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Hearing: "A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

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Good Afternoon Chairman Hensarling, Ranking Member Waters and Members of the Committee. Thank you for inviting me to testify at today's hearing on how to ensure that American families can obtain sustainable mortgages in a future mortgage finance system.

I am President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

The mortgage finance system should have a balance of consumer protections that prevent abusive lending practices and policies that prioritize access to sustainable credit. The Protect American Taxpayer and Homeowners Act (PATH Act) meets neither of these goals. Instead, the PATH Act would result in affirmative harm on both accounts. My testimony will make the following points:

- **First,** the PATH Act eliminates any government guarantee for eligible mortgages for most families, which would make the 30-year fixed-rate mortgage a product of the past. As a result, families striving to own their own home would face restricted access to credit, and fewer would become homeowners. Those able to obtain mortgages would end up with less affordable, less stable, and shorter-term mortgage financing. The PATH Act's creation of a unified utility to provide a securitization platform for issuers is a constructive contribution to the mortgage finance discussion, but it falls significantly short of sufficient housing finance reform given the other provisions of the Act. Importantly, small lenders such as community banks would still be squeezed out of the mortgage market under this regime.

- **Second,** on top of curtailing the 30-year fixed-rate mortgage, the PATH Act would fundamentally alter the FHA program and limit the number of families able to obtain FHA-insured mortgages. The PATH Act's approach to FHA reform is death by a thousand programmatic changes, with the cumulative effect being a much more restricted and expensive program that would likely have difficulty fulfilling its mission and meaningfully serving borrowers.

- **Third,** the PATH Act also strikes critical mortgage reforms included in the Dodd-Frank Act, which invites a return to the predatory and abusive lending that proliferated during the late 1990's and 2000's. Instead of learning from the subprime meltdown, housing downturn and foreclosure crisis, this legislation would allow the private label securities market to return to its old, harmful and reckless ways.

I. The PATH Act Would Curtail the 30-Year Fixed-Rate Mortgage.

Middle-class families across the country depend on having a 30-year fixed rate mortgage in order to build wealth and, at the same time, make ends meet. Borrowers with fixed-rate mortgages benefit from having stable mortgage payments for the life a loan. This prevents the kind of payment shock that can happen when borrowers take out an adjustable rate mortgage and interest rates increase. Borrowers also benefit from having mortgage payments spread out over 30-years, which makes the payments more affordable than a 10 or 15-year term. On top of these budgeting benefits, by enabling borrowers to become homeowners, the 30-year fixed rate mortgage helps borrowers build wealth through growing home equity. According to the Pew Research Center, "[a]mong households with net worth of less than $500,000, just 33% of their wealth comes from financial assets and 50% comes from their home."[1]

The 30-year fixed-rate mortgage – and the benefits this product provides to borrowers – would be scare without the availability of a government guarantee. This guarantee makes it possible to securitize mortgages through the so-called To-Be-Announced (TBA) market, which is a standardized system for investors to purchase securities with

[1] *See* Richard Fry and Paul Taylor, *A Rise in Wealth for the Wealthy; Declines for the Lower 93%*, Pew Research Center (April 23, 2013) (available at http://www.pewsocialtrends.org/2013/04/23/a-rise-in-wealth-for-the-wealthydeclines-for-the-lower-93/1/).

mortgages that meet specified underwriting standards. Investors bear the interest rate risk of these investments, rather than the credit risk, which is borne by Fannie Mae and Freddie Mac. Without this guarantee of timely payment of principal and interest investors would likely not purchase these securities. Additionally, without the TBA market, borrowers would be unable to get rate locks on their mortgage, transactions would take more time, and loan prices could vary significantly by geographic location. Not only would borrowers have difficulty getting a 30-year fixed-rate mortgage, but restricted access to credit would make it more difficult to get any kind of mortgage product, and that mortgage would be more expensive.

A future mortgage finance system must include an on-going, explicit, and actuarially sound government guarantee in order to preserve the 30-year fixed-rate mortgage. While systems should be designed to alleviate unnecessary risk as much as possible, government has an appropriate role to play in the event of a housing market crash. Given the reality that the Federal government will bear the risk of stepping in during a housing market crash, this risk should be accounted for up front and priced accordingly.

Yet, the PATH Act would eliminate a government guarantee and require investors to take on credit risk when purchasing mortgage-backed securities. This would have a dramatic effect on access to credit. Instead of expanding access to credit at a time when the average denial on a conforming loan is for a borrower with a FICO score of 734 and willing to put 19% down, the PATH Act, would make credit more scare and more expensive for borrowers.[2] As a result, housing prices would likely decline due to reduced demand. This could ultimately push many homeowners underwater on their mortgages and increase default rates. Additionally, private capital would likely pull even further back – instead of facilitating stable access to credit – during times of economic or housing market stress. The end result would be destabilizing the housing market and limiting homeownership to wealthier households.

Furthermore, although this portion of the bill does not explicitly address down payment requirements, it would result in very restricted access to credit for borrowers with smaller down payment amounts. Given that investors would assume credit risk of securities under the PATH Act, investor capital would prioritize borrowers with very high down payment amounts in an effort to make this credit risk as insignificant as possible. Prioritizing these lower LTV borrowers would box out lower-wealth borrowers – including many borrowers of color – who are capable of being successful homeowners but lack access to reserves. Extensive experience demonstrates that responsibly underwritten lower-down

[2] *See* Kenneth Harney, *Mortgage lenders set higher standards for the average borrower*, The Washington Post (September 28, 2012) (available at http://articles.washingtonpost.com/2012-09-28/news/35495052_1_fico-score-mortgage-lenders-debt-to-income).

payment mortgages perform well and provide critical homeownership opportunities for households.[3]

The PATH Act would also harm smaller lenders. The creation of a utility with a standardized securitization platform is laudable, but it is not sufficient to provide smaller lenders with equal access to the secondary markets. As a result of the PATH Act, smaller lenders would no longer have access to a liquid and efficient TBA market that can provide cash payments to purchase their loans. And, under the PATH Act's utility platform, there is no guarantee that aggregators and issuers will even use the utility, much less purchase from smaller lenders. Instead, aggregators and issuers could purchase from larger originators, because this would streamline the securitization process. Providing the Federal Home Loan Banks (FHLB) with the authority to act as aggregators also is not enough to place smaller institutions on equal footing under this system. First, this authority is voluntary for the FHLBs to use. Second, even when aggregated, securities built with loans from smaller lenders likely will not be as liquid as those aggregators drawing from larger lenders, which would result in unfavorable pricing. Additionally, section 312 of the PATH Act requiring that the privately-owned utility not adopt policies or procedures that disadvantage smaller lenders would be of little value in a system that makes it impossible for smaller lenders to have equal footing with their larger competitors.

Lastly, in the event of a borrower going into default on their mortgage, the PATH Act would make it difficult for borrowers to get a loan modification and likely that investors will face high foreclosure losses. As has been the case throughout the foreclosure crisis, borrowers with mortgages in private label securities are often unable to get loan modifications even though modifications would also provide a better return for the investor compared to a foreclosure.

II. The PATH Act Would Limit FHA Lending and Restrict Access to Credit for Borrowers.

FHA has played a critical role during the housing crisis and the economic downturn by providing credit to families who otherwise would not have been able to buy homes. In 2011, 27% of homes were purchased with an FHA insured mortgage.[4] An even higher percentage of African-American and Latino homebuyers have recently used FHA

[3] *See generally* Quercia, Freeman and Ratcliffe, *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families*, UNC Center for Community Capital (2011)
[4] U.S. Department of Housing and Urban Development, *Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund*, (November 16, 2012) (available at http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf).

financing – in 2011, 50% of African-American borrowers and 49% of Latino borrowers used an FHA insured mortgage to purchase their home.[5]

This access to FHA-insured loans during a time of otherwise restricted access to credit has not only helped new home owners, but has also helped stabilize neighborhoods and communities and boost the economic recovery overall. According to 2010 estimates from Moody's Analytics, FHA-insured lending during the housing downturn stopped home construction activity from dropping another 60% and housing prices from going 25% lower.[6] Moody's calculated that the cost of such a retraction would have resulted in an additional 3 million lost jobs and an almost 2 percent reduction in gross domestic product.[7] It is essential that FHA continue to fulfill its role in the housing market, especially as the recovery continues.

There are improvements that should be made to help improve FHA solvency, but that can be done without these harmful reforms. The PATH Act makes a myriad of changes that taken together would unnecessarily restrict who can obtain an FHA-insured mortgage and would result in a limited number of mortgages being originated with FHA insurance. These changes include reducing the FHA insurance level from 100% to 50% over a 5 year period, requiring additional risk sharing, imposing means testing for some borrowers, restricting mortgage amounts eligible for FHA insurance, mandating specified down payment requirements, and imposing added-cost accounting measures that will make FHA mortgages less affordable.

The collective impact of these changes would substantially reduce the effectiveness of the FHA. First, scaling back the guarantee would make FHA mortgages less affordable and less available for borrowers. Instead of providing an efficient and lower-cost 100% guarantee, the PATH Act would impose higher costs on borrowers by requiring investors to determine and bear part of the credit risk of these securities. In addition to affecting pricing, this would also significantly dampen if not all together eliminate investor interest in purchasing securities of FHA mortgages. This change – especially when considered in tandem with the PATH Act's elimination of the government guarantee in place for Fannie Mae and Freddie Mac securities – would result in a mortgage market with radically reduced access to credit.

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[5] *Id.*

[6] *See* John Griffith, *The Federal Housing Administration Saved the Housing Market*, Center for American Progress at 4 (October 11, 2012) (citing Moody's Analytics unpublished estimates from October 2010) (available at http://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federal-housing-administration-saved-the-housing-market/).

[7] *Id*.

Second, the PATH Act would impose overly restrictive eligibility requirements that provide unnecessary complexity in administering the program. Limiting eligible homebuyers to either first-time homeowners or households below either 115% or 150% of area median income could impact overall FHA pricing and restrict families from obtaining mortgages during periods when access to credit is otherwise restricted. The current mortgage market highlights this very real risk. While the PATH Act includes a provision allowing for countercyclical insurance authority, this structure is not only cumbersome but could be ineffective in meeting its stated goal. Additionally, the PATH Act would also reduce FHA loan limits in a way that could unnecessarily limit home purchases for borrowers. The PATH Act reduces the maximum FHA loan limit to the lower amount of either 115% of the Area Median Home Price or 150% of the threshold established for GSE mortgages in high cost areas, which is currently $625,500.

Third, the PATH Act would require the FHA to use inappropriate, added-cost accounting that uses the private sector's cost of funds instead of the government's to make credit programs appear more expensive than they truly are. This type of "added-cost" accounting results in a misstatement of the agency's true financial position and would under most circumstances make FHA-insured mortgages more expensive for borrowers.

III. Consumer Protections that Will Prevent Future Lending Abuses and Crises Should Not Be Weakened or Eliminated.

In addition to reducing access to credit, the PATH Act would increase reckless lending. Passage of this bill would allow many lenders to originate loans without regard to the borrower's ability to repay the loan and without verifying income, assets and debts. For those loans still subject to the Ability to Repay and Qualified Mortgage standards under the PATH Act, the bill would delay CFPB regulations and create loopholes in the points and fees definition. Eligible borrowers would be restricted in challenging a mortgage where the lender intentionally originated a mortgage the borrower could not afford. High-cost loan protections would be weakened. Requirements for timely mortgage disclosures to borrowers would be undermined. Capital requirements would be delayed. Regulators would have compromised authorities to properly supervise institutions. In effect, lenders and originators could return to lending in a market that would be primed to repeat the failures of the past.

The Title XIV provisions of the Dodd-Frank Act that would be repealed by the PATH Act are critical mortgage reforms that will prevent future mortgage lending abuses and crises. In fact, if the reforms in Title XIV had been in place earlier, there never would have been a lending crisis and subsequent housing market crash, and millions of

Americans would not have lost trillions of dollars of wealth or their jobs. Rather than stifling legitimate lending, these reforms will provide a level playing field and sensible rules of the road so that we will avoid the constriction of credit we're facing now that invariably follows a crisis. These are reforms for the long-term to prevent future abusive lending and foreclosure waves from resurfacing. Undoing these protections through the PATH Act would send borrowers back to a marketplace where short-term gains prevail over the long-term financial stability of both our markets and household balance sheets.

IV. Conclusion

In summary, reform of the housing finance system is certainly needed. However, the PATH Act would unduly reduce mortgage access, raise costs and limit options for American families. It would also disadvantage community banks and other small lenders and produce lower economic growth for the whole economy.