

**TO: State MBA Presidents  
State MBA Executive Directors**

**FROM: Kurt Pfothenauer  
Senior Vice President  
Government Affairs**

**RE: GSE reform and other federal issues**

**DATE: May 4, 2006**

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The Mortgage Bankers Association recently concluded our annual National Policy Conference in Washington, D.C. Nearly 350 MBA members attended, and heard from:

- House Financial Services Chairman Mike Oxley (R-OH), and Senator Hillary Clinton (R-NY);
- Three Cabinet Members, Treasury Secretary Snow, HUD Secretary Jackson, Commerce Secretary Gutierrez;
- Former Chairman of the Democratic and Republican National Committees, Ed Gillespie and Terry McAuliffe; and
- Senator Hagel (R-NE), more than a dozen Members of Congress or their staff, and FHA Commissioner Montgomery, at a MORPAC reception.

At this conference, our members made 242 personal visits to Senators and Members of Congress. Among the issues MBA lobbied on are:

- FHA reform – we support H.R. 5121, which would modernize and improve FHA's effectiveness;
- GSE reform – we support H.R. 1461 and S. 190, both of which would improve the regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.
- A number of tax items, including preserving important deductions for home mortgage interest and state and local taxes.
- Opposition to some items in the President's proposed budget, including a large increase in FHA mortgage insurance premium for many multifamily loans, and an administrative fee for using Ginnie Mae's MBS program.

Attached please find a copy of the materials we delivered to each of the offices we visited. We would be happy to discuss these issues if you wish. For additional information, please contact Paul Richman at (202) 557-2899, [prichman@mortgagebankers.org](mailto:prichman@mortgagebankers.org).



# Congress Should Create a New GSE Regulator

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## **Background**

Mortgage lenders originate loans in a robust and competitive primary market. These loans are either held in portfolio or sold to secondary mortgage market investors like Fannie Mae and Freddie Mac (“the GSEs”). The GSEs play a vital role in maintaining mortgage market liquidity and stability.

The GSEs’ portfolios help stabilize mortgage markets and encourage affordable housing. They also provide liquidity and stability in times of market turmoil. The GSEs can and should use their portfolios to facilitate affordable financing for lower-income families and underserved markets, as well as multifamily loans, and to develop new products to better reach underserved markets.

It is important that the GSEs remain financially safe and sound and focused on their secondary market mission. In keeping with these important public policy objectives, MBA supports Congressional efforts to create a new regulator with the necessary resources and authority to supervise the GSEs.

## **Principles for Reform**

As the legislative process moves forward, MBA urges Senators and Representatives to consider the following core principles:

- The new regulator must be independent and well-funded, with the resources and expertise to evaluate the GSEs both as financial institutions and as public purpose entities. Its enforcement powers and general regulatory authority should be on par with those of the bank regulators.
- Legislation should clarify permissible GSE activities. The GSEs should not be permitted to use their government-sponsored benefits to distort the competitive landscape of the primary mortgage market.
- The GSEs need flexibility to adjust their portfolios to changing conditions and marketplace needs.
- The new regulator should have the authority and flexibility to set and adjust risk-based and minimum capital requirements.

- Congress should not set limits on the amount or specific types of investments that a GSE can hold in portfolio. However, the regulator should be empowered to assure that the GSEs' portfolios and their use support the GSEs' secondary market mission.
- As the GSEs need flexibility in their operations, so too the regulator needs flexibility to adjust quickly to changing and unforeseeable GSE and market circumstances as it regulates the GSE portfolios.
- Legislation should permit the regulator to intervene in the event of a financially distressed GSE, but it should do so only when there is a serious capital deficiency at a GSE, a serious threat to market liquidity, or a real possibility of market disruption. Further, legislation should specify a priority of claims, ensuring that mortgage-backed securities (MBS) have a priority claim so as to ensure market stability.
- Legislation should amend the GSE affordable housing goals to provide a greater emphasis on low-income households and to assure that the goals do not distort the housing markets.

**MBA Recommends: Please urge Senate leadership to bring S. 190 to the floor for consideration and to make the compromises necessary to ensure the bill's passage. The House has passed its companion bill, H.R. 1461, but without Senate action this year, the opportunity to significantly improve regulation of the housing GSEs and thereby strengthen U.S. mortgage markets could be lost.**



## Congress Should Oppose Increasing FHA Mortgage Insurance Premiums for Multifamily Loans

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### **What is Federal Housing Administration (FHA) multifamily mortgage insurance?**

FHA insurance programs help finance the construction, rehabilitation and improvement of rental housing and healthcare facilities in communities across the nation. The FHA multifamily programs are at the heart of the Federal government's efforts to help meet the housing needs of low and moderate income families and communities and are among the most effective federal domestic programs to produce affordable housing and healthcare facilities with proven results.

### **What populations does the FHA multifamily mortgage insurance serve?**

According to HUD, FHA insured 903 housing developments and assisted almost 109,000 households in FY 05, including more than 85,000 families in rental housing and over 23,000 units in healthcare facilities.

FHA insurance is critical to the provision of housing for the elderly and handicapped ranging from independent living to skilled nursing care properties. Increasingly, these programs also are a vital mechanism for ensuring decent, safe and affordable apartments for the many teachers, nurses and municipal workers who cannot afford homeownership and provides the first step on the ladder to those families hoping to one day own their own home.

### **What is a mortgage insurance premium and how does it benefit the FHA program?**

The mortgage insurance premium is the amount paid by a borrower for mortgage insurance which protects lenders against the loss in the event of a default by the borrower. FHA insurance carries the full faith and credit of the US government. Mortgage insurance premiums cover the risk to the program for the insurance backing and bring in revenue for the federal treasury. Virtually all of the FHA multifamily insurance programs currently cover all their costs with their mortgage insurance premiums.

### **How is the mortgage insurance premium (MIP) determined?**

An economic model is used to determine the MIPs every year. The model tries to capture all of the direct costs as well as the risk factors appropriate to the programs and so that it can be set at a level sufficient to protect the integrity of the FHA Guaranteed Insurance/Special Risk Insurance fund (GI/SRI). OMB's program assessment acknowledges the work HUD has done to improve the models used to determine the MIPs and says the program has increased its efficiency by lowering the cost of the FHA

guarantee while maintaining or increasing loan volume. For each of the past three years we have seen reductions in the MIPs for most programs based on this model.

### **Why is the FHA multifamily MIP an issue this year?**

The Administration's FY 2007 budget proposes nearly doubling the mortgage insurance premium (MIP) on most FHA multifamily mortgage insurance programs. According to the budget documents, the mortgage insurance premium was increased to offset administrative costs of the programs because the affected programs do not serve a "public purpose." The budget proposal includes an exemption from the fee increase for properties with low income housing tax credits because these provide affordable housing. However, to suggest that only tax credit-assisted properties are affordable and provide a public purpose is misguided. The FHA programs have a strong public purpose, providing a key source of affordable rental housing for individuals and families throughout the country.

This position is supported by statistics collected by the 2001 Residential Financial Survey (RFS), which is sponsored by HUD and conducted by the Census Bureau. In summary, looking at only those properties financed with FHA insurance and where no subsidies are involved, in all but one of the twelve states for which data is available, more than 70% of FHA-insured rental housing is affordable to households at 60% of area median income. In fact, the FHA mortgage insurance programs are serving a wide range of households in need – including very-low income families where, in six of the twelve states, over 25% of the units serve families at less than 30% of median income.

### **What is the impact of raising premiums?**

Increasing the current mortgage insurance premiums will, according to the HUD budget proposal, generate approximately \$150 million in additional revenue. The industry believes this new tax will cause fewer properties to be built or rehabilitated and will actually result in significantly lower income than projected. And for those properties that will continue in the FHA programs, the result will be a 5 percent increase in rents.

### **Why should you oppose increasing premiums?**

This increase would inflate the cost of housing for low and moderate income families and individuals across the country, including those who are elderly or disabled.

**MBA Recommends: Congress should oppose increasing the FHA multifamily mortgage insurance premiums. This increase would raise rents for low and moderate income families and individuals across the country, including those who are elderly or disabled. The increase would also make it infeasible for many properties to be constructed or rehabilitated.**



## MBA Tax Policy Positions In Support of Housing and Small Business

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### **Mortgage Interest Deduction**

Since the enactment of the federal tax code in 1913, one of the most powerful incentives for the expansion and preservation of homeownership has been the deductibility of mortgage interest. The mortgage interest deduction is consistent with America's longstanding tradition of encouraging homeownership, a pillar of U.S. housing policy. Currently, taxpayers who itemize may deduct interest paid on mortgage debt used to acquire a first or second home up to \$1 million. The interest on an additional \$100,000 of debt secured by home equity is also deductible. The benefits of homeownership and the mortgage interest deduction extend far beyond positive social effects; homeownership and the mortgage interest deduction strengthen the economy and play a key role in our nation's accumulation of wealth.

**MBA Recommends: As Congress considers potential changes to the tax code, we urge you to preserve the mortgage interest deduction and the social and economic benefits it generates.**

### **Deductibility of State and Local Property Taxes**

The property tax deduction is another portion of the tax code that remains consistent with our nation's tradition of encouraging homeownership. Currently, homeowners may deduct taxes on real property paid to states and localities. To eliminate the property tax deduction would be tantamount to a significant tax increase for millions of homeowners.

**MBA Recommends: We urge you to preserve the deductibility of state and local property taxes.**

### **Deductibility of Mortgage Insurance Premiums**

MBA supports proposals allowing families to deduct mortgage insurance premiums against income in the calculation of federal income tax. Mortgage insurance is paid by most homebuyers who make a down payment of less than 20 percent. However, while interest on mortgages is tax deductible, mortgage insurance, which often costs over \$1,000 annually, is not. Allowing for the deduction of mortgage insurance premiums will promote the continued expansion of homeownership. The Senate-passed tax reconciliation bill includes such a deduction for one year.

**MBA Recommends: Please encourage tax bill conferees to include a deduction for mortgage insurance premiums in the final reconciliation bill conference report.**

### **Low Income Housing Tax Credit**

In order to promote affordable rental housing, the Low Income Housing Tax Credit (LIHTC) should be preserved, as it is the only incentive specifically designed to promote the production of low-income rental housing. While MBA continues its support for the program, it believes that a number of existing problems must be addressed. The program's bias toward non-profit sponsors should be eliminated. In addition, statewide rather than area median income should be used to determine income limits for tenants in rural areas. The LIHTC should also be revised to encourage the original goal of creating mixed-income developments.

**MBA Recommends: As Congress considers tax reform legislation, we urge you to preserve and enhance the Low Income Housing Tax Credit.**

### **Real Estate Mortgage Investment Conduits (REMICs)**

To enhance and maintain the viability of the secondary market for commercial and multifamily mortgage loans, tax rules for Real Estate Mortgage Investment Conduits (REMICs) should be modernized to allow for, among other things, improvements to be made to the underlying collateral. REMICs were created as part of the Tax Reform Act of 1986 and are vehicles that facilitate investment in mortgages, thus promoting homeownership and economic development. The 20-year-old regulations restrict the ability of borrowers to renovate or expand their property if the loan has been securitized through a REMIC in most instances. This artificial barrier to economic growth must be removed, and can be while not only protecting, but enhancing, the value of the investment to bondholders. By modernizing REMIC laws, S. 580 and H.R. 1010 will enhance greatly the ability of commercial property owners to upgrade buildings after the mortgage has been securitized, without the need for costly and burdensome tax opinions.

**MBA Recommends: Please cosponsor and support consideration of S. 580 or H.R. 1010 this year.**

### **Capital Gains Tax Rate**

MBA believes that the tax rate on capital gains associated with depreciation recapture for real estate should be lowered so it is the same as the rate for all other assets, and the holding period for capital gains on real estate should remain the same as the holding period for capital gains on all other assets. The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the rate on long-term capital gains to 15%. However, since passage of the Taxpayer Relief Act of 1997, depreciation allowances taken in prior years are "recaptured" and taxed at 25% when investment real estate is sold – a rate higher than the capital gains rates on most other assets. Prior to 1997, the recaptured amounts were taxed at the same rate as capital gains.

**MBA Recommends: Please support lowering the depreciation recapture rate and capital gains rates on the sale of income-producing real estate to the same rate for all other assets.**

### **Brownfields Development**

MBA strongly supports legislation that would expand and make permanent the expensing of environmental remediation costs associated with brownfields. Brownfields are properties blighted by rundown or abandoned facilities, often industrial in nature and contaminated by pollutants. A number of bills have been introduced in the House and the Senate which would enhance and make permanent brownfield programs, and MBA supports these initiatives. Additionally, MBA supports final passage of H.R. 4297, the "Tax Relief Act of 2005," as both the House and Senate version of this bill contain an extension of brownfields cleanup expensing in the tax code, which expired at the end of last year.

**MBA Recommends: Please encourage tax bill conferees to include an extension of expensing for brownfields cleanup in the final reconciliation bill conference report.**

### **Leasehold Improvement**

"Leasehold," or tenant improvements to commercial real estate properties are currently depreciated over 15 years. At the end of 2006, however, this depreciation period will revert back to a 39-year schedule. The majority of commercial real estate lease terms occur over a 5, 7 or 10-year period. Therefore, a 39-year depreciation period does not reflect the true economic life of these assets. Extending the 15-year provision of the 2004 Tax Act would provide for closer alignment with the true economic life of leasehold improvements, and represents sound tax policy. Provisions contained in the House and Senate versions of H.R. 4297, the "Tax Relief Act of 2005," currently under consideration by a conference committee, would extend the 15-year depreciation rule and MBA supports final passage of this extension.

**MBA Recommends: Please encourage tax bill conferees to include the leasehold improvement depreciation provision in the final conference report.**



## Empowering FHA to Serve American Families

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Since its inception in 1934, the Federal Housing Administration (FHA) has played an innovating role in financing homeownership and affordable housing opportunities for all Americans, creating programs that serve those unserved or underserved by conventional products. The FHA accomplishes its mission through mortgage insurance programs at little or no cost to the government, and in fact annually sends funds to the U.S. Treasury, thereby reducing the deficit.

The mortgage market has changed dramatically over the past 15 years, creating what is today the world's most sophisticated real estate finance system. This system has led to the highest rate of homeownership in U.S. history and to the efficient production of thousands of units of affordable rental housing each year.

While the mortgage market has changed significantly, FHA has not kept pace. FHA faces challenges in effectively managing its resources and programs in this quickly changing mortgage market. These challenges have already diminished FHA's ability to serve its public purposes. Unaddressed, these issues will cause FHA to become less relevant and will leave the families served by their programs with no alternative for homeownership or affordable rental housing.

Even with the world's most sophisticated real estate finance system, there is still much work to do. Minority families' homeownership rates lag those of non-minority families. In many cities, the average fireman or teacher cannot afford the rent on a 2-bedroom apartment in the communities in which they work.

MBA believes FHA needs to be empowered with a greater ability to invest in **technology**, a greater flexibility in managing its **human resources**, and the authority to **pilot products and program changes**. On this last point, H.R. 5121 the *Expanding American Homeownership Act of 2006* gives FHA much greater flexibility to implement single family program and product changes. S. 2597 the *Federal Housing Fairness Act of 2006* will help facilitate homeownership in high-cost areas.

Such authority is an important first step. MBA would like to work with Congress to build on this by developing additional changes related to FHA's technology and human resources. Our mutual goal should be to transform FHA for the 21<sup>st</sup> century.

**MBA Recommends: Please co-sponsor H.R. 5121 the "Expanding American Homeownership Act of 2006" and S. 2597 the "Federal Housing Fairness Act of 2006."**



# Ginnie Mae: Oppose Burdening it with Unnecessary Administrative Fees as Proposed In the Administration's FY 2007 Budget

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## **What Is Ginnie Mae?**

Ginnie Mae is a government owned corporation in the Department of Housing and Urban Development (HUD). Government-insured and -guaranteed residential and multifamily mortgage loans (FHA, VA and RHS) are converted through a Ginnie Mae guarantee into mortgage-backed securities (MBS) attractive to capital market investors. The result is lower mortgage rates for first-time, low- and moderate-income and minority borrowers and renters. Approximately \$400 billion in Ginnie Mae MBS are currently outstanding.

## **How Does Ginnie Mae Work?**

Most mortgage lenders need to replenish their cash available to keep lending money, which means that they need to sell their mortgages. The most efficient way to do that is to group similar loans into MBS. Investors purchase the MBS and receive interest and principal from monthly payments on the underlying mortgages.

Ginnie Mae guarantees its MBS so that investors receive principal and interest payments even if the homeowner, apartment owner or MBS issuer fails to make a monthly payment. The Ginnie Mae guarantee carries the full faith and credit of the United States and allows the lenders to sell their MBS to investors for a higher price than they would get for the whole mortgages. This increased price lowers interest rates to homebuyers and apartment owners and recycles money to the lender who makes more mortgages available.

## **What Does It Cost the Government to Provide Ginnie Mae's Guarantee?**

Nothing. Ginnie Mae charges *lenders* a guaranty fee which is a portion of the interest on the mortgages. Historically, Ginnie Mae has never operated at a loss and during Fiscal Year 2004, it generated a profit to the U.S. Treasury of \$737.7 Million.

## **Who Is the Typical Consumer of the Government Loans that Back Ginnie Mae MBS?**

First time homebuyers who may have little cash for a down payment and not much credit history qualify more easily for government loans than for conventional programs. FHA borrowers are **80% first-time homebuyers, and more than one in three borrowers is a minority homebuyer.** Almost 58% of FHA borrowers earn less than \$50,000. By comparison, only 27.6% of borrowers in the conventional market earn less than \$50,000.

## **How Important is Ginnie Mae to the Success of the FHA and VA Home Mortgage Loan Programs?**

Lenders use Ginnie Mae to assist them in selling the vast majority of their government loan production.

## **How Does Congressional Action Affect Ginnie Mae?**

Because Ginnie Mae is an entity created by statute, Congressional action could affect every aspect of Ginnie Mae's operations and even whether it continues to exist. The Administration's FY 2007 budget proposes adding an administrative fee to the guarantee that Ginnie Mae---which already generates a profit to the government---would charge. A change to Ginnie Mae's statute would be necessary to implement the administrative fee proposal. Ginnie Mae's fee levels are set in statute to assure that it continues to support the government loan programs in an efficient manner, which it does.

## **What's wrong with charging a new administrative guarantee fee?**

The administrative fee, which would double the first year expense of using the Ginnie Mae program, will be passed along to the home borrower or the multifamily borrower, effectively resulting in a tax on homeownership or affordable rental housing. If the six basis point guarantee fee is implemented, the effects would be as follows:

- The attractiveness of Ginnie Mae as a way to sell mortgages would decline.
- Obtaining money for new FHA/VA/RHS mortgage loans would be more costly.
- Guarantee fee income would actually fall as production drops because MBS pricing attractiveness deteriorates.
- Thousands of households would be excluded from homeownership, and the availability of new rental housing would be adversely impacted.
- A strong, effective government housing program would be weakened

Increases in the guaranty fee are simply not necessary. As noted above, Ginnie Mae generates a healthy profit to the U.S. Treasury with the current fee structure.

**MBA Recommends: MBA is asking that you oppose the Administration's proposal to add an administrative fee for use of the Ginnie Mae MBS program. The proposal is unnecessary because the guarantee fee easily covers the cost of the Ginnie Mae program. The added fee will result in less use of Ginnie Mae and could result in lower use of the FHA, VA and RHS programs.**