Testimony of Robert Nielsen

On Behalf of the

National Association of Home Builders

Before the

House Financial Services Subcommittee on Financial Institutions and Consumer Credit

Hearing on

<u>The Effect of Dodd-Frank on Small Financial Institutions and Small Businesses</u>

March 2, 2011

Chairman Capito, Ranking Member Maloney and members of the Subcommittee on Financial Institutions and Consumer Credit, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on the effect of Dodd-Frank on small financial institutions and small businesses. We appreciate the invitation to appear before the Subcommittee on this important issue. My name is Bob Nielsen and I am the 2011 NAHB Chairman of the Board and a home builder from Reno, Nevada.

NAHB represents over 160,000 member firms involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction. The housing sector is an industry made up of mostly small businesses. Over 85 percent of NAHB's builder members reported building fewer than 25 home per year in both 2008 and 2009. Over 85 percent of them have less than $5 million in annual receipts, and over 95 percent have less than $15 million. In comparison, the U.S. Small Business Administration (SBA) classifies construction businesses as small if they have average annual receipts under $33.5 million.

Thus, the typical home builder easily qualifies as a small business, and these small businesses depend almost entirely upon commercial banks and thrifts for housing production credit. Indeed, small community lenders account for over 90 percent of residential land acquisition, development and residential construction (AD&C) loan originations. With no alternative sources of housing production credit for most firms in the home building industry, NAHB is extremely interested in how the rule-makings required by the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* [1] (Dodd-Frank Act) will impact the ability of small community banks and credit unions to service our industry in the coming months and years. Federal banking regulators are now entering an intense period of rule-making on key components of the Dodd-Frank law. NAHB will be examining and commenting on these critical rule-makings not only for their potential to impact the already struggling housing industry, but also for the additional uncertainty that the sheer weight of new regulation will have on the ability of small builders to obtain much-needed housing production credit. With our industry already paralyzed by overly restrictive actions by federal banking regulators and examiners that have gone well beyond the steps needed to ensure safety and soundness, any additional burdensome and unnecessary regulatory excess will be sure to have a negative impact on small home building companies and thus for the economy as a whole.

NAHB's testimony today will focus on the following areas:

1. The potential impact that ongoing Dodd-Frank rule-making will have on housing finance and the housing industry.

[1] Pub. L. 111-203, July 21, 2010.

2. The current impact of restrictive actions by banking regulators and examiners on the home building industry's access to credit.
3. Policy solutions for improving access to credit for small builders.

Impact of Dodd-Frank on Housing Finance and the Housing Industry

The Dodd-Frank Act is the most sweeping piece of financial reform legislation since the Great Depression, impacting both financial and non-financial firms. The bill calls for more than 240 rulemakings and more than 60 studies. The financial regulatory agencies are now embarking on this intense rulemaking period which has added to the already uncertain economic environment. As noted, NAHB will be examining and commenting on individual rulemakings for the impact on the home building industry and the broader housing finance system.

Of most concern to NAHB at present, are the forthcoming credit risk retention rules required by Section 941 of the Dodd-Frank Act. NAHB is concerned that the rules may result in an unduly narrow definition of the important term "Qualified Residential Mortgage" (QRM) that could forestall the recovery of the housing market by making mortgages unavailable or unnecessarily expensive for many creditworthy borrowers. This could occur, for example, if the rules required homebuyers to make large down payments. The housing market is still weak, with a significant overhang of unsold homes, and an equally large shadow inventory of distressed loans. A move to a larger down payment standard at this juncture would cause renewed stress and uncertainty for borrowers who are seeking or are on the threshold of seeking affordable, sustainable homeownership. We believe careful calibration of the QRM exemption is imperative in light of the enormous potential impact it would have on the cost and availability of mortgage credit at this precarious point in the housing cycle.

Risk retention is intended to align the interests of borrowers, lenders and investors in the long-term performance of loans. This "skin in the game" requirement, however, is not a cost-free policy option. One analyst report[2] suggests that risk retention, when combined with other contemporary accounting and capital changes already in the works, could increase the cost of mortgages funded through securitization by as much as three percentage points. Obviously, an increase in mortgage rates by even a fraction of that amount would price many eligible borrowers out of the housing market.

To address this problem, the Dodd-Frank Act was amended to include an exemption from the risk retention requirements for certain high-quality, lower-risk mortgages. The statute requires the QRM definition to be based on "underwriting and product features that historical loan performance data indicate result in a lower risk of default," and provides guidance on the types of factors to be considered:

[2] JP Morgan Securities, Securitization Outlook, December 11, 2009.

- Documentation of income and assets;
- Debt-to-income ratios and residual income standards;
- Product features that mitigate payment shock;
- Restrictions or prohibitions on non-traditional features like negative amortization, balloon payments, and prepayment penalties; and
- Mortgage insurance or other types of credit enhancement obtained at the time of origination on low down payment loans, to the extent they reduce the risk of default.

This statutory framework is important for two reasons. First, it ensures that the definition is based on objective, empirical data rather than subjective presumptions. Second, it requires a multifactor approach to establishing the parameters of the QRM in order to promote sound underwriting practices without arbitrarily restricting the availability of credit.

We are concerned that the federal banking agencies may be considering a very narrowly defined QRM standard. For example, it has been suggested that the QRM standard include a very high down payment requirement in order to limit QRM eligibility to some arbitrarily small percentage of the market.

Creating an inordinately narrow QRM exemption could cause significant disturbances in the fragile housing market. Today's credit standards are tougher than they have been in decades. As a result, credit availability is extremely tight even for very well qualified borrowers. We have strongly urged the banking regulators to consider the negative ramifications of setting further limits on the availability of credit through a comparatively narrower QRM exemption. If the agencies establish a QRM that is significantly tighter than current credit standards, it would mean that millions of creditworthy borrowers would be deemed, by regulatory action, to be higher risk borrowers. As a result, they would be eligible only for mortgages with higher interest rates and fees and without the protections required by the statutory QRM framework that limit risky loan features.

An overly restrictive QRM definition also would drive numerous current lenders from the residential mortgage market, including thousands of community banks, and enable only a few of the largest lenders to originate and securitize home loans. This sharp dilution of mortgage market competition would have a further adverse impact on mortgage credit cost and availability.

A QRM definition that is too narrow would prohibit many potential first-time homebuyers from buying a home especially if the definition includes an excessively high minimum down payment requirement. Repeat buyers and refinancers also would be adversely impacted if the QRM includes exceedingly high equity requirements. In other words, the important goal of clearing historically high foreclosure inventory – a necessary condition for a stabilized housing market –

will be undermined. We therefore urge the agencies to define the QRM's parameters in a way that facilitates a housing recovery and ensures access to conventional mortgage credit for all buyers and refinancers, including low- and moderate-income households, minority families, and first-time buyers, while preserving high quality, empirically sound underwriting and product standards.

The purpose of the QRM is to create a robust underwriting framework that provides strong incentives for responsible lending and borrowing. Loans meeting these standards will assure investors that the loans backing the securities meet strong standards proven to reduce default experience. The exemption also will keep rates and fees lower on QRMs, which will provide incentives for borrowers to document their income and choose lower risk products. In turn, the market will evolve to establish the appropriate mixture of QRM to non-QRM borrowing.

The majority of industry participants (lenders, home builders, realtors, mortgage insurers) and the sponsors of the QRM language in Dodd-Frank support a broad QRM definition that would encompass the bulk of residential mortgages that meet the lower risk standards of full documentation, reasonable debt-to-income ratios and restrictions on risky loan features. In addition, most believe that loans with lower down payments that have risk mitigating features, most notably mortgage insurance, should be included in the QRM exemption.

A narrower definition would not only deny mortgage credit to many qualified borrowers, impairing the housing market and economic recovery, but would also have a major negative impact on the Federal Housing Administration (FHA), as borrowers who do not meet the QRM criteria would move to FHA in large numbers. This would move significant risk from the private sector to the government.

NAHB recommends the broadest criteria possible should be promoted when defining the QRM exemption, without interfering with the safety and soundness requirements of the Dodd-Frank Act.

Impact of Current Regulations on Home Builder Access to Financing

Community banks are under intense regulatory pressure that has resulted in a severe lack of credit to home builders for land acquisition, development and residential construction (AD&C). Residential AD&C loans are used to purchase land; develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. Loans extended to builders/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a six-to-18 month period. While interest payments are made during the development and construction period, the principal on the loan is not repaid to the lender until the home or lot is sold. In addition to the collateral represented by the project under construction, builders may also secure this financing through personal guarantees and/or offering other assets as collateral.

Portfolio lenders – commercial banks and thrifts – remain the predominant source of residential AD&C financing, accounting for over 90 percent of originations. There are no alternative sources of housing production credit for most firms in the home building industry, the bulk of which are small businesses building 25 or fewer homes a year. A major factor in the housing production credit crisis is overly restrictive actions by federal banking regulators and examiners that have gone well beyond the steps needed to ensure safety and soundness. These excessive regulatory restrictions have been noted by both borrowers and banks. Smaller home building companies are bearing the brunt of the credit retraction.

In this regulatory environment, we continue to hear from NAHB members that it is extremely difficult, if not impossible to obtain new AD&C loans. Builders with outstanding construction and development loans also are experiencing intense pressure as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. The credit window seems to have been slammed shut for builders all over the country. This is a major impediment to the housing recovery and an increasing threat to the ability of many home builders to survive the economic downturn.

Current AD&C Financing Conditions

NAHB's member surveys of the availability and cost of AD&C credit find that AD&C credit conditions remain a critical problem for the home building industry with little signs of easing. Our latest survey for the fourth quarter of 2010 found that the number of survey respondents reporting that they have access to credit has hit alarmingly low levels, with condition steadily worsening from the final quarter of 2007 through the middle of last year. With housing conditions almost back to normal in many parts of the country, it is disturbing that very few builders are reporting that loan availability has improved. This is true for both single family and multifamily builders:

- Fifty-four percent of those seeking single family construction loans in the fourth quarter reported that credit availability was about the same as the previous quarter. For the past three years, however, the most frequent response has been that credit availability was worsening. Only eight percent said credit conditions were improving in the fourth quarter.

- Among those seeking multifamily construction credit, 52 percent said credit conditions were about the same as in the third quarter. However, from the last quarter of 2007 through the middle of last year, the vast majority of respondents reported that loan availability for multifamily construction worsened each quarter. In the fourth quarter, only 12 percent reported signs of improvement.

- Respondents also reported adverse treatment on outstanding AD&C loans. Ninety-two percent of builders who reported tighter terms on outstanding single family construction loans said their loans were performing prior to the lender's decision to tighten, while 94 percent of multifamily construction loans called into question also were in good standing.

Financial Institution Regulatory Obstacles to Home Builder Financing

Of concern to NAHB is that lenders often cite regulatory requirements or examiner pressure that banks shrink their AD&C loan portfolios as the reasons for their actions. While the federal bank regulators maintain that they are not encouraging institutions to stop making loans or to indiscriminately liquidate outstanding loans, reports from NAHB members and their lenders in a number of different geographies suggest that bank examiners in the field are adopting a significantly more aggressive posture.

Commercial Real Estate (CRE) Concentration Guidance

The primary regulatory guidance impacting AD&C loans is the *Interagency Guidance on Concentrations in Commercial Real Estate (CRE) Lending and Sound Risk Management Practices* (CRE Guidance) issued in December 2006, by the Federal Insurance Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC) and the Federal Reserve (Fed) (collectively referred to as "the Agencies")[3].

Though the 2006 Guidance does not define specific CRE concentration limits it specifies the criteria of CRE loans that the Agencies will watch for to indicate "potentially exposed CRE concentration risk" and specifically focuses on land development and construction loans (including 1 to 4 family residential and commercial loans). The guidance includes supervisory screens to identify institutions that are "potentially" exposed to significant CRE concentration risk that would trigger heightened risk management practices. Criteria that the Agencies look for include***:***

1) Total reported loans for construction, land development and other land loans representing 100 percent or more of the institution's Total Capital; and,

2) Total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction and land development and other land loans, representing

[3] See 71 Fed. Reg. Number 238, pages 74580-74588, Dec. 12, 2006.

more than 300 percent of the institution's Total Capital where the outstanding balance of CRE loans has increased by more than 50 percent during the prior 36 months.

The 2006 Guidance stated that institutions with CRE concentrations above these levels will receive closer supervisory scrutiny and should have risk management systems commensurate with the CRE portfolio's risk characteristics, size and complexity.

While the Agencies maintain that the CRE capital criteria are not hard limits, anecdotal evidence and statements from bankers and builders indicate that the 100 percent of capital lending criteria has become a trigger or hard threshold at which banks either will not or cannot expand their AD&C lending. This is largely due to bank examiner pressure and the belief by some banks of a strict prohibition to lend in excess of this amount.

Financial institution CRE concentrations have a significant impact on the availability of residential AD&C credit since roughly 90 percent of NAHB builder members get their AD&C financing from smaller financial institutions. The highest concentrations of institutions exceeding the criteria are mid-size institutions, those between $100 million and $10 billion in assets. These institutions have the made largest share of loans to home building companies, most of which are small businesses.

The Independent Community Bankers of America (ICBA), which represents smaller banks, has stated in Congressional testimony that regulatory hindrances are impeding the ability of banks to make new CRE loans and to refinance or restructure outstanding loans.[4] ICBA's testimony includes statements that bank field examiners are placing restrictions on banks that go well beyond what is required to protect bank safety and soundness. The result of this examination pressure is that community banks are avoiding making good loans they would have made in the past and are reducing the amount they will lend in the limited cases where they can provide financing.

Collateral Valuations

Appraisers, lenders and examiners have been using liquidation values when assessing collateral on residential AD&C loans on projects that they intend to fund to completion. This practice discourages banks from maintaining funding for residential AD&C loans in good standing and results in inappropriate equity calls that can lead to foreclosure on loans on otherwise viable projects.

[4] See testimony of Stephen G. Andrews, on behalf of Independent Community Bankers of America, hearing before Committees on Financial Service and Small Business, U.S. House of Representatives, February 26, 2010.

In October 2009, the Agencies issued the *Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts* (2009 Policy Statement).[5] The objective of the 2009 Policy Statement is to encourage financial institutions to pursue workouts on troubled CRE loans, a category that includes residential AD&C loans. Their stated intent is to ensure that supervisory policies and actions do not impair the flow of credit to viable borrowers and projects. The statement says that financial institutions that implement prudent CRE workouts will not be subject to criticism for engaging in such efforts and loans should not be subject to adverse classification solely because the value of the underlying collateral has declined.

The 2009 Policy Statement includes specific instructions stating that the appraisal method should be based on the status of the loan and project:

> *"The institution should use the market value conclusion (and not the fair value) that corresponds to the workout plan and the loan commitment. For example, if the institution intends to work with the borrower to get a project to stabilized occupancy, then the institution can consider the "as stabilized" market value in its collateral assessment for credit risk grading after reviewing the reasonableness of the appraisal's assumptions and conclusions. Conversely, if the institution intends to foreclose, then the institution should use the fair value (less costs to sell) of the property in its current "as is" condition in its collateral assessment."*

Although NAHB believes the 2009 Policy Statement was a positive step in encouraging workouts as a preferred course of action and in directing examiners to make balanced assessments of institutions' workout efforts, the criteria specified for prudent loan workouts will allow institutions fairly limited ability to structure workouts for residential AD&C borrowers. Since residential AD&C loans are collateral-dependent with no internal cash flows to service principal and interest, borrowers on these loans will have to demonstrate other sources of loan repayment, provide additional collateral and/or make principal repayments in order to satisfy the criteria for prudent workouts. Many AD&C borrowers are not in a position to meet such requirements.

However, if the collateral value is based on the "as-completed" value of the project, it is less likely that additional equity or other collateral will be required, allowing the borrower to complete the project, rather than facing foreclosure. In the vast majority of cases, lenders would be better off working with their builder/developer borrowers to modify or extend loans, rather than requiring additional equity or shutting off credit.

[5] Federal Deposit Insurance Corporation, Financial Institution Letter, FIL-61-2009, October 30, 2009.

Equity Calls on Performing Loans

Builders with outstanding construction and development loans are experiencing intense lender pressure, including calls for significant additional equity, denials on loan extensions, and demands for immediate repayment. Even builders who are current on their AD&C loan payments are facing bank demands for additional capital. These equity calls are often triggered by reappraisals of the collateral backing the loan. In many instances, the construction projects are solid projects that simply need to be built out for completion.

AD&C loans are entirely dependent on collateral (the project being financed) for repayment of principal. In other words, sale of the lot or home is required to provide funds to retire the AD&C loan. 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. Such actions can result in a cut-off of loans on other projects a builder is undertaking and can also have severe adverse consequences for other AD&C loans in the bank's portfolio. Foreclosure on such loans is not in the best interest of the lender, builder or the community.

Performing loans that have been extended routinely in the past are now being called. Banks are increasingly refusing to modify AD&C loans or to provide builders more time to complete their projects and pay off these loans. Some lenders are abandoning the construction lending business, without regard to a builder's ongoing projects, and some institutions are auctioning off loans without negotiating with the builder. These actions have increased foreclosures on AD&C projects which in turn have hurt communities by unnecessarily increasing the inventory of unsold or partially completed homes and projects.

Lenders often cite regulatory requirements or pressure from examiners, to reduce AD&C loan exposures as the rationale for the lenders' actions. As noted, the Agencies maintain that they are not encouraging institutions to stop making loans or to indiscriminately liquidate outstanding loans. The federal banking regulators have been reminding financial institutions to adhere to the December 2006 CRE Guidance. In addition, since the economic downturn in 2008, the federal banking regulators have issued several statements encouraging banks to lend to creditworthy borrowers.[6]

While the statements of the banking regulators seem to support a flexible and pragmatic approach to examination of bank AD&C and other lending activities, NAHB has seen no evidence that the problem of extreme regulatory pressures on lenders is abating. We hear daily from builders <u>and bankers</u> who are complaining of excessive actions from bank examiners.

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[6] In addition to the 2009 Policy Statement, other key statements include: *Interagency Statement on Meeting the Needs of Creditworthy Borrowers*, November 2008*; and, Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers*, February 2010.

Furthermore, there are indications that the banking agencies are discussing plans to issue new tougher standards to rein in CRE lending and are considering hard limits on the amount of these holdings on bank ledgers as well as more stringent underwriting standards and increased capital requirements for CRE loans. While NAHB believes that banks should engage in sound, balanced underwriting standards when considering all types of loans, the pendulum has already swung too far on the restrictive side in the current regulatory climate.

At a time when financial institutions need to be engaged in responsible lending practices to spur job creation and economic growth, establishing overly harsh limitations on construction lending will do just the opposite by further stifling the flow of credit for housing production. With the housing market struggling to regain its footing, regulators need to be issuing more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. Tightening the screws further could have a devastating impact on the housing market and jeopardize the budding economic recovery.

SBA Regulatory Constraints on Home Builder Credit

The policy initiatives that have been undertaken to address credit problems of small businesses, for the most part, have not addressed the financing disruptions in the home building sector, which is made up largely of small companies. The failure of these efforts to provide any relief to builders seeking financing for housing production stems from the fact that the initiatives generally utilize programs of the Small Business Administration (SBA), which prohibits borrowing for residential development and construction except for limited purposes.

As noted the home building is an industry made up of mostly small businesses that qualify as a small business under SBA's small business definition. Although there have been legislative efforts to utilize the SBA as a source of funding to small business generally they have not worked for builders. SBA has very limited programs for builders. Building under contract for an identified purchaser is eligible for SBA financing. SBA also provides builder financing through a line of credit, under the Builders' CAPLine program (13 CFR 120.391), if the builder can show that financing is available for potential buyers and that a market exists for the project. According to SBA, CAPLines for builders is currently underutilized. Potential issues that NAHB has been made aware of are lenders find it easier to lend directly because of additional SBA process requirements. An example of this is that in addition to the lender approving loan draws SBA must also approve the draws prior to dispersing the funds.

In general, however, SBA has long held the position that the business of home building is speculative. SBA's Standard Operating Procedures defines building homes for future sale as speculative, and therefore ineligible for SBA's loan programs.[7] Consequently, small home building companies have not seen any real improvement in financing prospects as a result of recent SBA program changes.

A case in point is SBA's America's Recovery Capital (ARC) Program, established in the American Recovery and Reinvestment Act of 2009 (ARRA). The ARC program guarantees interest free, deferred payment loans of up to $35,000 from participating lenders to help existing small businesses meet their current obligations. When the ARC program was rolled out in June 2009, NAHB was hopeful that this program would help many of NAHB's members to stay afloat through these tough economic times. Unfortunately, builders have been informed by bankers and SBA field staff that their businesses are not eligible for this assistance.

More recently, builders have been shut out from the $30 billion Small Business Lending Fund (SBLF) enacted last fall. NAHB weighed-in forcefully during congressional consideration of the SBLF Act to allow construction loans to small builders to be eligible for the SBLF. While the House unanimously supported the builder provision, the Senate version, which was ultimately signed into law on September 27, 2010, did not include builder eligibility.

Economic Impact of the AD&C Credit Crunch

The credit crunch faced by home builders will exacerbate the current housing inventory problem, prolonging the downward spiral in home prices and the housing slump. Clearing out the excess inventory of unsold homes is a key factor toward stabilizing housing markets and prices. While the level of unsold homes varies significantly across markets, builders in depressed areas have slashed home production to levels well below that needed to meet longer-term demand. Lenders in these markets will not resume lending until a supply-demand balance is restored. The credit crunch is also contributing to slowing housing production in areas not impacted by excessive inventories.

The problems in the housing sector have had a significant impact on the nation's economy. The sharp decline in home building from the 2005 peak – a drop of one million units – has translated into 1.4 million lost jobs for construction workers and the loss of $70 billion in wages.

The housing plunge has also affected industries that provide materials and services to home builders. Over 560,000 jobs have been lost in the manufacturing sector due to the housing decline as makers of products such as lumber, concrete, windows, doors, plumbing, flooring and appliances have slashed their workforce in response to slumping demand. This has produced a loss of $25 billion in wages.

[7] See SBA Standard Operating Procedures, SOP 50 10 5(A) at page 110.
http://archive.sba.gov/idc/groups/public/documents/sba_homepage/serv_sops_50105a.pdf

Further, jobs have been lost by lenders, architects, real estate agents, lawyers, support staff and others who provide services to home builders and home buyers. There has been a loss of over 580,000 jobs and $32 billion in wages for these service providers. The total impact of the housing slump has been the loss of over 3 million jobs and $145 billion in wages in all housing-related industries.

The ongoing credit problems for home builders will further inflate these totals. Home builders cannot keep their doors open and provide jobs in their communities if they cannot get credit to build even pre-sold homes. And builders in the middle of viable projects cannot pay subcontractors and other materials and services providers if lenders will not grant routine loan extensions or if banks require payment-in-full before homes can be finished and delivered.

The credit crunch also will cause longer-term economic damage. The development process is lengthy, taking years from the acquisition of land to the completion of homes. With lenders refusing to finance lot development, the pipeline of ready-to-build-on land will drain dry. This will result in a major delay in meeting demand for new homes when consumers return to the marketplace in more significant numbers. In cases where federal permits are also required, expirations of these permits will force builders to start the approval process anew, adding at least several years to the pipeline. The effect will be most severe in markets that have not suffered the boom-bust extremes and would otherwise be poised for more rapid recovery.

NAHB estimates that over the next decade there will be a need for at least 1.7 million additional homes per year. This translates into 5 million jobs and significant economic activity. Without increased AD&C lending, this future demand will not be met, job loss will occur and job creation will suffer.

Policy Solutions for Improving Access to Credit for Small Builders

NAHB has presented banking regulators with specific instances of credit restrictions; provided data showing no difference in credit access across market conditions and requested specific changes to current regulatory guidance. To date, these efforts have not produced any tangible results. With the spigot for housing production loans cut off, and threat that the uncertainty from Dodd-Frank rule-making will further impact the ability of small community lenders to service the credit needs of our industry, it is clear that Congressional action is needed to help open the flow of credit to home builders. Without such action, there can be no housing recovery, which has major implications for our nation’s ability to recover from the current economic downturn.

NAHB will soon be presenting a formal legislative blueprint to Congress outlining four key elements critical to help ensure adequate credit availability to home builders. Three of these key elements focus on fixing specific instances of regulatory excess, while the final element aims to address the ability of the Small Business Administration (SBA) to meet the credit needs of small home builders. In the coming weeks and months, NAHB will be working with Congress to address these critical issues and seek congressional action to address each specific concern.

Allow me to highlight the key elements of NAHB's legislative proposal:

Bank Regulators Need to Follow Their Own Guidelines

Problem: As highlighted earlier, bank regulators should be required to ease or eliminate the 100% of capital bank lending limit for AD&C loans. Bank regulators including the FDIC, OCC and Federal Reserve have not adhered to their own *2006 Interagency Guidance on Concentrations in CRE Lending and Sound Risk Management Practices* which states that regulators should simply *screen* institutions that are potentially exposed to CRE concentration risk because of construction, land development and other land loans representing 100% or more of Total Capital. Rather, based on NAHB member experiences as well as statements from both bankers and builders, it appears that the 100% AD&C capital lending criteria has become a hard threshold or trigger at which banks will not or cannot expand their AD&C lending.

NAHB Legislative Proposal: Our proposal would direct bank regulators to issue regulations to cease implementing the 100% capital lending limit as a "hard" threshold.

Realistic Market Based Appraisals

Problem: Federal banking regulators should be required to issue guidance clarifying that appraisers, lenders and examiners utilize an "as-completed" value, as detailed in the financial regulators *2009 Policy Statement on Prudent Commercial Real Estate Loan Workouts*, when assessing values of loan collateral on residential AD&C projects that have reasonable prospects of reaching completion. Recently, appraisers, lenders and examiners have been using *liquidation values* in assessing collateral on residential AD&C loans on projects they intend to fund to completion. This discourages banks from maintaining funding for residential AD&C loans in good standing and often results in inappropriate equity calls that can lead to unnecessary foreclosures and a further weakness in the housing market.

NAHB Legislative Proposal: Our proposal would require bank regulators to issue regulations clarifying that the 2009 Policy Statement actually requires appraisers, lenders and examiners to utilize an "as completed" value for projects that have reasonable prospects of reaching completion, and that such valuation standards should be applied to all residential AD&C loans in lending institutions portfolios.

Performing Loans Should Not Be Called or Curtailed

Problem: Lenders should be prohibited from curtailing or calling AD&C loans where payments are current. Builders are experiencing increased lender pressure, including calls for additional equity, denials on loan extensions and demands for immediate repayment. Lenders are often citing regulatory requirements or pressure from bank examiners to reduce AD&C loan exposures as rationale for the lenders' actions.

NAHB Legislative Proposal: 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. Regulators should issue more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. Our proposal would mandate that bank regulators issue regulations that explicitly direct lenders to stop calling or curtailing AD&C loans in cases where the borrower is making payments in accordance with the original loan documents. In determining collateral values, third-party appraisals utilizing "as-completed" values should be used to determine if the collateral has actually declined in value. If the collateral has declined in value based on "as completed" valuation, but the loans are performing, regulators shall, for a 24 month period, encourage lenders to work with residential construction borrowers by taking actions such as providing workout assistance and loan modifications.

SBA Programs to Assist Small Home Builders

Problem: As noted, the majority of homebuilders are small businesses. In fact, 95 percent of homebuilders have less than $15 million in annual receipts. However, most home builders do not have access to SBA loans because of the SBA's long held belief that the business of building of homes is speculative and therefore ineligible for SBA loan programs.

NAHB Legislative Proposal: Our proposal would enact legislation authorizing a new SBA program to specifically address AD&C financing needs for home building companies that meet the SBA's small business definition. Our proposal would further amend an existing SBA program (CAPlines) to remove impediments to AD&C financing as an eligible activity.

Conclusion

Thank you again for the opportunity to testify on this important issue. NAHB stands ready to work constructively with this Subcommittee, as well as the full House Financial Services Committee, to find prudent and workable solutions to both current and ongoing regulatory constraints that are impacting the ability of the home building industry to fully participate in our nation's economic recovery.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Robert Nielsen	National Assoc. of Home Builders (NAHB)
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.