Testimony of Tom Woods

On Behalf of the

National Association of Home Builders

Before the

United States Senate

Committee on Banking, Housing and Urban Affairs

Hearing on

"Regulatory Burdens to Obtaining Mortgage Credit"

April 16, 2015

Introduction

Chairman Shelby, Ranking Member Brown, and members of the Committee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on regulatory burdens to obtaining mortgage credit. My name is Tom Woods, and I am a home builder from Blue Springs, Missouri and NAHB's 2015 Chairman of the Board. We appreciate the invitation to appear before the committee on this important issue.

NAHB represents over 140,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. Each year, NAHB's builder members construct approximately 80 percent of all new housing in America.

The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that provides adequate and reliable credit to home buyers and home builders at reasonable interest rates through all business conditions. At present, home buyers and builders continue to confront challenging credit conditions weighed down by a zealous regulatory response to the Great Recession. In addition, the ongoing uncertainty over the future structure of the housing finance system has intensified these challenges. This statement will examine several cases where government regulation and other developments have impeded the ability of the housing sector to recover from the historically steep downturn and meet the credit needs of home buyers and home builders.

The housing finance system is governed by statutes and regulation overseen by a myriad of federal agencies. In response to the recent financial crisis, the Dodd-Frank *Wall Street Reform and Consumer Protection Act of 2010 (*Dodd-Frank) mandated significant mortgage finance reforms and created the Consumer Financial Protection Bureau (CFPB) to supervise and monitor many of the new requirements. Additionally, the Federal Housing Finance Agency (FHFA), the Federal Housing Administration (FHA) and the federal banking regulators all have taken steps to ensure the U.S. economy will never again be as vulnerable to "risky" mortgage lending. The collective force of the actions taken by these agencies, along with the lingering doubts and uncertainty of market participants, has resulted in an undue restriction on the availability of mortgage credit to many creditworthy borrowers.

While there have been some actions taken by the individual agencies to mitigate the overly tight lending conditions, the housing sector is still struggling to return to normal. NAHB believes there are additional steps that can be taken to eliminate some of the barriers to credit availability and support a stronger, more robust recovery of the housing and mortgage markets while still employing balanced reforms to protect the housing market from another crisis.

Factors Constraining Availability of Mortgage Credit

While mortgage rates remain near historically low levels, access to mortgage credit is limited to home buyers and homeowners with pristine credit histories who can qualify for government-backed programs. Presently, FHA, the Department of Veteran's Affairs (VA), Fannie Mae and Freddie Mac (the Enterprises) account for an overwhelming majority of mortgage originations.

Today's tight lending conditions are keeping more buyers on the sidelines even as the housing market strengthens. As discussed below, significant new regulations, lender credit overlays, high fees and other factors continue to impact the availability of mortgage credit. At a time when housing affordability has been at record favorable levels, more buyers should be entering the housing market. However, many creditworthy borrowers are not able to take advantage of these opportunities. As more new rules are implemented, consideration should be given to how

the cumulative impact of this imposing regulatory environment will adversely affect the availability of mortgage credit and housing market and economic activity.

Regulatory Constraints

The regulatory environment for mortgage lending is undergoing significant changes as regulators implement new rules mandated by Dodd-Frank. Uncertainty about the eventual impact of these regulations and the cost of compliance are key factors in tightened access to mortgage credit.

Total loan production costs continue to escalate and NAHB is concerned about the effect of the additional regulatory cost to originate loans in today's environment, particularly for smaller banks and independent mortgage bankers. Many of these smaller originators serve rural communities, first-time homebuyers and other underserved market segments. NAHB members are hearing that many smaller banks and independent mortgage bankers are choosing to depart the residential mortgage business, and in some cases, closing or merging their banks. This exodus will cause less competition and provide consumers with fewer choices.

Ability to Repay Rule

The implementation of the final Ability to Repay (ATR) standard by CFPB, which took effect on January 10, 2014, defined new lender underwriting requirements for mortgage loans and liabilities. However, the rule has created new hurdles for borrowers, especially low- to moderate-income buyers and self employed borrowers that are under increased scrutiny due to the debt-to-income calculation and more stringent documentation requirements.

The ATR rule establishes standards for complying with the ability-to-repay requirement by defining a "qualified mortgage" (QM). The QM standard is intended to balance protecting consumers from unduly risky mortgages and providing lenders more certainty about potential liability. Lending outside the QM box still is allowed, and in fact, the CFPB is encouraging lenders to make non-QM loans. Lenders, however, must balance being exposed to increased litigation risk with expanding their non-QM product offerings. To the extent that lenders will remain cautious during the transition and beyond, creditworthy borrowers may not have access to affordable mortgage credit, or may be left out of the credit box all together. According to a Fannie Mae survey released in August 2014, 80 percent of lenders said they do not plan to pursue non-QM loans or prefer to wait and see.

As required by Dodd-Frank, FHA and VA released separate QM definitions for loans insured or guaranteed by these agencies. As the HUD and VA QM definitions allow for lenders to follow current FHA and VA underwriting criteria, this has helped keep credit flowing.

The final ATR rule included a seven year window in which loans that are eligible for purchase by Fannie Mae and Freddie Mac are considered qualified mortgages. This provision will expire in 2021, or when the conservatorships of the Enterprises end. This provision of the ATR rule also has aided the continued flow of conventional mortgage credit through this transition period. With the Enterprises still purchasing a large percentage of mortgage originations, the market may not experience the full effect of the ATR rule until 2021 or when the conservatorships of the Enterprises has ended.

Since issuing the final ATR rule, the CFPB has made several amendments to the rule to address the practical implementation of the rule. Most recently, CFPB proposed beneficial amendments relating to small creditors and rural underserved areas.

An area that continues to be of concern to NAHB is how the final ATR rule requires lenders to calculate the three percent cap on points and fees. The final ATR rule includes closing charges paid to affiliated settlement service providers in the three percent cap on points and fees, while the points and fees charged by unaffiliated companies are not included. NAHB strongly objects to this disparity and has urged CFPB to exclude points and fees paid to affiliated firms when calculating the limit. Many home builders and lenders have established settlement service affiliates such as mortgage and title companies to facilitate home purchases for consumers. Requiring affiliate fees and points to be included in the three percent cap creates disincentives to establish these beneficial relationships. Affiliated and non- affiliated settlement services should be treated equally. NAHB adamantly believes that fees and points from affiliated firms should be excluded in the three percent cap, thereby giving equal treatment to affiliated and non-affiliated settlement service providers. We strongly urge the CFPB to implement such an exclusion.

H.R. 685, the *Mortgage Choice Act*, introduced in February, and passed by the House on April, 14, 2015, would amend the Truth-in-Lending regulation to clarify the final QM rule's definition of points and fees. The specific adjustments provided in the bill would clarify that title insurance charges by a title insurance provider affiliated with the lender and a homeowner's escrowed insurance premiums do not count toward the three percent cap on the points and fees limit for a QM loan. The bill is intended to help more sound loans pass the QM test and ensure that consumers can choose the lender and title provider best suited to their needs.

Representative Andy Barr (R-KY) recently introduced H.R. 1210, the *Portfolio Lending and Mortgage Access Act*. The legislation is intended to ease the ATR requirements for community lenders who may be fearful to originate non-QM loans and, therefore, may limit access to credit for home buyers in their communities they believe to be creditworthy. This bill would amend the Truth-in-Lending regulation to provide that a loan satisfies the ATR requirement if the loan remains in the originating lender's portfolio. Banking regulators would be required to treat such a loan as a QM, if the lender has, since the loan's origination, held it on its balance sheet and all prepayment penalties with respect to the loan comply with specified limitations.

NAHB believes the concepts behind each of these bills have merit and should be passed by both the House and Senate as methods to ease the components of the ATR rule with the most potential to restrict mortgage credit.

Qualified Residential Mortgages

The implementation of the Credit Risk Retention rule, also mandated by Dodd-Frank, was finalized in 2014 and aligns the definition of a qualified residential mortgage (QRM) with the QM. Though the rule is not effective until December 2015, NAHB believes aligning the QRM with the QM has many benefits. Establishing one streamlined regulation, instead of having two separate sets of underwriting criteria, will alleviate confusion in the marketplace and will help provide clarity and transparency for home buyers, lenders, investors and other housing market participants. Aligning QRM with QM levels the playing field, promotes liquidity in the mortgage market and allows access to credit for a diverse range of home buyers, particularly first-time and low- to moderate-income home buyers. Additionally, the underwriting criteria and product limitations contained in the QM will promote more prudent lending and will provide investors with an assurance that the loans are sustainable.

Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act and the Truth in Lending Act Proposal - "Know before you owe"

In December 2013, the CFPB finalized new mortgage disclosure forms that are intended to help consumers make informed decisions when shopping for a mortgage and avoid costly surprises at the closing table. The new forms will become effective August 1, 2015. The rule applies to most closed-end mortgages but does not apply to home-equity lines of credit, reverse mortgages or mortgages not attached to real property. The rule also does not apply to loans made by a creditor who makes five or fewer mortgages in a year.

For over 30 years, federal law has required lenders to provide consumers with a Good Faith Estimate of closing costs and a Truth-in-Lending disclosure of the loan's annual percentage rate, total finance charges and total loan payments within three days of applying for a mortgage loan. The law also required the two different forms to be re-disclosed shortly before closing on the loan. The information on these forms was determined to be overlapping and the language inconsistent. As directed by Dodd-Frank, the CFPB updated and integrated the forms based on extensive consumer and industry research.

The new combined forms are called the "Loan Estimate" which is provided at application and the "Closing Disclosure" which must be provided at least three business days before the consumer closes on the loan. Any change to the information provided on the form that is made during that three-day period will restart the three-day waiting period (with limited exceptions). NAHB and other housing industry stakeholders are concerned with the practical outcome of transitioning to the new forms, particularly that there is no opportunity under this regulation to comply early, which means that industry will not be able to test systems, in real-time, in real circumstances, until after August 1. NAHB joined with other industry groups and recently wrote CFPB Director Cordray to encourage the agency to announce and implement a "restrained enforcement and liability" or "grace period" for those seeking to comply in good faith with the provision after August 1 through the end of 2015.

NAHB members depend on the certainty of a smooth closing process and NAHB is concerned that any confusion related to the new rules, compounded by the fear of aggressive enforcement activities, will negatively impact the ability to close on a home in a timely manner.

<u>Lender Credit Overlays and Buy Back Risk</u>

Lender overlays in the mortgage credit process have been a major factor in the greater difficulty potential home buyers are having in obtaining financing as lenders impose credit underwriting standards that are more restrictive than those required by FHA, VA, Fannie Mae and Freddie Mac. These credit overlays are employed due to heightened lender concerns over forced loan buy-backs on mortgages sold to Fannie Mae and Freddie Mac and/or greater required indemnifications on FHA-insured and VA-guaranteed loans.

When lenders sell loans to entities, such as Fannie Mae and Freddie Mac, and through the FHA/VA/Ginnie Mae securities process, they are required to make assurances that they have performed the appropriate level of due diligence on the loan application, and the lenders agree to buy back a loan if it is discovered that they were at fault in their underwriting process. These representations and warranties ("reps and warrants") have been a standard practice in mortgage lending.

In the aftermath of the collapse in the housing market, the underwriting of delinquent loans was alleged not to have met the established criteria of FHA, the Enterprises, and other secondary

market entities. As a result, lenders have faced a protracted struggle with these agencies about the buy back of loans that have been deemed ineligible for Enterprise guarantees or government insurance based on the finding of faulty due diligence practices. Lenders complain that the criteria triggering buy-back demands by Fannie Mae and Freddie Mac and insurance claims rejections by FHA and VA are unclear and inconsistent. The resulting uncertainty has caused lenders to employ underwriting standards that are more restrictive than those required by FHA, VA, Fannie Mae and Freddie Mac. These lender "overlays" have closed the credit window to many aspiring home buyers who actually meet the loan qualification requirements established for these programs.

The recent sharp increase in borrower credit scores since 2001 is an indication of how lenders have responded to concerns about how the federal agencies will implement repurchases and indemnifications. A recent report from the Urban Institute (UI)[1] found that credit has become much less available to borrowers with lower credit scores. From 2001 to 2013, the share of new purchase borrowers with FICO credit scores below 660 declined from 28 percent to 11 percent; those with FICO scores between 660 and 720 remained at 28 percent of the total. Meanwhile the share of borrowers with FICOs above 720 increased from 44 percent to 62 percent of the total. The UI report estimates that as many as 1.25 million fewer mortgage purchases were made in 2013 than would have been made had credit availability been the same as in 2001. For 2009-13, UI estimates that 4 million more loans would have been made based on 2001 credit standards.

The weighted average credit score for loans purchased by Fannie Mae and Freddie Mac in 2014 was 744, while in fact, both Fannie Mae and Freddie Mac have a minimum credit score requirement of 620 for most purchased mortgage loans.

FHA will insure mortgage loans with credit scores as low as 500 under certain scenarios. However, according to the 2013 State of the Nation's Housing Report,[2] in 2007, borrowers with credit scores below 620 accounted for 45 percent of FHA loans. By the end of 2012, that share was under five percent.

Similar trends are evidenced in the share of first-time home buyers which accounted for only 28 percent of home sales in February 2015, well below the historical average of about 40 percent. In the new home market, NAHB survey data indicate the current share of first-time buyers is only 16 percent compared to an historic average of 30 precent.

In 2014, the Enterprises' regulator, FHFA, and FHA announced efforts to clarify and, in some cases, ease, the reps and warrants and identification of loan defects that will trigger enforcement actions against lenders. NAHB anticipates positive results from these modifications and is hopeful to see lenders originating to the underwriting specifications of the agencies rather than implementing their own, more strict, standards.

Alternative Credit Scores

It is possible that the use of alternative credit scores could offer lending opportunities to borrowers currently lacking access to mortgage credit due to a low or inaccurate FICO credit score. Fannie Mae and Freddie Mac have been directed by FHFA to assess the feasibility of using alternative credit score models in their automated loan-decision models. The Enterprises are planning to study the costs and benefits associated with VantageScore 3.0 and FICO

[1] The-Impact-of-Tight-Credit-Standards-on-2009-13-Lending
[2] The State of the Nation's Housing 2013

Score 9.

To generate a traditional credit score, a borrower must have one trade line that is at least six months old, with a balance on it. Fair Isaac Credit Services, Inc. estimates that 50 million U.S. consumers have credit histories that do not meet that requirement. These potential borrowers are disproportionately Hispanic (24 percent), African-American (14.6 percent), and recent immigrants. However, it is estimated these 50 million people have a history of paying regular bills such as rent, utilities, insurance, and telecommunications.

FICO Score 9's primary enhancement is its separation of medical debt collection from other unresolved debts. As a result, Fair Isaac estimates that a consumer with the median credit score of 711 whose only negative collection issue is medical-related will see his or her credit score increase by 25 points. FICO also recently announced a new credit score based on a consumer's payment history with telecommunications and utility bills. The new score could help applicants who don't use credit often but are responsible with other monthly payments.

VantageScore 3.0 claims the ability to calculate a score for 30 to 35 million previously "unscoreable," or "thin file," consumers. VantageScore requires just one month of credit history and less frequent updates than the current FICO score used by the Enterprises. Credit scores can now be made available to consumers who are brand new to credit, those who only use credit occasionally and people who have not used credit at all recently. The VantageScore 3.0 credit score also ignores all paid collections, as well as any collections, paid or unpaid, under $250.

HUD Secretary Castro also has stated that FHA is exploring the use of new credit scoring models that use non-traditional factors, such as rent and utility payments, to determine creditworthiness. The potential use of alternative credit scoring models by FHA and the Enterprises could help to open the credit box.

Fees

Fees for government-backed mortgages continue to be at an increased level, even though the credit quality of the underlying loans has increased significantly, as evidenced by the high FICO scores referenced earlier. These higher fees are usually passed on to consumers, making it more expensive for borrowers to obtain a home loan or, in some cases, even preventing them from qualifying for a loan.

In the wake of the housing downturn, FHA steadily and significantly increased its upfront and annual mortgage insurance premiums (MIP). The annual MIP on a typical 30-year FHA loan (LTV less than 95 percent and loan amount below $625,500) was raised six times in five years and had reached 130 basis points by April 2013 compared to 50 basis points in April 2010. Further, FHA also terminated the policy that allowed borrowers to stop paying mortgage insurance premiums after their loan reaches 78 percent of its original value. As a result, the cost of an FHA loan over the life of the loan had become higher than that of a conventional loan with private mortgage insurance, which borrowers can stop paying when the LTV reaches 78 percent of original value.

NAHB strongly supports FHA's announcement in January that, effective with case numbers dated on and after January 26, 2015, it would reduce its annual upfront MIP by 50 basis points to 80 basis points on FHA loans with LTVs less than 95 percent and loan amounts of $625,500 and below.

At the direction of the FHFA, Fannie Mae and Freddie Mac have been increasing their guarantee fees (g-fees) that are charged to lenders to protect against credit-related losses. G-fees charged by Fannie Mae averaged 62.9 basis points on new single-family originations in Q4 2014. This is a significant increase over 2012 in which the average was 39.9 basis points.

In addition to the g-fees, Fannie Mae and Freddie Mac continue to charge adverse market fees and loan level pricing adjustments. Fannie Mae and Freddie Mac have charged a 25 basis point adverse market fee since March 2008 for whole loans and mortgage loans delivered into MBS. The loan level price adjustments, which have been charged since 2009, add delivery fees to mortgages purchased by the Enterprises. The delivery fees which vary based on credit score and loan-to-value ratio range from 25 to 325 basis points. This translates into a 6 to 80 basis point increase in mortgage financing costs.

In June 2014, FHFA requested input on setting the g-fees. NAHB's comments to FHFA opposed a further increase in g-fees and urged that affordability should be a significant consideration in setting g-fees. NAHB's comments also included a recommendation for the Enterprises to eliminate the upfront adverse market charge and loan level price adjustments. Current market conditions in which defaults and foreclosures are declining and housing markets nationwide are improving have rendered these charges obsolete.

Though FHFA still is in the process of reviewing and considering comments received on the g-fee request for input, NAHB is hopeful that Director Watt will make an announcement soon that will provide for lower fees to lenders and, ultimately, home buyers

Downpayments

In an acknowledgement that high downpayments are a significant impediment to some borrowers, especially first-time home buyers, last October FHFA Director Mel Watt directed the Enterprises to begin purchasing three percent downpayment mortgages from creditworthy borrowers. Fannie Mae began purchasing 97 percent LTV mortgages in December and Freddie Mac's purchse program began in March.

NAHB agrees with Director Watt's assessment that three-percent downpayment mortgages can be made safely by imposing strict credit and underwriting standards that ensure borrowers have strong credit and meet income, asset and employment requirements. Also, a recent Urban Institute analysis found that the default rates on 3 to 5 percent downpayment loans and 5 to 10 percent downpayment loans purchased by the Enterprises are similar. [3]

Appraisals

The housing recovery also has been impeded by ongoing problems in the U.S. residential appraisal system. While lenders, federal banking regulators and federally related housing agencies implemented corrective measures in response to valuation breakdowns that came to light in the wake of the Great Recession, and Congress mandated additional measures in the Dodd-Frank Act, these steps did not address fundamental flaws and shortcomings of the U.S. residential appraisal framework. Improper appraisal practices, a shortage of experienced appraisers and inadequate oversight of the appraisal system continue to restrict the flow of mortgage credit and retard the housing recovery. NAHB is not advocating that appraisals should be higher than the real market. Rather, our goal is to establish an appraisal system that produces accurate values through all phases of the housing cycle.

[3] Urban Institute, Why the GSEs' Support of Low-Downpayment Loans Again is No Big Deal.

The principal focus of reforms to-date has been on eliminating undue influence on appraisers to produce inflated valuations that facilitate transactions. However, when home prices began declining, improper appraisal practices exacerbated the slide in values. Some appraisers used distressed sales – many of which involved properties that were neglected and in poor physical condition – as comparables in assessing the value of brand new homes, without accounting for major differences in condition and quality. Without such adjustments, the two housing types are not comparable. The inappropriate manner in which distressed sales were utilized distorted home valuations. Use of the cost and income approaches in conjunction with the comparable sales approach could mitigate such distortions.

The dramatic increase in the use of Appraisal Management Companies (AMCs) is another factor contributing to inaccurate appraisals. Some AMCs have reduced appraiser compensation, which has led to more activity by appraisers with less training and experience, and shortened turnaround times for valuations to as little as 48 hours. These changes have had a significant adverse effect on appraisal quality.

Other challenges facing the appraisal industry include shortcomings in appraiser training and experience in dealing with new construction and green building. Additionally there is insufficient new construction, energy efficient and green building data available to appraisers and current valuation practices do not provide a process for expedited appeals of inaccurate or faulty appraisals. Oversight of appraiser qualifications and appraisal practices falls to the individual states, and many jurisdictions have inadequate resources to adequately perform this function. In some states, fees collected for appraiser licensing and certification are swept into a general fund and are not utilized in appraisal/appraiser oversight and enforcement.

NAHB has been a leading advocate for correcting the valuation process and has undertaken a number of actions to raise awareness and address the adverse impacts inaccurate appraisals are having on the housing sector. NAHB has conducted five Appraisal Summits to provide opportunities for the agencies and organizations that establish appraisal standards and guidelines to join housing stakeholders in a constructive dialogue on major appraisal topics of concern.

Through the Appraisal Summits and feedback from builders and others in the field, NAHB has identified the following key areas of focus to improve current appraisal requirements and practices, which are presented in a white paper entitled *A Comprehensive Blueprint for Residential Appraisal Reform*, which contains the following recommendations:

Strengthen Education, Training and Experience Requirements for Appraisers of New Home Construction, including:

- The establishment of greater education, training and experience requirements for those who are assigned appraisals of new construction to ensure that lot values and building costs, including those for energy efficient, green building and other evolving new construction techniques and mortgage products, are fully considered in valuation of new home construction.
- The incorporation of the qualifications for appraisers of new construction into appraisal regulations and guidelines of the bank regulatory agencies, Fannie Mae, Freddie Mac, FHA, VA and USDA.

Improve the Quantity and Quality of Data for New Construction through:

- Establishment of an appraisal data base system for new construction.
- Standardization of loan level valuation data by Fannie Mae, Freddie Mac, FHA, VA and
- USDA in their Uniform Appraisal Dataset (UAD).
- Expansion of the UAD to include new construction, energy efficient and green building data standards.

Develop New Appraisal Standards and Best Practices for Conducting Appraisals in Distressed Markets by:

- Modifying current appraisal practices and procedures to consider all three approaches to value -- cost, income and sales comparison -- in appraisals of residential properties to mitigate distortions and volatility.
- Giving greater weight in distressed markets to alternative means of valuation, such as the cost-based approach to value.
- Revising banking agency guidelines to require the appraisal entities used by financial institutions to avoid the use of distressed sales as comparables for new construction sales and, if distressed sales are the only comparables available, to make adjustments to accurately reflect possible condition and stigma issues associated with distressed properties.

Develop Processes for Expedited Appeals of Inaccurate or Faulty Appraisals through:

- Federal agency adoption of an appeals structure similar in design to that of the Department of Veterans Affairs Loan Guaranty Service Home Loan Program.
- The establishment of more efficient, timely and effective processes for state and local appraisal oversight.
- The establishment of a timely value dispute resolution process that is fair, balanced and appropriate to allow interested parties to appeal appraisal values when appraisal techniques and/or assumptions are incorrect.

Strengthen Oversight of Appraisal Activities through:

- Streamlining and coordinating the current regulatory framework to devote adequate resources and ensure effective oversight and enforcement.
- Full implementation of appraisal mandates in recent federal legislation addressing:
  - Appraisal independence
  - Customary and reasonable fees
  - Mandatory reporting of appraisal standards violations
  - Strengthening of state appraisal oversight and enforcement of regulations
  - Dispute resolution
- Establishment of best practices for effective and consistent appraisal practices, policies and procedures.

NAHB stands ready to work with appraisal, housing and financial stakeholders to address the real challenges we face in restoring the public trust in how we build, transfer, value and finance the American consumer's most valuable asset. Solving these issues, in the short and long term, is a critical step toward establishing an efficient and sustainable housing finance system.

Regulatory Constraints to Housing Production Credit

Despite signs of improvement in recent months, many home builders continue to deal with a significant adverse shift in terms and availability of land acquisition, land development and home construction (AD&C) loans. Lenders are reluctant to extend new AD&C credit citing regulatory requirements or examiner pressure on banks to shrink their AD&C loan portfolios as reasons for their actions. While federal bank regulators maintain that they are not encouraging institutions to stop making loans or to indiscriminately shrink their portfolios, reports from NAHB members in a number of different geographies continue to suggest that bank examiners in the field are maintaining a more aggressive posture.

According to data from the FDIC and NAHB analysis, the outstanding stock of 1-4 unit residential AD&C loans made by FDIC-insured institutions to residential construction businesses rose by $1.158 billion during the fourth quarter of 2014, a quarterly increase of 2.32%. On a year-over-year basis, the stock of residential AD&C loans is up 17% from the final quarter of 2013. Despite these gains, AD&C lending remains much reduced from years past.

The current stock of existing residential AD&C loans of $51.2 billion now stands 74.9% lower than the peak level of AD&C lending of $203.8 billion reached during the first quarter of 2008. However, the count of single-family homes under construction is down only 33% from the first quarter of 2008 compared to today. Thus, there exists a lending gap between home building demand and available credit. This gap is being made up with other sources of capital, including equity, investments from non-FDIC insured institutions and lending from other private sources, which may in some cases offer less favorable terms for home builders than traditional AD&C loans.

Concentrations in Commercial Real Estate Lending

In general, the federal banking regulators have been reminding financial institutions to adhere to the December 2006 bank regulatory guidance *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* issued by the Office of the Comptroller of the Currency (OCC); the Board of Governors of the Federal Reserve System (Federal Reserve); and the Federal Deposit Insurance Corporation (FDIC) (collectively “the Agencies”) in which the Agencies specified criteria they would review to determine when a bank was exposed to potential CRE concentration risk. A financial institution is considered to have a high CRE concentration, and thus subject to the Guidance, if it exceeds or is rapidly approaching the following thresholds:

- If loans for construction, land development, and other land loans equal 100 percent or more of total capital, the institution would be considered to have a CRE concentration and should have heightened risk management practices.
- If loans for construction, land development, and other land loans secured by multifamily and non farm nonresidential property (excluding loans secured by owner-occupied properties) equal 300 percent or more of total capital, the institution would be considered to have a CRE concentration and should employ heightened risk management practices.

The guidance emphasized that the 100 percent and 300 percent thresholds are not to be considered as limits or caps on bank CRE lending but rather are intended as guidelines for banks and their examiners in determining appropriate loan underwriting and review systems, risk management practices and levels of reserves and capital.

NAHB continues to raise awareness in Congress about the lack of AD&C financing and the possible adverse economic impacts of this situation.

Basel III

In mid-2013, the U.S. federal banking agencies approved a new regulatory capital regime for all federally insured banking institutions. Referred to as Basel III, the new requirements increase the quantity and quality of capital for all federally insured banking institutions and will impose additional capital thresholds for the largest banking organizations. Basel III was effective for the largest banks beginning January 2014; compliance for community banks was mandatory beginning January 2015.

Basel III revised the definition of High Volatility Commercial Real Estate (HVCRE) and required HVCRE financings to be risk-weighted at 150 percent up from 100 percent. AD&C loans considered HVCRE financings which generally will include commercial real estate projects with an LTV greater than 80 percent and borrower-contributed capital of less than 15 percent of the project's "as completed" value.

HVCRE loans do not include:

(1) One-to-four residential property; or
(2) Commercial real estate projects that meet certain prudential criteria, including with respect to the LTV ratio and capital contributions or expense contributions of the borrower.

The new HVCRE capital requirement is affecting the ability of community banks to provide financing for AD&C loans using traditional methods and will impede the ability of banks to make high quality AD&C loans to builders and developers. As AD&C lending finally begins to recover, NAHB is extremely concerned that this rule introduces a significant new impediment to further improvement.

Cost of Regulation

NAHB appreciates the Committee's focus on regulatory activities that are adversely impacting the housing credit availability. Along with the challenges faced by home buyers and home builders in securing financing, regulatory burdens impose costs on the development of land and the construction/remodeling of homes, both multifamily and single-family, that are passed along to homebuyers/homeowners and renters through higher costs for housing, both in terms of prices and rents. New regulations are being developed that impact all aspects of home building. For instance, the housing and construction industry is actively engaged with OSHA, EPA, FEMA and other agencies on new regulations which could drive up the cost of housing further.

NAHB survey data of builders has demonstrated that, on average, regulation imposed during development accounts for 16.4% of the price of a home built for sale; regulation imposed during construction accounts for 8.6% of the price. Thus, in total, 25% of the price of an average single-family home built for sale is attributable to regulation imposed by all units of government at various points along the development/construction process. Most of these burdens are associated with permitting, land use, and construction codes, however, other financial burdens impose costs on the construction process and contribute to an increased cost of housing.

In turn, higher housing costs "price out" households from homeownership. For example, according to 2014 estimates from NAHB, on a national basis, a $1,000 increase in home prices leads to pricing out just slightly more than 206,000 individuals from a home purchase. The size

of this impact does vary widely across states and metro areas, depending on population, income distributions and new home prices.

Housing is an important source of economic growth and job creation; and regulations are limiting home builders' ability to grow and contribute positively to the economy. As of the final quarter of 2014, housing's share of gross domestic product (GDP) was 15.2 percent, with home building yielding 3.1 percentage points of that total. Historically, residential investment has averaged roughly 5 percent of GDP while housing services have averaged between 12 percent and 13 percent, for a combined 17 percent to 18 percent of GDP. While these shares tend to vary over the business cycle, clearly housing is an important factor in a healthy economy. Job creation is one of the important ways that housing contributes to GDP. NAHB estimates that building an average new single family home creates 3.05 jobs; building an average new multifamily rental unit creates 1.16 jobs; and every $100,000 spent on residential remodeling creates 1.11 jobs. Therefore, the cost and availability of credit for builders and home buyers has a direct impact on the ability of housing to contribute to economic growth.

All of these issues must be factored into the cost of housing. As the cost of housing increases and the credit box remains tight, home buyers and renters will have fewer safe, decent and affordable housing options.

Conclusion

NAHB supports steps to ensure that mortgage lending occurs in a safe and sound manner, with appropriate underwriting, prudent risk management and sound consumer safeguards and disclosure. NAHB continues to advocate for comprehensive mortgage finance system reform. While we believe regulatory barriers can be alleviated to some degree by the various regulators of the system as well as by specific legislative reforms, comprehensive legislation would ensure that components of reform are not in contradiction, but will work together to offer the hoped-for result; minimum disruptions to the mortgage markets while ensuring consumer protections.