the Obama administration some cushion for announcing its recommendations for the future of the Government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, which are expected to be included in February's budget announcement. We hope the Administration will address some of the ambiguity in the degree of Federal support for the long-term securities issued by Fannie and Freddie—ambiguity that partially caused credit spreads to increase significantly earlier this year and led to the initiation of the Fed's MBS purchase program.

In addition to whatever additional interim measures are announced for Fannie Mae and Freddie Mac, the Administration and Congress will need to address the long-term structure of the secondary market. The Federal Government has played a key role in providing stability to the secondary market since the creation of Fannie Mae in the 1930s. However, the current housing crisis has tested the Government's role and led to calls for a fundamental rethinking of how the Government plays its part.

In the fall of 2008, MBA established the Council on Ensuring Mortgage Liquidity to provide information and insights to this rethinking. The council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should like for the long term. After nearly a year of discussions and deliberations that resulted in a set of key considerations and principles for ensuring mortgage liquidity, the council formulated a suggested new framework (attached) for the Government's involvement in the secondary market, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac.

MBA's plan envisions a system composed of private, nongovernment credit guarantor entities that would insure mortgage loans against default and securitize those mortgages for sale to investors. These entities would be well-capitalized and regulated, and would be restricted to insuring only a core set of the safest types of mortgages. The resulting securities would, in turn, have the benefit of a Federal wrap that would allow them to trade similar to the way Ginnie Mae securities trade today. The Federal wrap would not be free. The entities would pay a risk-based fee for the wrap, with the fees building up an insurance fund that would operate similar to the bank deposit insurance fund, and would be subject to tight regulation. The advantage to this system is that any credit losses would be borne first by private equity and any risk-sharing arrangements put in place with lenders and private mortgage insurance companies. In the event one of these entities failed, the insurance fund would cover the losses. Only if the insurance fund were exhausted, would the Government need to intervene.

While not the only potential framework, the council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the Government's involvement with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. We believe this proposal represents an important improvement over the present structure in a number of areas and we are eager to discuss it further with the Members of this Committee.

MBA Policy Recommendations

As Congress continues to examine ways to stabilize the economy, MBA has endorsed a series of near term measures to enhance liquidity, assist homebuyers and improve the overall functioning of the housing market.

Market View on Loan Limits

When the housing finance system collapsed nearly 2 years ago, private investors fled the secondary market, leaving Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) as the only significant sources of liquidity. However, these entities are restricted from purchasing loans above a statutory limit. For the GSEs, this limit is known as the conforming loan limit. The temporary increase in the FHA and conforming loan limits under the Economic Stimulus Act of 2008 and the continued temporary extension for high-cost areas under the American Recovery and Reinvestment Act of 2009 clearly had a positive impact on the mortgage market by increasing liquidity for and lowering the interest rates of loans that were previously beyond the GSEs' and FHA's reach.

Due to the temporary nature of the higher loan limits, which are scheduled to expire on December 31, 2009, the investment community will not purchase bundles of loans if they include more than ten percent of loans over $417,000. Because many lenders report their volume of high loan balance transactions exceed this ten percent threshold, they are being forced to resort to costlier alternatives to the securitization market.

Due to the pending loan limit expiration, MBA members are already seeing the investment community pull away from certain transactions. MBA believes it is critical for the GSEs and FHA to provide support for the broadest possible spectrum of home prices in all areas during these challenging times. By permanently increasing the FHA and conforming loan limits to $625,500, and up to $729,500 in high-cost areas, the investment community will be provided the necessary certainty to remain in the market, and American consumers will continue to have access to affordable mortgage credit.

MBA would also like to highlight the importance of FHA's multifamily programs in today's housing market. During the current market downturn, affordable rental housing has become a more urgent need for families and elderly individuals who either cannot afford to buy or who chose to rent. While FHA's multifamily loan limits are sufficiently high in most markets, in some areas of the country they are severely restricting the ability to use FHA insurance programs to finance rental housing. MBA encourages Congress to consider increasing the loan limits for elevator buildings and provide the HUD Secretary with additional discretion in extremely high-cost areas (similar to that provided in Alaska and Hawaii today).

Homebuyer Tax Credit

The Internal Revenue Service (IRS) recently reported that more than 1.4 million taxpayers have benefited from the first-time homebuyer tax credit enacted by Congress as part of the Housing and Economic Recovery Act of 2008.[2] MBA has supported the homebuyer tax credit since it first passed Congress and recognizes that we have an excessive inventory of available homes in many parts of the country. As I noted earlier, demand is simply not keeping up with the current oversupply. MBA supports tax initiatives that would encourage home purchase activity.

Specifically, MBA recommends the following changes to the current tax credit:

- Extend eligibility to all primary residence homebuyers.
- Increase the tax credit to up to 10 percent of the home purchase price up to a maximum of $15,000.
- Require the tax credit to be repaid in certain instances—The borrower should repay the tax credit if the residence is sold within 3 years (with an exception for employment-related moves) or in the event of a taxpayer default on any other mortgage that existed at the date the tax credit is claimed. This would serve to discourage "buy and bail" behavior, where a borrower uses the tax credit for his or her advantage and then walks away from an existing mortgage obligation.
- Allow taxpayers to claim and receive the tax credit immediately, and facilitate the IRS sending funds claimed by the taxpayer directly to the settlement agent for use in the purchase mortgage transaction.
- Any enhancements to the program should be effective on the date of enactment.

Warehouse Lending Capacity Issues

Warehouse lending is a critical conduit that brings the funds from the secondary market to the closing table. In past years, independent, nondepository mortgage bankers that rely on warehouse lines to fund loans sold to Fannie Mae, Freddie Mac, and Ginnie Mae were responsible for upwards of 40 percent of all residential mortgages originated in the United States and originated nearly 55 percent of all FHA loans.

Over the last 18 months, warehouse lending has been reduced as some warehouse lenders were bought or went out of business and others terminated or added restrictions to their warehouse lines of credit. Recently, new entrants to the warehouse lending business and a new Freddie Mac warehouse lending pilot program have helped ease the credit crisis for a small number of the largest independent mortgage bankers. However, for the small to midsized mortgage banker, the unavailability of credit is still an issue.

These small businesses have been faithfully serving their communities for decades and provide unparalleled customer service. MBA urges you to continue to support all independent mortgage bankers, and the mortgage industry at-large, by encouraging the Department of the Treasury, Fannie Mae, Freddie Mac, and Ginnie Mae to support initiatives that help restore the flow of mortgage credit through warehouse lines of credit.

Commercial Market Concerns

For much of the year, the commercial mortgage-backed securities (CMBS) market has been virtually frozen, and we expect to see continued challenges in the commercial area. In June 2009, the Federal Reserve expanded the term asset-backed securities loan facility (TALF) to include legacy and recently issued CMBS. The market reacted positively, as spreads for highly rated CMBS began to narrow. Unfortunately, the challenges facing the commercial real estate finance market will extend past the current TALF expiration dates for legacy CMBS (March 31, 2010) and newly issues CMBS (June 20, 2010).

[2] *http://www.irs.gov/newsroom/article/0,,id=213375,00.html.*

In order to provide certainty to all market participants, MBA recommends that Congress encourage the Treasury Department and the Federal Reserve to extend the program to December 31, 2011. This extension period will allow market participants to include consideration of the TALF CMBS program in their short-term and midterm finance strategies. This 2-year timeframe will end rampant speculation and market disruption when extensions are announced several weeks or months before a program is set to expire. With a typical CMBS taking 4 to 6 months from the start of the loan aggregation process until the CMBS is issued, providing a 2-year window will allow for an orderly CMBS aggregation and execution process and a bridge for new private sector lending structures to emerge.

Conclusion

While our economy is showing signs of recovery, and a number of local housing markets appear to be reaching the bottom, our long term recovery will be dependent on the creation of jobs. As we begin to see new employment opportunities, consumer confidence and spending will also return, and a new wave of homebuyers will begin to absorb the oversupply of homes. MBA looks forward to continuing to work with the Committee as it examines additional policy initiatives to help stabilize our economy and improve our Nation's housing market.

Attachment

MBA's Recommendations for the Future Government Role in the Core Secondary Mortgage Market

MBA's RECOMMENDATIONS FOR THE FUTURE GOVERNMENT ROLE

IN THE CORE SECONDARY MORTGAGE MARKET

MORTGAGE
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INTRODUCTION

Since the creation of Fannie Mae in the 1930s, the federal government has played a key role in providing stability to the secondary mortgage market. The current housing crisis has tested the government's role and led to calls for a fundamental rethinking of how the government plays its part.

To provide information and insights to this rethinking, in October, 2008 the Mortgage Bankers Association (MBA) established the Council on Ensuring Mortgage Liquidity. The Council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should like for the long term.

On November 19, 2008, the Council hosted a summit on the future of the secondary mortgage market and the GSEs that brought together leading thinkers from industry, academia and regulators to discuss what fundamental elements would be required for a functioning secondary market. The discussion led to the Council-issued report *Key Considerations for the Future of the Secondary Mortgage Market and the Government Sponsored Enterprises (GSEs),* which was released in January, 2009.

The Council's second task was to develop a set of guiding principles embodying the key considerations mentioned in the primer. The report *Principles for Ensuring Mortgage Liquidity* was released by the Council on March 19, 2009. The principles serve as a tool for evaluating proposals that arise for restructuring the secondary market.

As the policy spotlight has turned to the futures of Fannie Mae and Freddie Mac, the Council has taken on the questions of what an appropriate future government role in the core secondary mortgage market might look like. After thoughtful discussions and deliberations, we now present the Council's *Recommendations for the Future Government Role in the Core Secondary Mortgage Market.*

This report presents the Council's suggested framework for government involvement in the single-family and multifamily secondary mortgage markets, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the government's ability to ensure liquidity with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. This and the other Council reports can be found at: www.mortgagebankers.org/CEML.

In the coming months, MBA and the Council will continue to study the critical issues related to the future of the secondary mortgage market, and will continue to provide information and insights to regulators, legislators and others involved in the policymaking process. We want to thank the members of the Council for their valuable service, and for helping define a workable model for the future government role in the secondary mortgage market.

John Courson
President and Chief Executive Officer
Mortgage Bankers Association

Michael Berman, CMB
President and Chief Executive Officer, CWCapital
Vice Chairman, Mortgage Bankers Association
Chair, Council on Ensuring Mortgage Liquidity

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1. OVERVIEW

The importance of housing in the economic and social fabric of the United States warrants a federal government role in promoting liquidity and stability in the market for mortgage debt. The size and scope of the U.S. housing market mean that, except in times of extreme duress, the federal government's role should be to promote liquidity for investor purchases of mortgage-backed securities, not to attempt to provide the capital for or absorb the risks itself.[1]

As a necessary component of this provision of liquidity and stability, a security-level credit guarantee backstop will be needed for the core mortgage market,[2] which should rely on security-level risk-based premiums paid into a federal insurance fund and loan-level guarantees provided by a small number of privately-owned, government-chartered and regulated mortgage credit-guarantor entities (MCGE). The government backstop should be explicit and should be focused on the credit risk and market liquidity of mortgage-related products, not any interest rate risk. The loan-level MCGE guarantee should be such that it absorbs all mortgage-related credit losses and that the federal insurance fund is called upon only in situations of extreme distress.

The centerpiece of federal support for the secondary mortgage market should be a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG) like that on a GNMA security; which would in turn be backed by b) private, loan-level guarantees from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The GG would be conceptually similar to the Ginnie Mae model and would guarantee timely interest and principal payments to bondholders, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. The MCGEs would in turn rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Through these programs, the credit risk of the underlying mortgages would be removed from the securities issued, while the interest rate risk would remain with the security investor.

2. MORTGAGE CREDIT-GUARANTOR ENTITIES (MCGE)

The MCGEs should be privately owned, mono-line institutions focused solely on the mortgage credit guarantee and securitization business. This business encompasses both single-family and multifamily residential mortgages. The loan-level MCGE guarantee would be backed by private capital held by the MCGEs which would be overseen by a strong regulator. The MCGEs would be required to manage their credit risk by using risk-based pricing, originator retention of risk (such as reps and warrants backed by sufficient capital to support them), private mortgage insurance (PMI) and risk transfer mechanisms including other risk-sharing arrangements, to ensure that there is a strong capital buffer before the GG and insurance fund would come into play. Loans would not be included in a GG security unless they were guaranteed by a MCGE.

In most cases the MCGEs would own the loans underlying the GG securities they issue, and in the event of foreclosure could own the real estate collateral.

The MCGEs would have standard corporate powers to raise debt and equity. Other than access to the related GG security they could issue, none of the corporate debt or equity the MCGEs issue would be guaranteed, either explicitly or implicitly, by the federal government. The corporate capital levels of the MCGEs must be actuarially sound and the entities should report regularly to the satisfaction of the GG, Treasury and the MCGEs' regulator.

The number of MCGEs should be based on the goals of a) competition, b) strong and effective regulatory oversight, c) efficiency and scale, d) standardization, e) security volume and liquidity, f) ensuring no one MCGE becomes "too big to fail" and g) the transition from the current government sponsored entity (GSE) framework. Initially, the number of MCGEs should be either two or three. The regulator would have the ability to increase that number over time, through the granting of charters, as the market develops. The ownership of at least one of the MCGEs could be in a co-op form with mortgage lenders as shareholders. The governance structure of the MCGEs should adequately represent both the multifamily and single-family mortgage markets.

Allowable Mortgage Products of the MCGEs

The federally related securitization guarantee should support only "core" mortgage products with well-understood, well-documented risk characteristics. The federally related securitization guarantee should generally support: a) "conventional" single-family mortgage products traditionally supported by the GSEs, including those currently eligible for TBA funding; and b) multifamily mortgage products that fit the GSEs' published underwriting guidelines, including affordable multifamily rental housing mortgage products. If CRA-related loans are included in the definition of core products, the MCGEs and GG should provide a transparent and liquid market into which lenders can deliver them on a pricing and risk-adjusted basis.

In defining the products covered by the new guarantees, industry participants, the MCGEs, the GG and federal regulators should carefully review current product definitions and classifications to ensure maximum market transparency, efficiency and liquidity. New products would be proposed by the MCGEs, recommended by the GG and would require approval from the regulator. Thus new product development would be measured, prudently regulated and conservatively responsive to market demands.

Portfolio Authority

The key mission of the MCGEs should be to guarantee and securitize mortgages through the program described. The MCGEs should therefore hold only a *de minimus* portfolio of mortgage assets.[3] The portfolios' purposes would be to support securitization by allowing the MCGEs to a) aggregate allowable mortgages for securitization, b) manage loss mitigation through foreclosure, modifications and other activities, c) incubate mortgages that may need seasoning prior to securitization, d) develop new mortgage products through a strictly limited level of research and development prior to the development of a full-fledged securitization market and e) fund highly structured multifamily mortgages that are not conducive to securitization.

Regulator

The MCGEs' regulator should be strong, empowered and adequately funded through the GG insurance premiums.[4] The regulation regime contemplated would be similar to that of a public utility, with the MCGEs earning a conservative return on equity. The regulator should have the power to adequately oversee the MCGEs, specifically with regard to products, pricing and capital adequacy.

3. FEDERAL GOVERNMENT GUARANTEED "WRAP" (GG) SECURITIES

GG securities would carry a guarantee of timely interest and principal payment, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. Ginnie Mae could potentially take on the responsibilities of the GG.

The GG would be responsible for standardization of mortgage products, indentures and mortgage documentation for the core mortgage market. Minimum regulated fees would be established for ongoing servicing, surveillance and reporting. This would ensure standardization and liquidity throughout the core market. Each MCGE would individually issue GG securities under this standardized regime. These new GG securities could also be issued by private institutions approved by the MCGEs. These securities would also carry the GG security-level guarantee backed by the MCGE loan-level guarantee; accordingly, the MCGEs will have approved and insured the underlying collateral.

The GG is not intended to support the entire mortgage market, but rather only those products needed to keep the secondary market for core mortgage products liquid and functioning through all environments. There would continue to be key roles for FHA, VA, RHS and Ginnie Mae as well as for the fully private market, particularly as such roles evolve in support of public or social housing policy goals and objectives. FHA, VA, RHS and Ginnie Mae would continue to play critical roles in providing government credit support for affordable housing, while the fully private market would provide finance vehicles for mortgages that fall outside of core product profiles. Mortgages made outside of a federally guaranteed framework would rely entirely on private capital and management of risks, in as much as such mortgages may exhibit risk characteristics that would not be well documented or well understood (and therefore would not be allowable products eligible for inclusion in GG securities).

The mission of any federally related mortgage securitization and guarantee program should be explicitly limited to ensuring liquidity in the core mortgage market through the issuance and guarantee of mortgage-backed securities.[5] This important mission should not be distorted by additional public or social housing policy goals. To the degree additional objectives are desired, they should be pursued through FHA, VA, RHS, Ginnie Mae and direct federal tax and spending programs, which should be adequately funded and supported to meet these important objectives. The self-supporting GG federal insurance fund, which is likely to run surpluses in all but the most extreme circumstances, could be a potential source of funds for Congress when considering affordable housing expenditures.

While the full faith and credit of the U.S. government should mean there will not be a need for a liquidity backstop, in times of extreme market distress, liquidity could be provided to the GG securities market through Treasury and/or Federal Reserve purchases of GG mortgage securities.[6] As a result, there would not be a need for the MCGEs portfolios to be sized and structured to take on the role of "liquidity providers of last resort."

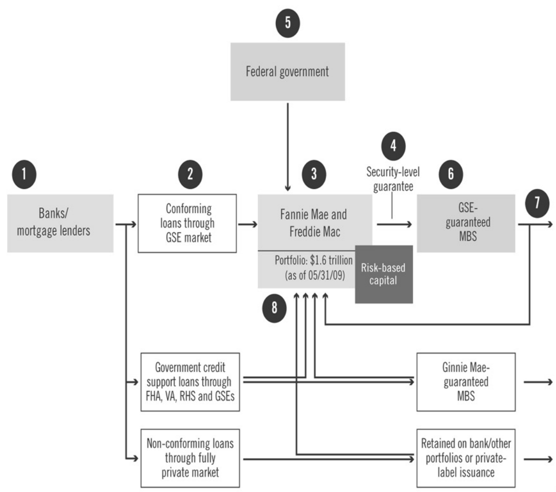
4. TRANSITION

The infrastructure of the existing GSEs should be used as a foundation for new MCGEs, with the technology, human capital, standard documents and existing relationships that the GSEs have developed available to one or more MCGEs. Every effort should be made to transfer existing origination, servicing and other industry relationships from the GSEs to the new MCGEs so as not to strand originators and servicers with ties to the existing GSEs. Historical performance data and other information should be made available to originators, the MCGEs, regulators, rating agencies, investors and providers of credit support to enhance the efficiency of the market.

Decisions regarding the futures of the GSEs should be made expeditiously so as to reduce continued losses of talent at Fannie Mae and Freddie Mac. This will be important both to maintain the ongoing management of the GSEs' existing books of business as well as to fully leverage their infrastructures for use by the new MCGEs.

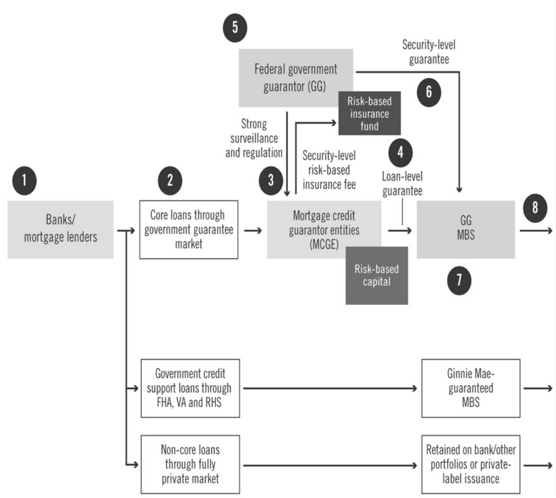
In order to facilitate a more rapid transition, to maximize the usefulness of the existing infrastructure of the GSEs and to allow the federal government to continue to use that infrastructure to address the current housing market challenges, a good bank/bad bank resolution of the GSEs, their assets and liabilities should be considered.

HIGH-LEVEL VIEW
CURRENT STATE: FANNIE MAE, FREDDIE MAC AND THE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are sold to Fannie Mae or Freddie Mac (FM).
3. FM prices and holds capital for the credit risk of the loans. FM either holds the loan in portfolio or includes it in MBS.
4. FM guarantees timely payment of principal and interest on MBS.
5. Federal agency provides oversight and regulation.
6. FM or mortgage lender issues FM-guaranteed security to the market.
7. Based on special status of the GSEs, security trades at a premium to other MBS.
8. FM may also purchase their own or other GSE-issued, Ginnie Mae or private label MBS as well as non-conventional government credit support loans to hold in portfolio, taking both the credit and interest rate risks.

HIGH-LEVEL VIEW
TARGET STATE: POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN THE CORE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are submitted to MCGE for credit underwriting and pooling.
3. MCGE prices and holds capital for the credit risk of the loans.
4. MCGE guarantees timely payment of principal and interest of the loans.
5. Federal agencies provide oversight, regulation and security-level guarantee in exchange for risk-based fee.
6. GG guarantees timely payment of principal and interest of the security.
7. MCGE or mortgage lender issues GG security to the market.
8. Based on the GG guarantee, security trades in equivalence to full faith and credit of the U.S. government; security buyer takes all the interest rate risk.

NOTES

1. The Mortgage Bankers Association's Council on Ensuring Mortgage Liquidity. *Principles for Ensuring Mortgage Liquidity*. March 2009. "1.a. Except for times of extreme market stress, and except for the availability of a credit guarantee program as described in section 7 below, secondary market transactions should be funded by investors seeking market returns and who take on the credit, interest rate and / or other associated market risks for market-derived yields."

2. Ibid. "7. There is a role for a government credit-guarantee program to help attract investment to the residential secondary mortgage market."

3. Ibid. "7.c. Any government sponsored entity or program should preclude the creation of a GSE-like investment portfolio assembled for the purpose of arbitrage profits. A GSE or GSE-like entity may require a portfolio to support its securitization activities (i.e. aggregation, incubation, innovation), to accommodate limited amounts for highly structured products not conducive to securitization and /or to maintain an infrastructure for serving as a liquidity backstop for the market."

4. Ibid. "5.c. The regulator of any government sponsored / owned entity and other secondary mortgage market regulators should be strong, empowered and adequately funded."

5. Ibid. "8.a. The government should balance and coordinate any pursuit of social policy goals through the secondary mortgage market operations of government sponsored / owned entities with their implications for safety and soundness, the efficient operation of the secondary mortgage market and their consistency with primary mortgage market and / or other requirements. Such policy goals should be limited to residential housing in a way that does not contain market distortions."

6. Ibid. "10.a. In times of extreme market stress, the government should provide a mechanism to step into the secondary mortgage market as a liquidity provider of last resort by providing a liquidity backstop." MBA is currently developing a working brief discussing the merits of this approach.

PREPARED STATEMENT OF DAVID CROWE

CHIEF ECONOMIST, NATIONAL ASSOCIATION OF HOME BUILDERS

OCTOBER 20, 2009

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the Senate Committee on Banking, Housing, and Urban Affairs on the current state of the Nation's housing market, prospects for the future and what else can be done by the Federal Government to address these challenges.

Downturn in the Housing Market and Overall Economy

Leading into this year, the markets for new and existing homes were in a state of free fall. Between January of 2006 and January of 2009, sales of existing homes fell by one-third, from 6.72 million (at seasonally adjusted annual rate) to 4.49 million. Over the same period, total housing starts fell 79 percent, from 2.27 million (seasonally adjusted annual rate) to 488,000. The decline was even more precipitous for single family housing starts, which fell by more than 80 percent, from a peak of 1.82 million at the start of 2006 down to 357,000 in the first 2 months of 2009. The inventory of new unsold homes on the market increased to a record high of more than 12 months supply.

Meanwhile, the repeat home sales index published by the Federal Housing Finance Agency showed house prices declining every quarter since the beginning of 2008. One positive impact of the decline in house prices is that is has, in combination with historically low interest rates on fixed rate mortgages, improved housing affordability for many Americans—especially for first-time home buyers who do not suffer a loss in equity from selling a previously owned residence. NAHB's Housing Opportunity Index (HOI), which measures the share of homes sold that a median-income family can afford, increased to over 72 percent in the first two quarters of 2009. This marks the first time the national HOI has been over 70 percent since NAHB began reporting the index in 1992.

However, this improvement in affordability has not translated into housing sales and starts as strongly as it would have in the past. At present, in order to obtain a mortgage, buyers need exceptionally good credit and access to timely and accurate appraisals, which are often not available. These factors reduce the pool of eligible buyers well below the level we would otherwise expect.

In addition to problems in the housing market, by the start of 2009 the overall U.S. economy was in a state of recession. Real GDP contracted at a rate of over 6 percent in the first quarter, one of the worst performances in the entire post-war period. Labor markets softened, and the unemployment rate rose above 9 percent. The decline in the housing market and the overall economy were related, as the drop in single family construction alone resulted in more than 3 million lost jobs in construction and the related industries supplying materials and services to home builders and buyers.

Positive Impacts of the First-Time Homebuyer Tax Credit

The American Recovery and Reinvestment Act (ARRA) improved upon the homebuyer tax incentive enacted in 2008 by establishing an up to $8,000 refundable tax credit for first-time buyers of a principal residence in 2009. The law defines a first-time home buyer as a buyer who has not held an ownership stake in a principal residence in the 3 years prior to the sale. To claim the tax credit, the taxpayer must complete the sale of the home before December 1, 2009. The credit is subject to an income phase-out that begins at $75,000 modified adjusted gross income for single taxpayers and $150,000 for married taxpayers. Partial credits are available for some taxpayers with incomes above those amounts.

Overall, there is strong evidence that the Federal first-time home buyer credit is working to stabilize housing markets in the United States. Since the credit has been in effect, existing home sales, which were in sharp decline, have stabilized and started to edge up gradually, from a low of 4.49 million to 5.10 million in August. Similarly, housing starts stabilized and started to edge up from a low point of 479,000 to 587,000 in that same month. Single family starts, in particular, improved steadily, from the low point of 357,000 in January and February up to 494,000 by July of this year. Incomes of buyers who can claim the Federal credit are limited, and sales of new homes have increased most in the affordable range—homes priced under $200,000.

NAHB estimates conservatively that approximately 200,000 additional home sales are attributable to the tax credit. Of these, 121,000 are first-time buyers induced to buy homes because the credit makes the purchase more affordable. As well, 71,000 of these additional home sales are a ripple effect of repeat buyers who were able to sell their existing homes because of the credit. NAHB further estimates that the increase in sales stimulated by the credit has resulted in the absorption of about 50,000 vacant and rental units. Recent data from the National Association of Realtors indicates that 40 to 50 percent of recent home sales are due to first-time buyers, and this increase in demand is in part responsible for recent declines in housing inventories.

The modest improvement in new home construction has not produced an inventory of unsalable homes, as the inventory of new homes on the market has continued to decline from a peak of 572,000 in July 2006 down to 261,000 in August of 2009—the lowest this measure has been since 1992. The decline has reduced the month's supply of unsold homes, but not as dramatically because sales continue at a very slow pace. The NAHB Housing Market Index (HMI) languished at a single digit rate for 5 straight months from late 2008 through the first quarter 2009, but has improved steadily since then, up to 19 in September. Although still very low by historical standards (and values less than 50 indicate negative conditions), this is the highest the HMI has been since the middle of 2008.

A Fragile and Uncertain Recovery in Housing

These recent positive prospects notwithstanding, a number of housing-specific headwinds will continue to buffet any significant housing recovery:

- A large inventory of vacant homes and apartments on the market.
- A pipeline of foreclosures feeding the inventory.
- Continuous downward price pressures from too much supply and not enough demand.
- Tight mortgage underwriting and low appraisals making it difficult for a willing buyer to complete the sale.
- Extremely difficult financing terms and availability for builder Acquisition Development & Construction (AD&C) loans.

After several months of gradual improvement, the rate of single-family production declined in August, from 494,000 down to 479,000, suggesting that upward momentum is being lost as builders anticipate the depressing effect that expiration of the home buyer tax credit may have on demand. NAHB survey data also indicate a loss of momentum that underscores the fragile nature of the recovery in the housing sector. The NAHB HMI for October 2009 has fallen from 19 to 18, the first decline in the index following 5 months of increases, due in part to the tax credit program. In particular, all the components of the index (present sales, expected sales over 6 months, and prospective buyer traffic) fell in October.

Indeed, there continue to be reasons why prospective home buyers are reluctant to purchase a home. In a September 2009 NAHB survey, 81 percent of home builders reported prospective buyers holding back because they cannot sell their existing homes at favorable prices. As well, 73 percent reported prospective buyers waiting on a purchase because they think their employment/economic situations are deteriorating.

Since September 2008, the Nation has lost a total of 5.8 million jobs, including 443,000 residential construction jobs. The national unemployment rate for September was 9.8 percent—up from 9.7 percent in August. The construction unemployment rate increased in September, jumping to 17.1 percent from 16.5 percent the month before. It is worth noting that the construction sector has registered the highest unemployment rate among the major sectors of the economy, with durable goods manufacturing registering the next highest unemployment rate at 13.1 percent. While it is normal for employment to lag the rest of the economy, job growth could prove to be sluggish in this recovery, putting a drag on the general economy and the housing sector, in particular.

With respect to overall consumer confidence, the University of Michigan's consumer sentiment index rose to 73.5 in September from 65.7 in August, while the Conference Board's Confidence Index slipped from 54.5 in August to 53.1 in September. On housing in particular, consumers' views of the marketplace held steady in the Michigan survey, but there was, consistent with NAHB builder survey data, declines in the Conference Board's assessment of consumer plans to buy a house over the next 6 months.

And despite the positive impacts of the $8,000 tax credit, NAHB survey data of home builders reveal that only 27 percent of builders recorded any new home sales to a move-up buyer who was able to sell their existing home to a first-time homebuyer tax credit qualified buyer. Only 2 percent of builders indicated that half of their single-family sales were to such move-up buyers. This seems to suggest a great value in expanding the tax credit to all buyers of principal residences.

These survey data are consistent with Census New Home Sales data, which indicate limited positive impacts of the tax credit for homes priced $300,000 or less (typical markets for first-time homebuyers), but continued weakness in sales of homes priced higher than $300,000. In whole, these data indicate a languishing market for the move-up buyer sector.

And, as discussed in more detail below, NAHB survey data indicate difficulty in financing development. More than 70 percent of surveyed builders reported worse conditions for obtaining new loans for the purposes of land acquisition and development or multifamily construction (rental and owner-occupied), while nearly 60 percent reported worse conditions for single-family construction loan availability.

Moreover, despite the modest improvements in some measures, production of new housing remains far below sustainable levels. NAHB is forecasting 568,000 in 2009 and 716,000 in 2010. Given the size of the U.S. population and projections the forecast for household formations, the long-run sustainable rate of production should be between 1.8 million and 1.9 million per year.

The considerable gap between the amount of housing being produced and the amount needed, coupled with signs that the small amount of upward momentum in housing markets is being lost, indicates that buyers are now especially in need of a stimulus to help them overcome the obstacles of a tight credit market and problem appraisals, and keep production on the track toward a long-run sustainable path.

The Economic Benefits of Extending and Expanding the Homebuyer Tax Credit

As the deadline for the homebuyer tax credit program approaches, NAHB supports extending and enhancing this important housing demand stimulus program. In particular, NAHB recommends extending the sunset date until December 1, 2010, and expanding the eligible buyer definition to include all purchasers of a principal residence.

We estimate that these enhancements would increase home purchases by 383,000 in the next year; increase housing starts by 82,000; create more than 347,000 jobs; generate $16.1 billion in wages and salaries; $12.1 billion in business income and tax income of $8.4 billion for the Federal Government; and $3.2 billion for State and local governments.

The increased home purchase generated by these enhancements will help soak up the excess supply and push house prices back in a positive direction. The economic stimulus created by established households moving into new homes and the added construction necessary to answer demand where there is no excess supply generates jobs, wages, salaries, business income, and tax revenues. As well, these economic impact estimates do not include the larger macroeconomic benefits that would result from the stabilization of housing prices and the housing market in general.

Other Housing Finance Challenges

In addition to the approaching expiration of the first-time homebuyer tax credit, there are other challenges that prevent the housing sector from contributing to a vigorous economic recovery.

AD&C Lending

As noted earlier, another persistent problem in the home building industry that is blunting the recovery of the housing market is the availability of credit for Acquisition, Development and Construction (AD&C) loans. Banks are increasingly refusing to extend new AD&C credit or to modify outstanding AD&C loans in order to provide builders more time to complete their projects and pay off these loans. Often this is being forced by examiners demanding that banks shrink their AD&C loan portfolios.

On outstanding loans, examiners are requiring banks to obtain new appraisals on properties for fully performing loans, which can result in the banks having to downgrade those loans, turning them into troubled "nonperforming performing loans." Once a loan is classified as such, the institution must hold more capital against the loan. As a result, an increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan. Since most home building companies are small businesses and do not have the capacity to meet significant equity calls, the result is often foreclosure on a loan that had been performing.

NAHB is proposing that members of Congress urge the Federal banking regulators to put a halt to these shortsighted practices that are adversely affecting the financial condition of the banking industry as well as having devastating impacts on home building companies. Instead, financial institutions should be encouraged to fund viable new projects and to take steps to avoid foreclosure on AD&C loans by accommodating loan modifications and workouts. This would provide relief for a major sector of the economy that has suffered because of regulatory excess and the inability of banks to provide the necessary funding and flexibility that would otherwise keep loans performing as scheduled.

Banks that have received funds from the Troubled Asset Relief Program (TARP) should be required to account for how these funds are being used in financing and/or working out loans on acquisition, development and construction (AD&C) projects. In many instances, banks that have received TARP funds are letting projects fail rather than pursuing workouts with the original developer and builders. This questionable action, which imposes serious hardship on home builders, often putting them out of business, should not be condoned or subsidized by the Federal Government.

Congress should direct the banking regulators to require banks that have received TARP funds to account for how these funds are being used in lending on new projects. Further, they must demonstrate how the institution is working out the restructuring of existing loans and providing more flexible terms to facilitate continued funding and eventual repayment of performing AD&C loans.

Real Estate Appraisals

There are increasing complaints of real estate appraisers using foreclosure or other distressed sales as comparables in determining values of single family homes without properly adjusting the comparable property values to reflect the relative condition of the properties. If foreclosed and/or distressed property sales are used as comparables, appropriate adjustments must be made to reflect the condition of such properties as compared to the subject property. Improper or insufficient adjustments to the comparable values of foreclosed and/or distressed homes results in the undervaluation of new sales transactions. Such practices contribute to a continuing downward spiral in home prices and forestall economic recovery.

Often, properties that have been subject to foreclosure or distressed sales have issues relating to deferred maintenance or internal damage that an external inspection simply cannot reveal. A prospective purchaser would most assuredly recognize the differences in the value proposition between a well-kept home and a distressed property that is damaged or not properly maintained and the same should be true of an appraiser.

NAHB believes the Federal agencies and organizations that establish appraisal requirements for home mortgages should immediately issue and enforce guidance requiring appraisers to obtain sufficient information and make appropriate adjustments in the prices of comparable sales (“comps”) in order to bring those comps to the level that represents a reasonable alternative to the home they are appraising.

Further, NAHB recommends the establishment of a required appeals process for Fannie Mae, Freddie Mac, and the Federal Housing Administration similar to that used for appeals of appraisals that are performed with the Department of Veterans Affairs (VA) Loan Guaranty Program. The VA instituted a policy in 2003 to reduce the number of requests for reconsideration of property values by facilitating improved communication between appraisers and lenders before appraisal assignments are completed.

Appraisal problems have been exacerbated due to unintended consequences that resulted from the implementation of the Home Valuation Code of Conduct (HVCC) earlier this year. The HVCC was put in place by Fannie Mae and Freddie Mac, as the result of a settlement with New York State Attorney General Andrew Cuomo, to insulate appraisers from inappropriate influence from parties at interest in a home sales transaction.

NAHB strongly supports the intent of the Home Valuation Code of Conduct and we are not among the groups calling for a repeal or suspension of the HVCC. However, NAHB also strongly believes that additional clarifications and implementation reforms are needed in order for the HVCC to work effectively without causing serious market disruptions. NAHB recently convened an Appraisal Summit involving representatives of major housing and financial institution stakeholders, appraisal organizations, and Federal housing and banking regulators to discuss appraisal problems and solutions. There was strong sentiment at the Summit that clearer information on what the HVCC allows, requires and prohibits should be widely disseminated. There also were calls for reforms to establish a system where participants can be confident that appraisers have the training and experience needed to make valuations in complex markets and that appraisers are required (and are given enough time) to collect the information needed to make the appropriate adjustments to distressed sales used as comparables. NAHB urges members of Congress to reinforce the need for such changes.

Conclusion

NAHB appreciates the opportunity to share our views on the current state of the Nation's housing markets and policy options to enable an effective and viable long-term renewal of this critical sector of the economy. There are significant challenges to overcome, but they are not insurmountable. We are ready to work with the Committee and the Congress to meet these challenges and ensure sustainable economic recovery.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM SHAUN DONOVAN

Q.1. What factors have contributed to the delay in launching the foreclosure alternatives program?

A.1. The Administration implemented and published guidance on the Home Affordable Foreclosure Alternatives program (HAFA) as quickly as possible given the complexities surrounding the program.

Q.2. When will the program be launched, and what systems will be put in place to ensure that homeowners who meet the program's criteria can get assistance as quickly as possible?

A.2. On November 30, 2009, the Administration published Supplemental Directive 09–09 to provide guidance to servicers for adoption and implementation HAFA. In short, borrowers who meet the eligibility criteria for HAMP but do not successfully complete a Trial Period Plan, or default on a HAMP modification are eligible for relocation assistance of $1,500 and servicers will receive a $1,000 incentive for completing a short sale or deed-in-lieu.

The effective date for the Supplemental Directive is April 5, 2010. However, servicers are permitted to implement HAFA prior to that date provided they are able to collect and report all information required. Homeowners can participate in HAFA provided that their Short Sales Agreement or Deed-in-Lieu (DIL) agreement is fully executed and received by the servicer by December 31, 2012.

By establishing standard timeframes, documents, processes and deadlines to be used between a borrower, servicer and purchaser in these transactions, HAFA will make these transactions more transparent and accessible to borrowers as an alternative to foreclosure. The standardized and streamlined process will help to facilitate clear communication between the parties to the listing and sale transaction.

Q.3. What specific changes, if any, have been made to the program since it was first announced in May? To the extent that changes have been made, what were the criteria for the changes and how will they speed short sales?

A.3. One important change involves the time period servicers will allow borrowers to market and sell the property. The initial announcement provided borrowers with at least 90 days with the possibility of more time based on local market conditions. The Supplemental Directive gives borrowers at least 120 days to sell that home unless the servicer extends the agreement. The extended time should increase the chances that the borrower may be able to sell the home.

Another important change involves the incentive payment structure. Under the Supplemental Directive, first lien investors will be paid up to $1,000 for allowing a total of up to $3,000 in short sale proceeds to be distributed to subordinate lien holders (on a one-for-three matching basis) who release their lien. In the initial May announcement, it was intended that Treasury would share the cost of paying junior lien holders to release their claims on a one-for-two basis. Treasury would match $1 for every $2 paid by the investors, up to a total contribution of $1,000 by Treasury.

Q.4. What minimum performance timeframes do you anticipate participating servicers will be required to meet in responding to homeowner requests for short sales?

A.4. Under the Supplemental Directive, servicers must consider all HAMP eligible borrowers for HAFA in accordance with their policies within 30 days of the date the borrower: does not qualify for HAMP, does not successfully complete a HAMP trial modification period, is delinquent on a HAMP modification by missing at least two payments, or requests a short sale or Deed-in-Lieu (DIL). Servicers must contact borrower in writing of the availability of the short sale and DIL option and allow borrowers 14 days to notify the servicer and request consideration under HAFA. Moreover, within 10 days of receipt of the Request for Approval of a Short Sale (RASS) and all required attachments, the servicer must indicate its approval or disapproval of the proposed sale by signing the appropriate section and mailing it to the borrower.

Q.5. How many homeowners does HUD estimate will benefit from the program once it is launched, and how was this estimate determined?

A.5. This data is currently not available. We will to get the estimate to you as soon as possible. We do have estimates for FHA foreclosure alternative program participation. FHA borrowers who are not served by HAFA will benefit from FHAs preforeclosure sale and deed-in lieu programs. Based on straight line projections of Q1data, in FY2010, approximately 12,400 borrowers will benefit from the agency's preforeclosure sale and deed-in-lieu programs.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM SHAUN DONOVAN

Q.1. The current state of the housing market sheds light on the increasing need for accessible and decent rental housing stock. What actions is HUD taking place to ensure that multifamily housing units are available nationwide. How do you address regional disparities and diversity in the housing market?

A.1. HUD is aware that in this fragile economy, the need for affordable rental housing is acute. Our programs of rental assistance, public housing, project-based rental assistance, Section 202/811, and others address these needs within our budgetary constraints. HUD makes a concerted effort to ensure distribution or resources relative to need in a number of ways. For example, Section 8 voucher payments are based on Fair Market Rents, that take into consideration some of the variation in costs in different regions.

HUD has programs to provide mortgage insurance to provide credit enhancement to finance the construction or substantial rehabilitation of apartment projects, as well as a program to insure mortgages for the purchase or refinancing of existing projects. There were 510 Firm Commitments issued in FY2009 for 68,778 units of apartment housing, totaling approximately 4.24 billion dollars. This is an increase of 10 percent over the previous year in terms of units, and almost 50 percent by dollar volume.

Most of our programs limit the mortgage by statutory limits that are updated annually. The Department publishes high cost factors to account for regional disparities and diversity in the housing market.

Q.2. According to HUD's most recent data, how many multifamily properties located in high cost housing markets are currently insured by FHA? If FHA mortgage loan limits are exceeded what is the estimated take up rate for these loans. By increasing the mortgage loan limit for this program, will it be easier for a development to receive a loan? Will this result in increased cost to taxpayers?

A.2. Of the 510 apartment projects insured by FHA in FY2009, approximately 95 (19 percent) were located in high cost housing markets. In cases where the FHA statutory limits are going to be exceeded based on the projected project cost, the lender will not even bother to submit an application. Therefore a "take-up rate" cannot be determined. Increasing statutory limits will make it possible for some additional projects in high cost areas to obtain FHA-insured financing. It is important to note, that the FHA higher loan limits would only be a benefit in high cost and high rent areas. In some areas, even though costs are high, the rental income will not support a higher mortgage.

Q.3. There have been rising concerns regarding FHA due to an increasing assumption of risk in its single family portfolio. Does the single family portfolio delinquency rate act as an indicator for the delinquency rate of FHA's multifamily portfolio?

A.3. 60 day default rates for MF properties have been flat since April 2007, ranging from ½ to 1 percent. The claims rate has ranged from 0.3 percent to 0.9 percent from FY2001–2008, and has generally trended downward. Consequently, it does not appear that these factors from the single family portfolio can be relied upon as indicators for the multifamily portfolio. There is growing distress in multifamily and commercial real estate and this would be a better indicator of future problems for the FHA multifamily portfolio. FHA will not be immune to these challenges. However, the fact that FHA does only long-term fixed rate financing should lessen the impact.

Q.4. How is FHA's single-family mortgage loan program different from FHA's multifamily loan program? What steps does FHA take to ensure that a loan for the multifamily loan program does not create risk for the taxpayer?

A.4. Virtually all single-family FHA mortgage lending is done through Direct Endorsement (DE), which enables an FHA-insured mortgage to be processed as rapidly as conventional mortgages. DE is not a separate program; rather, it is the mechanism that enables HUD/ FHA-approved lenders to consider single-family mortgage applications without first submitting paperwork to HUD. With DE, the lender actually closes the loan and then submits the loan package to HUD for insuring.

The typical multifamily loan is processed under HUD's Multifamily Accelerated Processing (MAP) program. MAP-approved lenders perform all the underwriting including the procurement of third party reports such as the appraisal and environmental site assessment. They submit the package to HUD for review. If HUD is satisfied that the lender's underwriting meets the Department's requirements, a Firm Commitment is issued. The lender then prepares loan closing documents and submits them for review by HUD's local office counsel and technical staff.

Multifamily Housing Development mitigates risk by monitoring MAP-approved lenders through its Lender Quality Management Division (LQMD). LQMD employs traveling field personnel who are experts in the fields of architectural/engineering, appraisal and mortgage credit, who visit selected projects and lender's offices to ascertain the level of compliance with the Department's underwriting requirements. Various levels of sanctions, including loss of MAP-approved status, can be applied to lenders who are not meeting HUD's standards.

Q.5. FHA has helped stabilize the housing market since the 1930s by insuring mortgages that meet certain criteria. However, this program has had limited success in promoting the construction of new rental housing units since the maximum loan size for this category is so small compared to the average construction costs in urban areas. In New York City, for example, the average construction costs for a high-rise building (defined as a building that is 16 stories or taller) is $419,000, or more than double the current FHA limit. This makes it harder to secure affordable financing for multifamily rental development and rehabilitation.

Given that the housing market is currently experiencing difficulties with credit illiquidity and a lack of private financing for large housing developments, existing programs must serve the purpose for which they are intended. What additional measures can Congress take to assist HUD in providing multifamily loans that accurately address construction costs in high cost areas but do not add increased risk to taxpayer money?

A.5. There are several actions that Congress could take that might promote greater use of HUD programs in high cost areas:

A. Congress could raise the statutory exceptions, currently at 170 percent for any geographic area, and 215 percent on a project-by-project basis for high cost areas.

B. Congress could amend those sections of the National Housing Act that contain statutory limits per family unit by repealing the portions of those sections that refer to the statutory limits. The insurance fund is protected by the objective mortgage limitations of cost, value or debt service, although these criteria do not insure that FHA mortgage insurance exclusively promotes low and moderate income housing. FHA could then implement regulations that would prohibit amenities that were considered luxury and atypical for comparable affordable properties in the market place.

Further analysis is needed with respect to the likely effectiveness and cost implications of these potential changes.

Q.6. How do construction costs compare for multifamily buildings that include elevator-like structures and multifamily buildings that do not? Should loan limits for the construction or rehabilitation of high-rise buildings with elevators reflect this discrepancy? If this is so, what is an accurate cost differential between multifamily buildings that include elevator-like structures and those buildings that do not?

A.6. Construction costs for elevator-type buildings, mostly steel or reinforced concrete frame buildings, are generally somewhat higher than an equally large walk-up wood frame building, but these buildings are also generally bigger and construction efficiencies create an economy of scale. FHA uses the Marshall & Swift Valuation Service cost estimating guide for calculation of the high cost percentage factors to be applied to the basic statutory family unit limits. These factors account for the differences in construction costs based on location. We have also studied the difference in construction costs (not including land acquisition) between steel/concrete, and wood frame construction using the Marshall and Swift online Commercial Estimator. Depending on quality of construction and building height, steel/concrete construction can be about 7 percent to 25 percent higher than wood frame. This is consistent with interviews conducted with field staff.

One of the biggest differences is the cost of land in high cost areas that is not fully reflected in the calculation of the per-unit limits or the high cost percentage adjustments. Expensive high density zoned land is needed for elevator buildings. In addition there may be significant impact fees associated with the construction of large elevator projects.

In general, we have found that the mortgages that we have insured on elevator buildings for the past 7 years run about 30 percent per unit higher than on nonelevator projects. This is a useful statistic since the cost of land is included. However, it also assumes the statutory limits in effect at the time the project was mortgaged and projects that were too expensive to meet the statutory limits would not be included in the calculation; which suggests that the average differential between elevator and nonelevator buildings could potentially be higher than 30 percent per unit if the statutory limits did not exist. This is not consistent with the average differential in the currently published statutory limits which is about 9 percent.

Determining an accurate differential for Statutory Limits between elevator and nonelevator construction is hampered by the fact that Statutory Limits are based on unit type (*i.e.,* one bedroom, two bedroom), while construction costs are estimated by structure size in square feet. Consequently, variations in unit mix can result in differences in a statutory-limited mortgage amount in buildings that are the exact same size.

Q.7. FHA-insured mortgage amount limits for buildings with elevator-type structures under the Section 220 program are useful tools for urban renewal and revitalization efforts. Because this program is typically utilized in high cost housing market(s) for the construction of mixed-use developments, do construction costs for these developments compare with other multifamily properties with elevator-type structures?

A.7. Should loan limits for the construction of developments under Section 220 reflect a discrepancy in cost? If this is so, what is an accurate cost differential between multifamily buildings with elevator type structures insured under Section 220 *versus* multifamily buildings with elevator type structures that are not insured under the Section 220 program?

There is no reason that a building for a Section 220 project should cost more to build (exclusive of land) than a Section 221 project at the same location. Cost data on Section 220 projects is limited since there have only been 10 projects insured in the past 5 years and not all of them were new construction. However, due to their mostly urban locations Section 220 projects may require expensive high density zoned land which is why the current statutory limits are slightly higher for Section 220 than for Section 221(d)(4).

An accurate cost differential between elevator and nonelevator projects for Section 220 would need to be the same as for any other program.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM SHAUN DONOVAN

Q.1. Secretary Donovan, following up on our conversation regarding the Home Valuation Code of Conduct (HVCC), it is my understanding that FHA's clarifying appraisal requirements from September 18, 2009, will go into effect on January 1, 2010. Specifically, it states, "FHA does not require the use of Appraisal Management Companies or other third party providers, but does require that lenders take responsibility to assure appraiser independence." While I appreciate attempts you have made to tone down the impact of the HVCC, it is my understanding that there is still a very large segment of the market—all GSE backed loans—that were not covered by FHA's announcement that is operating under an agreement between a State Attorney General and the two GSEs. Do you believe Congress should act to ensure full consideration is given to the HVCC's impacts and challenges?

A.1. FHA published Mortgagee Letter 2009-28, Appraiser Independence, to restate and expand FHA's existing policy and more closely align the language to that which became commonly used in the industry as a result of the Home Valuation Code of Conduct (HVCC). In areas in which FHA's existing policies regarding appraiser independence were consistent with the HVCC, FHA adopted language from the Code to ensure full alignment of FHA and GSE standards and prevent confusion in the marketplace. The HVCC became effective at a time of significant change in the housing market and mortgage lending practices. With so many changes in the residential marketplace, some specific to geographic areas, property types and selling practices (short sales and bankruptcies), coupled with the number of Federal recovery initiatives, it is very difficult to gauge the impact HVCC has had on the valuation of residential housing and if a quantifiable impact is due to HVCC or some other condition or event.

However, we can be reasonably certain that the use of Appraisal Management Companies (AMC) increased as a result of HVCC. It is important to note that FHA has never prohibited the use of AMCs or other appraisal management services and believes that reputable, well run companies provide great benefit in supporting appraiser independence. Due to the growth in number and use of AMCs, many States are working independently to create and implement regulations and oversight requirements. Because many larger AMCs operate in multiple States, we believe there would be support within the industry to have one set of national requirements which could potentially lessen the burden of tracking and compliance with individual State requirements.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM SHAUN DONOVAN

Q.1. You have stated that homeowners may qualify for the Making Home Affordable Program in accordance with a number of eligibility criteria, including the value of the home, but that it is not clear to what extent MHA offers "a viable mechanism for addressing" this problem. Could you please explain why it is not clear whether MHA addresses extreme losses in value that owners of these homes have experienced?

A.1. This is still being assessed by the Government-wide Making Home Affordable Program group.

Q.2. You say that you cannot send HUD Foreclosure Rapid Response Teams to southeastern Virginia because clusters of impacted homes have not yet been identified (you have to wait for CPSC results, consult with HUD teams, *etc.*). I disagree. I have met with numerous constituents in southeastern Virginia facing foreclosure because of this drywall problem, and I think it could certainly qualify as an area worthy of a visit from HUD Rapid Response teams. Why do you have to wait before deciding whether to send the teams to areas that are facing foreclosure problems now?

A.2. After polling our largest servicers, who service over 75 percent of the FHA loan portfolio, we have found two possibly impacted FHA-insured homes. We have informed our servicers of the information in HUD's Press Release 09-237, dated December 22, 2009, and trained our call centers to be able to respond to any inquiries. For more information, servicers and homeowners can call HUD's National Servicing Center at 888-297-8685 for more information.

Q.3. You mention that the Community Development Block Grant program could be used to address problems caused by contaminated drywall. What could the money be used for—mortgage modification? Replacement of contaminated drywall? What else? How can individual homeowners access CDBG funds?

A.3. On December 22, 2009, HUD issued Press Release 09-237, announcing that HUD's CDBG Program is another resource to help States and local communities address the rehabilitation expenses associated with problem drywall. Historically, CDBG has helped to support local efforts to rehabilitate homes through grants, loans, loan guarantees, and other means. In addition, CDBG may also support code enforcement, acquisition, clearance and remediation, and relocation activities.

All CDBG-assisted activities must meet one of the program's three national objectives: Provide benefit to low- and moderate-income persons; Eliminate slums or blighting conditions; or address an immediate threat to the health or welfare of the community.

The Consumer Product Safety Commission (CPSC) reports that more than 2,360 homeowners in 35 States and the District of Columbia (primarily in Florida, Louisiana, and Virginia) have filed complaints of possible drywall-related problems including damage to electrical wiring, plumbing, utilities, and a variety of health concerns. The drywall emits sulfur gases. One of these, hydrogen sulfide, which corrodes copper, was found at higher levels in homes with the drywall. Copper sulfide corrosion damage has been found on wiring, pipes, and household appliances in homes with the drywall. In addition, the Centers for Disease Control and Prevention (CDC) is examining possible health consequences related to this drywall.

CPSC, in partnership with the CDC, the Environmental Protection Agency (EPA), U.S. Customs and Border Protection and HUD is coordinating the Federal Government's response into which particular drywall products pose a risk to human safety and health and structural integrity. All related reports and findings are available online at the CSPC Drywall Information Center (*http://www.cpsc.gov/info/drywall/index.html*).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BENNETT FROM SHAUN DONOVAN

Q.1. The decrease in the credit available for conventional low-downpayment financing has led to a significant increase in FHA-backed loans, especially for first-time, low-income and entry level homebuyers. Where it once insured only one in 50 loans, it now insures about one in four loans. However, when the new policy takes effect, FHA-backed loans will be limited to only 30 percent of all condo loans within a property. What does FHA intend to accomplish with this limitation? Did FHA and HUD take into consideration the impact this will have on the housing market? Was the particular effect on low-income, first time homebuyers, and other entry level homeowners taken into consideration? Does FHA have any intent of monitoring the impact and consequences of this rule?

A.1. Since receipt of Chairman Dodd's inquiry of November 12, 2009, the Department has issued two new Mortgagee Letters (ML), ML 2009-46 A and 2009-46 B. In ML 2009-46 B, the Department announced the new permanent baseline guidance for condominium project eligibility. This permanent guidance replaces the previously issued ML 2009-19 in its entirety.

The temporary guidance issued in ML 2009-46 A waives five provisions of the permanent guidance and serves as a temporary directive to address current housing market conditions. This temporary guidance is effective for all case numbers assigned on or after December 7, 2009, through December 31, 2010. FHA recognized the concerns of various trade associations, lenders, and other interested parties in establishing the permanent and temporary policy guidance.

One of the provisions provided for in the temporary guidance was an increase in the FHA Concentration percentage for "new construction" projects from 30 to 50 percent. In addition, FHA increased the concentration in "established" condominium units to 100 percent due to the ability to understand marketability of the project and performance of the HOA budgets. In its considerations for issuance of the new policy guidance, FHA carefully analyzed the impact that this would have on the housing market. While FHA recognizes its responsibility to ensure the availability of affordable, sustainable housing opportunities, it must also balance its fiduciary responsibility to protect the insurance fund. In fact, FHA's requirements are more lenient than those of Fannie Mae, Freddie Mac, and the Veteran's Administration. FHA will monitor the performance of condominium loans, including the impact of the 50 percent concentration requirement.

Q.2. FHA's proposed rule will limit the volume of FHA-insured loans in an approved project. Currently, the condo market attracts individuals and families who are first-time homebuyers, moving from renter to homeowner status. However, FHA has also altered the approval process to require that at least 50 percent of all units be owner-occupied. During our current economic situation, where FHA insures over 25 percent of loans, this additional restriction is expected to freeze the sale of condos across the country. What motivated FHA to place this restriction on condos? Was the increased impact on first-time, low-income and entry-level owners considered? And does FHA have any intent of monitoring the impact and consequences of this rule?

A.2. The proposed rule is actually a decrease in the existing required owner occupancy percentage from 51 percent to 50 percent. Additionally, FHA issued temporary guidance (ML 09-46A) that excludes both vacant and tenant occupied REOs from owner occupancy calculations. This guidance was in response to the current elevated number of REOs in the marketplace, FHA's temporarily elevated share of the mortgage market, and in recognition of FHA's responsibility to assist with neighborhood stabilization by providing housing opportunities. FHA incorporated the concerns of various trade associations, lenders, and other interested parties in establishing the permanent and temporary policy guidance. FHA recognizes its responsibility to ensure the availability of affordable, sustainable housing opportunities, and must also balance its fiduciary responsibility to protect the insurance fund. In fact, FHA's requirements are more lenient than those of Fannie Mae and Freddie Mac.FHA will monitor the performance of condominium loans, including the impact of the permanent and temporary guidance.

Q.3. It appears that the scheduled changes have been made in response to increased in defaults that have hit some markets particularly hard. However, the Utah, and specifically in Salt Lake, my constituents' feel that other methods could have been selected to resolve the problems without such anticipated negative effects. What reasoning led to the selection of these specific factors for change? Were less Draconian changes to underwriting guidelines considered? Were changes based on default rates in different metropolitan statistical areas considered as a method of more carefully applying the more stringent standards?

A.3. FHA developed the guidance after significant on-going discussions with various trade associations, lenders and other interested parties. Given the current market conditions, contraction of available credit and the fact that many of the newly constructed condominium projects have significant numbers of unsold units, FHA, as an insurance agency, has a fiduciary responsibility to protect the insurance fund. The requirements established will assist in ensuring that purchasers have affordable and sustainable home ownership opportunities. FHA determined that the guidance issued is flexible, yet allows for mitigation and management of the associated risks. FHA cannot be the sole insurer in a project and take on all the associated risk—as previously stated, the new requirements are more lenient than those of Fannie Mae, Freddie Mac and the VA.

Q.4. The release of the Mortgage Letter 2009-19 was not well-received by most of my constituents and many have complained to me that the new regulations don't take into consideration the different markets across the country, don't appear to have the best interests of potential homebuyers, builders, lenders of other involved in the condo market at heart, and the also feel the regulations are being thrust upon them with little or no time for public comment. Many of my constituents feel that these rules were thrown together, with little insight or consideration of the likely negative consequences. What public input was considered? What responders led the changes, both in terms of implementation date and the loosening of some of the restrictions? At this point, does it appear that further loosening of the regulations may come in response to public opinion?

A.4. The FHA held conference calls and meetings with representatives from the major trade associations (Mortgage Bankers Association, National Association of Realtors, and National Association of Home Builders) and their members communicated that these combined changes limited opportunities for buyers to obtain financing, impede resale of homes and slow absorption of excess condominium housing stock. Based on these communications, on November 6, 2009, the Department of Housing and Urban Development issued two new Mortgagee Letters (ML), ML 2009-46A and ML 2009-46B. In ML 2009-46B, the Department announced the permanent baseline guidance for condominium project eligibility. This permanent guidance replaces the previously issued ML 2009-19 in its entirety and was effective December 7, 2009. The temporary guidance issued in ML 2009-46A waives five provisions of the permanent guidance and serves as a temporary directive to address current housing market conditions. This temporary guidance is effective for all FHA case numbers assigned on or after December 7, 2009.

Key provisions of the temporary policy changes are:

1. *"Spot Loan" Approval Process.* This process, originally scheduled to be eliminated December 7, 2009, has been extended through January 31, 2010 in order to prevent any shock to the housing industry.
2. *FHA Concentration.* The overall limit will be increased to 50 percent. Additionally, in order to further increase the number of eligible loans in a project, FHA will allow 100 percent FHA concentration for projects that meet all basic condo standards plus the following:
    - The project is 100 percent complete and construction has been completed for at least 1 year.
    - 100 percent of the units have been sold and no entity owns more than 10 percent of the units in the project.

- The project contributes a minimum of 10 percent of the annual budget to the reserve account.
- Control of the Homeowners Association has been transferred to the owners; and
- The owner-occupancy ratio is at least 50 percent.

3. *Owner-Occupancy Requirement.* The temporary waiver expands the calculation to exclude vacant or tenant-occupied Real Estate Owned (REO), including properties that are bank-owned enabling this requirement to be obtained sooner.
4. *Presale Requirements.* Presale has been reduced to 30 percent to increase the stability of the development by allowing lenders to submit closed loans sooner for FHA insurance and reduce the projects vulnerability to today's market conditions.
5. *Florida Condominium Project Approval.* All requests for approval of condominium projects located in Florida will require submission to HUD for review. FHA anticipated a more stabilized market in Florida once lenders observe we are taking an active role in approving projects, thereby assuring that these projects are both stable and marketable.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM SHAUN DONOVAN

Q.1. Will HUD grant RESPA §19 relief from liability to those who are unable to comply with the unclear rule or the last-minute FAQs? If not, why do you want to hold lenders to unknown rules? If yes, when? For how long?

A.1. Since the Department issued its final rule to improve the mortgage settlement process on November 17, 2008, the agency has participated in more than 60 industry forums designed to assist mortgage professionals in complying with the regulatory requirements under the Real Estate Settlement Procedures Act (RESPA). In addition, the Department has published more than 250 frequently asked questions to answer many of the mortgage industry's specific compliance issues. Staff have also answered hundreds of questions directly to individual lenders, mortgage brokers and title insurance companies clarifying the new rule requirements as they relate to the their individual business practices.

On November 13, 2009, the Department issued a press release stating that there will not be a delay on the implementation of the new requirements under the Real Estate Settlement Procedures Act (RESPA), but for the first 4 months of 2010, the staff of the Mortgagee Review Board will exercise restraint in enforcing the new regulatory requirements.

The Department is sensitive to the concerns of the industry as it integrates these new rules into their day-to-day business practices and we will continue to work with those who are making an honest effort to work with us as we implement these important new consumer protections.

Q.2. In this time of high foreclosures, when families need to refinance rather than get foreclosed, why are you driving honest lenders out of business?

A.2. Buying a home in America should be the fulfillment of a dream. Instead, millions of families go to the settlement table each year without clearly understanding the loan product or associated charges. In many respects, it's clear that the way people bought and financed their homes did not serve consumers very well and contributed to the current housing crisis.

Further, many Americans cannot refinance because they unknowingly entered into negative amortization mortgages. This has led them to a situation where their principal balance increased and they are likely to owe more for their home than the home is currently worth.

Finally, the Department does not believe that the new RESPA rule requirements will drive honest lenders or mortgage brokers out of business. The new requirements provide consumers with accurate and binding disclosure about charges and loan terms. The Department believes that if consumers had received the critical information contained in the new Good Faith Estimate, many borrowers may not be facing the prospect of losing their homes today.

Q.3. Where do you suppose the families will go?

A.3. The Department firmly believes that the first line of defense is an informed consumer. The Department is working with our State and local partners on the ground, particularly housing counselors, to increase consumer awareness and give homeowners and homebuyers a trusted place to turn for assistance. HUD sponsors counseling agencies throughout the country that give advice on buying a home, renting, foreclosure, credit issues and reverse mortgages.

On May 20, 2009, the President signed the "Helping Families Save Their Homes Act of 2009." This law provides the Federal Housing Administration (FHA) with additional loss mitigation authority to assist FHA mortgagors under the Making Home Affordable Program (MHA). The MHA Program is designed to help homeowners retain their homes and to prevent the destructive impact of foreclosures on families and communities.

One key component of MHA provides homeowners the opportunity to reduce their mortgage payments through the use of a loan modification through the Home Affordable Modification Program.

Q.4. What good are new loan disclosures when there are no lenders?

A.4. The Department firmly believes that the new regulations promote the borrower's ability to shop for the best loan for them which serves to enhance and stabilize a competitive market and that the new RESPA rule requirements will not drive honest lenders or mortgage brokers out of business.

Q.5. The final rule does not prohibit a lender from issuing a good faith estimate (GFE) that differs from a GFE a broker gave a consumer. The FAQs take the opposite position. Which is the true story?

A.5. The final rule and FAQs are consistent. The final rule permits any loan originator (mortgage broker or lender) to issue the GFE. The FAQs state that loan originators are bound to the terms of that GFE unless a revised GFE is permitted to be issued pursuant to the new rule, specifically section 3500.7(f).

Q.6. If lenders want to comply with the new FAQs, they don't have time. They have to stop letting consumers use brokers. Isn't that absolutely the wrong thing to do to consumers? Shouldn't HUD be doing everything it can to promote consumer choice?

A.6. The Department firmly believes that the new regulations are a big step forward for restoring trust and transparency between the industry and the homeowner. The regulations promote consumer choice through accurate information disclosed early in the process and binding settlement service providers to the charges and loan terms in the GFE.

The Department is working with industry associations and individual settlement service providers to clarify the new rule requirements. The Department worked diligently to avoid bias for or against mortgage brokers and believes that the new rule, by allowing consumers to accurately compare loan offers from lenders and mortgage brokers, will allow lenders and brokers to compete on a level playing field based upon rates and services.

Q.7. Which do you want lenders to choose, violating your rule or taking away families' tax deductions?

A.7. Loan originators can comply with the rule while preserving consumer's available tax deductions. The FAQs offer two options for disclosing deductible origination points. Both of these disclosure methods were reviewed and approved by the IRS to ensure that the availability of tax deductions was preserved.

Q.8. The Truth in Lending Act (TILA) requires disclosures that overlap the RESPA disclosures. I think it makes sense for the disclosures to work together so people can understand them. But they don't. The RESPA rule requires different disclosures than the Truth in Lending Act disclosures. RESPA prohibits putting the APR in the RESPA forms. Your new FAQs are making the differences bigger, not smaller. The FAQs define the initial interest rate differently. The FAQs disclose settlement charges differently. The FAQs disclose changed circumstances differently. The FAQs disclose semi-monthly payments differently. The FAQs even can identify the lender differently. This is backwards. Why are we going backwards but calling it forewords?

A.8. RESPA and TILA are separate statutes that have separate disclosure requirements. The Department remains committed to coordination and communication in creation of complementary disclosures with the Federal Reserve.

Q.9. Will you commit to sitting down with the Federal Reserve, come up with one integrated disclosure, and use that instead of what is a seemingly incoherent and erratic process for developing this RESPA reform set in place by the previous Administration?

A.9. The Department remains committed to coordination and communication in creation of complementary disclosures with the Federal Reserve.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM EMILE J. BRINKMANN

Q.1. FHA has helped stabilize the housing market since the 1930s by insuring mortgages that meet certain criteria. However, this program has had limited success in promoting the construction of new rental housing units since the maximum loan size for this category is so small compared to the average construction costs in urban areas. In New York City, for example, the average construction costs for a high-rise building (defined as a building that is 16 stories or taller) is $419,000, or more than double the current FHA limit. This makes it harder to secure affordable financing for multifamily rental development and rehabilitation.

Given that the housing market is currently experiencing difficulties with credit illiquidity and a lack of private financing for large housing developments, existing programs must serve the purpose for which they are intended. What additional measures can Congress take to assist HUD in providing multifamily loans that accurately address construction costs in high cost areas but do not add increased risk to taxpayer money?

A.1. The current FHA multifamily loan limits are severely restricting the ability to use FHA insurance programs to finance rental housing in many urban areas. While the base loan limits and high-cost factors have been raised over the past 8 years to address issues in most parts of the country, the problems are now concentrated in major cities where high-rise construction is involved. HUD data shows that, over the past 7 years, there have been 478 Section 221(d)(4) new construction projects (without Federal assistance) finally endorsed for HUD insurance. Of those 478 projects, only 31 involved elevator structures. Most recently, in fiscal years 2007 and 2008, only three elevator projects nationwide have been endorsed for insurance with FHA. We believe this is largely due to the maximum loan limits imposed by statute on the FHA insurance programs.

Congress can address this issue by increasing the FHA multifamily loan limits for elevator buildings by establishing a 50 percent differential between the nonelevator and elevator loan limits in each FHA insurance program and each unit size (with a slightly higher increase to serve redevelopment areas). The Secretary of HUD should also be given authority to increase the high-cost factor in extremely high-cost areas (as determined by the Secretary) to the same high-cost factor now allowed by statute for Special Limit Areas (*i.e.,* Alaska, Hawaii, Guam, and the U.S. Virgin Islands). The House of Representatives recently passed H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act, on a bipartisan voice vote. MBA strongly supports this legislation, which would achieve the above policy goals.

Increasing the loan limits will not add increased risk to the FHA multifamily insurance fund or taxpayers, as each loan is not only fully underwritten by approved lenders but also reviewed by HUD staff. The underwriting and review are comprehensive, involving a market study, appraisal, cost and architectural reviews, and extensive examination of the owner/developer, to assure that the rental units being developed are needed in the community, will be affordable to the prospective tenants and will be developed according to appropriate building standards. The multifamily insurance programs charge a mortgage insurance premium that is reviewed each year to ensure that it is sufficient to cover the costs of the program. To date, FHA's delinquencies and claims in the multifamily programs have been modest and well within expected ranges.

Q.2. How do construction costs compare for multifamily buildings that include elevator-like structures and multifamily buildings that do not?

Should loan limits for the construction or rehabilitation of high-rise buildings with elevators reflect this discrepancy? If this is so, what is an accurate cost differential between multifamily buildings that include elevator-like structures and those buildings that do not?

A.2. In order to estimate the difference in total cost between a garden style apartment and a high rise (and thus the difference that should exist between elevator and nonelevator loan limits), MBA used the RS Means construction estimation system to estimate and compare costs of similar, modestly constructed developments in several markets. This analysis (copy attached) shows a 45 percent difference in per square foot construction cost between labor and materials for a nonelevator apartment and an apartment in an 8 to 24-story building. MBA suggests adding to that an additional 5 percent to provide for Davis-Bacon wage rate differentials. While the wage rates vary across the country, the difference can be substantial (*e.g.,* in Washington, DC, the difference between the residential and commercial wage rate for a carpenter is 183 percent). (Adding this 5 percent to the 45 percent difference in RS Means costs outlined above provides a total differential of 50 percent.)

MBA has also compared per square foot costs between actual, proposed projects in the same market area, where this data was available. In the D.C./Northern Virginia market area, the per square foot cost differential between a high rise apartment building in downtown Washington and a garden apartment in Fairfax County, VA, is 89 percent. In the Baltimore market area, the cost differential between a high rise project in downtown Baltimore and a garden apartment in Waldorf, MD, is 66 percent. As noted above, this substantial difference in cost is due largely to the combination of Davis-Bacon wage rates and the increased construction costs resulting from the use of steel, concrete, and other costly construction materials.

Q.3. FHA-insured mortgage amount limits for buildings with elevator-type structures under the Section 220 program are useful tools for urban renewal and revitalization efforts. Because this program is typically utilized in high cost housing market for the construction of mixed-use developments, do construction costs for these developments compare with other multifamily properties with elevator-type structures?

Should loan limits for the construction of developments under Section 220 reflect a discrepancy in cost? If this is so, what is an accurate cost differential between multifamily buildings with elevator-type structures insured under Section 220 *versus* multifamily buildings with elevator type structures that are not insured under the Section 220 program?

A.3. Construction costs vary primarily by type of construction (wood *vs.* steel frame, for example) and by location (to account for differences in land costs and wage rates), not by whether the development is insured under Section 220 or 221(d)(4). However, because the Section 220 program is used in urban renewal and concentrated development areas, construction costs are generally higher, reflecting the need for additional site preparation costs, on-site security costs and/or a higher percentage of commercial space. Loan limits for Section 220 elevator buildings have, traditionally, been set approximately 10 percent higher than the Section 221(d)(4) loan limits. In order to maintain that differential and to account for the higher costs often involved in urban renewal and concentrated development areas, MBA recommends that the differential for Section 220 loans be set at 60 percent, rather than the 50 percent differential recommended for the other programs.

Q.4. Would the housing industry support legislation that would extend the FHA-insured mortgage loan limit for multifamily properties for developments in high cost areas as well as those with elevator like structures?

A.4. The industry would be very supportive of increasing the loan limits in extremely high-cost areas. In fact, MBA and other industry groups have endorsed H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act, which passed the House of Representatives on September 15, 2009. A copy of the joint industry letter in support of H.R. 3527 is attached.

MBA recommends that the Secretary of HUD be given authority to increase the high-cost factor in extremely high-cost areas (as determined by the Secretary) to the same high-cost factor now allowed by statute for Special Limit Areas (*i.e.,* Alaska, Hawaii, Guam, and the U.S. Virgin Islands). For example, cost data from McGraw Hill show an average cost per unit in New York City of $419,000 for 16+ story buildings, which is significantly higher than other large cities, demonstrating a need for special consideration for such an extremely high-cost area.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

PREPARED STATEMENT OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

The Independent Community Bankers of America (ICBA) welcomes the opportunity to share its views with Members of the Senate Banking Committee on the state of the Nation's housing market.

As reminded daily in the press, housing market woes still plague the U.S. economy. The sharp decline in the housing and housing finance sector remains at the heart of our Nation's weak economy and troubled credit markets. The weak housing sector continues to have a ripple effect throughout the entire Nation and is putting severe stress on households and small businesses nationwide.

The current turmoil in our housing and financial markets is also jeopardizing the availability of credit for small business. Some of the Nation's largest lenders and money-center banks tripped up on aggressive subprime lending and toxic investments and are now forced to pull in their lending across-the-board, write down losses, and rebuild capital.

However, community banks represent the other side of the financial story. Community banks rely on relationships in their communities, not on relationships with investment banks or hedge funds. Commonsense community bankers largely avoided the subprime debacle. Community bankers live and work in the communities they serve and do not put their customers and neighbors in loan products they could not possibly repay. Community banks did not cause the current turmoil in the housing sector but are well-positioned, well-capitalized, and willing to help. In fact, community banks are currently playing an important role in the homebuying market. We estimate that community banks closed $100 billion in mortgage loans in the first half of 2009.

Homebuyer Tax Credit

Restoring confidence in the housing market is vital to restoring economic growth. One of the policies, introduced by Senator Johnny Isakson (R–GA) and cosponsored by Chairman Dodd (D–CT), is the extension and expansion of the highly successful homebuyer tax credit. In order to address a slowing economy, ICBA recommended a first-time homebuyer tax credit in early 2008. A first-time homebuyer tax credit was initially enacted in a 2008 stimulus plan and expanded in the Recovery Act of 2009. The National Association of Realtors reports an increased number of individuals are shopping for a home based on the homebuyer tax incentive and existing home sales have increased in the past several months.

However, the housing sector remains a troubled spot for the economy and can use additional support. ICBA strongly supports additional targeted housing tax incentives to arrest the downward spiral in the housing market. One of the largest underlying problems preventing an economic recovery remains declining home prices. Housing and household related spending typically accounts for 20 percent of the Nation's Gross Domestic Product (GDP). Plunging home values are putting record numbers of borrowers' underwater and fueling record foreclosures. Millions of small businesses are suffering the fallout from the dramatic decline in the housing market.

The vicious downward cycle in the housing sector must be stopped. The current homebuyer tax credit is working but is set to expire at the end of November. This is too soon and the credit may be too limited to boost the housing market back to robust levels. ICBA respectfully recommends Congress increase the first-time homebuyer tax credit to $15,000; allow it to be used by all homebuyers—not just first-time buyers, and extend it through 2010. The housing market must be stabilized and growing in order to achieve a sustained economic recovery. Stabilizing real estate prices will better allow small businesses to use their real estate values as collateral for credit. An extended and expanded homebuyer-tax credit will help.

Government Sponsored Enterprises (GSEs)

Another important aspect of stabilizing the housing market is the future of the Government Sponsored Enterprises (GSEs). Fannie Mae and Freddie Mac have long been important partners of community banks by providing community banks an important source of housing finance funding and an impartial outlet to convey community bank mortgages to the secondary market. The two GSEs continue to play a vital role in supporting residential mortgage lending and home ownership, particularly in these difficult times when other sources of credit have dried up or offer only above market rates.

In a recent survey of ICBA members, nearly 50 percent of the respondents indicated that they sell mortgages directly to the two GSEs, while nearly 40 percent indicated they sell indirectly to the secondary market (most likely because they do not generate adequate volume to sell directly). The volume of sales to the GSEs has increased recently. In 2009, ICBA members have increased the volume of loans sold to the GSEs by 300 percent over the prior year as they worked to fill the credit gap left by other lenders. Without access to a secondary market, most if not all of these loans would not have been made because community banks would not be able to keep the loans in portfolio due to interest rate risk. Thus, Fannie Mae and Freddie Mac have enabled community banks to competitively offer fixed-rate mortgages to their customers.

The future of the Government sponsored enterprises must be resolved in a manner that ensures the continued existence of a strong, impartial secondary market for community bank residential mortgages so that community banks can continue to offer this important mortgage product to the communities they serve. Community banks need a strong, impartial secondary market for residential mortgages where they can sell mortgages without fear that the entity to which they sell mortgages will steal away their customers. As Congress looks to the future structure of our residential mortgage secondary market entities, we urge Congress to ensure a secondary market that does not directly compete with the private sector and that provides equitable access and pricing to all lenders regardless of size or volume.

Recent market events demonstrate the important role Fannie Mae and Freddie Mac have played in providing liquidity and market stability. In that regard, the secondary market entity or entities that emerge from the GSE conservatorship need to have the operational flexibility to hold mortgages when market conditions dictate, along with their securitization authorities. Fannie Mae and Freddie Mac's Government ties have enabled them to continue to function and provide a critical source of housing finance during the recent market upheaval. The future secondary market for housing finance should continue to have some type of Government ties, to insure that home ownership will continue to play a crucial role in the financial well-being of American families and the American economy.

Conclusion

ICBA appreciates the opportunity to provide a statement on these critical issues. ICBA looks forward to working with this Committee and Congress on these and other steps that will help us emerge from this current crisis to improve and preserve our housing market for the future.

The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA's Web site at *www.icba.org*.

PREPARED STATEMENT OF LARRY H. KEENER

CHAIRMAN, CHIEF EXECUTIVE OFFICER AND PRESIDENT PALM HARBOR HOMES, INC.

OCTOBER 20, 2009

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, my name is Larry Keener, and I am the Chairman, Chief Executive Officer, and President of Palm Harbor Homes, Inc. (Palm Harbor). Based in Texas, Palm Harbor is one of the Nation's leading manufacturers and marketers of factory-built homes. The company markets nationwide through vertically integrated operations, encompassing manufactured and modular housing, finance, and insurance. Through its financing subsidiary CountryPlace Mortgage (CountryPlace), Palm Harbor offers conforming mortgages to purchasers of factory-built homes sold by company-owned retail sales centers and certain independent retail dealers, builders, and developers.

Mr. Chairman, Palm Harbor strongly encourages the extension of the availability of the First-Time Homebuyer Tax Credit until December 1, 2010. Retention of the tax credit, which is scheduled to expire on December 1, 2009, will encourage continued economic recovery and provide many potential first-time buyers the opportunity for affordable home ownership. Further, Palm Harbor believes expansion of the tax credit to all homebuyers would significantly increase opportunities for home ownership and maximize the effectiveness of the subsidy to generate economic activity and related job creation.

The availability of financing remains a barrier to home ownership. This barrier is particularly daunting for low- and moderate-income buyers. Not only has the tax credit been an effective tool for creating more opportunities for these first-time homebuyers; it has also begun to assist in increasing liquidity in the housing market. As a manufacturer of affordable housing, the tax credit has been particularly impactful for Palm Harbor's customer base—in most instances the credit provides purchasers of manufactured homes with the down payment necessary to meet homeowner equity requirements for financing approval. Further, the overwhelming majority of new manufactured homes are delivered to rural areas and, therefore, the growth of home ownership in rural areas is dependent on the availability of financing for manufactured housing. While site-built housing can obtain economies of scale through the development of tract housing and large subdivisions, such opportunities are not available in rural areas where homes are located on scattered lots. Instead, manufactured housing affords the prospective rural buyer a quality, low-cost alternative for obtaining home ownership.

While manufactured housing represents some of the most affordable housing in the market, with an average sales price of $85,600, the prevailing economic uncertainties and depressed housing market have continued to challenge even the manufactured housing industry. The economic crisis has materially impacted liquidity in the financial markets, making terms for certain financing less attractive and resulting in the unavailability of most types of financing. CountryPlace and similar manufactured housing specialty lenders have been effectively precluded from issuing private-label mortgage-backed securities for the past 2 years. Secondary markets for loan types traditionally used for the purchase of manufactured homes have severely contracted, making these loans illiquid. As a result, several major third-party lenders, which previously provided financing for Palm Harbor's customers, have exited the manufactured housing finance business. CountryPlace has been unable to raise sufficient capital to fill the void created by these lenders' departure from the industry.

In an ongoing effort to remove regulatory impediments to homeowner financing, the manufactured housing sector has been working closely with the Department of Housing and Urban Development (HUD), Ginnie Mae, Fannie Mae, and the Federal Housing Finance Agency (FHFA). By extending and/or expanding the tax credit, the Congress can play a continued role in assisting families with securing affordable home ownership.

I thank you for this opportunity to present our view on the importance of extending and/or expanding the First-Time Homebuyer Tax Credit. Palm Harbor stands ready to work with the Committee and the Congress to promote the strength of the housing market and the continued recovery of the economy.