STATEMENT FOR THE RECORD

OF

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FOR THE HEARING ON

# "FRAMEWORK FOR EVALUATING CERTAIN EXPIRING TAX PROVISIONS"

BEFORE

THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS & MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES

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Thank you for the opportunity to submit this statement for the record. I am Teresa Bryce Bazemore, and I am submitting this testimony on behalf of Radian Guaranty Inc. ("Radian"), one of the nation's leading private mortgage insurers. Private mortgage insurance ("MI") helps promote and preserve the tradition of homeownership, while protecting taxpayers from default-related losses on residential first mortgages.

Radian urges Congress to extend the deduction for private mortgage insurance premiums (the "private MI deduction"). The private MI deduction expired on December 31, 2011, along with a number of other critical tax policies. When evaluated against the key criteria discussed at the June 8th hearing, the private MI deduction is an important tax policy that should be made permanent. In this regard, we commend Congressman Nunes and Congressman Crowley for their introduction of H.R. 1018, broadly-supported, bipartisan legislation that would make permanent the private MI deduction.

Reviewing tax extenders in the context of tax reform would provide an opportunity to comprehensively consider the tax extenders and other tax policies. However, until such a review, we strongly urge the immediate and seamless extension of the private MI deduction. Until there is an opportunity to address tax policy in a long-term and comprehensive manner, extension of the private MI deduction is important to ensuring that there continue to be incentives aimed at stabilizing and strengthening the housing market, which is still undergoing a fragile recovery.

## PRIVATE MORTGAGE INSURANCE

For many families, the most common hurdle to homeownership is saving enough money for the down payment. The traditional 20% down payment is a hardship for many and an impossibility for others. Private MI enables borrowers with less than a 20% down – typically first-time and low- and moderate-income borrowers – to achieve the dream of homeownership.

When a borrower places less than 20% down to purchase a home, the lender is required to obtain private MI in order for that loan to be eligible to be subsequently sold to Fannie Mae or Freddie Mac ("the GSEs"). Lenders are willing to make low down payment loans, and the GSEs are willing to purchase them, because in the event of a homeowner's default on the mortgage, the private MI company pays the owner of the loan a claim that is typically in the amount of 25-35% of the value of the loan.

This amount of private MI generally covers costs associated with defaulted loans (interest charges during the delinquent and foreclosure periods, legal fees, home maintenance and repair costs, real estate brokers' fees, and closing costs) and any losses resulting from reselling the property for less than the outstanding mortgage loan balance.

Placing the private MI company's private capital at risk in a "first loss" position after the borrower's equity means both the insurer and the borrower have a vested interest in making home loans that are affordable not only at the time of purchase, but throughout the years of homeownership. Having their own capital at risk also means that mortgage insurers have very clear incentives to work with lenders, investors, and community groups to help borrowers in default stay in their homes. Also, private MI is automatically canceled when the loan reaches 78% of the original home value, and private MI may be canceled earlier, at the borrower's request, if an appraisal shows that the borrower's equity has reached 80% of the original home value.

Over the past four years, private mortgage insurers have paid approximately $33 billion in foreclosure losses that would have otherwise been paid by taxpayers. Private mortgage insurers are projected to pay approximately $50 billion in total to cover losses from the recent, unprecedented housing downturn.

The history of the private MI industry proves that private mortgage insurers have paid their claims through good and bad economic cycles. This is because of the rigorous, countercyclical capital and reserve requirements imposed by state insurance commissioners. In fact, half of each premium dollar earned goes into a contingency reserve and generally cannot be touched by the mortgage insurer for 10 years. This ensures that significant capital reserves are accumulated during good times and then drawn upon to absorb losses during downturns.

The private MI model has stood the test of time. Looking ahead, private mortgage insurers stand ready to play a critical role in the future of housing finance by continuing to safely and soundly enable first-time and lower income families to purchase homes while protecting taxpayers from losses that result from borrower default. Housing policies should encourage the return of private capital to the housing market and maintain a role for low down payment loans as long as they are prudently underwritten and insured by private MI.

## PRIVATE MORTGAGE INSURANCE DEDUCTION

The private MI deduction was first enacted in 2006 on a broadly-supported and bipartisan basis. Under Section 163(h) of the Internal Revenue Code ("IRC" or "tax code"), premiums paid or accrued for qualified private MI by a taxpayer in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably. The private MI deduction was most recently extended as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) and has since expired.

Evaluating the private MI deduction underscores the importance and effectiveness of the tax policy and the need to make it permanent. This section considers the key criteria discussed at the June 8th hearing.

### *Rationale for Tax Policy*

During the June 8th hearing, witnesses discussed the need to understand the rationale behind a tax provision. In particular, witnesses recommended considering whether a tax provision reflects sound tax policy.

One of the key reasons the private MI deduction was enacted was to foster homeownership. Private MI is a critical factor for low- and moderate-income families seeking to become homeowners, as it allows borrowers to qualify for a mortgage with less than a 20% down payment. The private MI deduction makes private MI premiums deductible to the taxpayer, assisting in offsetting the cost of private MI. Maintaining incentives for these borrowers is important to ensuring continued access to the housing market.

The private MI deduction also increases the fairness of the tax code by equalizing the tax treatment of private MI and mortgage interest, which is deductible by the taxpayer. Private MI premiums are the economic equivalent of mortgage interest. Paying premiums on mortgage insurance has a direct and quantifiable impact on interest expense. Without the insurance purchased by those premiums, interest charges would be much higher as a consequence of the much higher credit risk. Consequently, the private MI deduction effectively provides some parity to those homeowners who must rely on mortgage insurance by offsetting some of the costs with those homeowners that have the means to make a 20% down payment.

Finally, by encouraging the use of private MI, the deduction reduces losses to the taxpayers. In the past, borrowers were circumventing private MI, which was not tax deductible, by instead procuring a "piggyback" or second loan, which *was* tax deductible, to make up the difference between the amount they were able to put down and the 20% down payment required for loans to be eligible for purchase by the GSEs. Eliminating the tax deductibility of private MI will incentivize borrowers to obtain risky piggy backs for which the interest is tax deductible, despite the fact that piggy back loans permit borrowers to obtain a home with almost no down payment and do not provide protection to lenders, investors, or the GSEs from the risk of default. The deduction puts private MI premiums on par with piggyback loan interest.

### *Revenue and Efficiency*

During the June 8th hearing, witnesses discussed the importance of evaluating a tax provision by its revenue effect and its efficiency, meaning whether the provision accomplishes its goals effectively.

JCT has estimated that a one-year extension of private MI deduction would cost $739 million over ten years. JOINT COMMITTEE ON TAXATION, ESTIMATED BUDGET EFFECTS OF REVENUE PROVISIONS CONTAINED IN PRESIDENT'S FY 2012 BUDGET PROPOSAL, JCX-19-11 (Mar. 17, 2011). The cost, however, must be considered in light of the significant benefits associated with the private MI deduction.

The private MI deduction has been an important tool in promoting access to homeownership. By acquiring private MI, low- and moderate-income families are much better positioned to obtain the loans needed to purchase homes for their families. According to Internal Revenue Service figures, in 2009 alone, the private MI deduction was claimed on 3.6 million tax returns. The majority of the taxpayers that claimed the deduction had annual incomes under $60,000. The provision has resulted in an average of approximately $350 in annual savings per family, a considerable sum for many families. Of all the tax provisions which expired at the end of 2011, only the private MI deduction was limited to low- and moderate-income taxpayers and only the AMT patch and deduction for state and local sales taxes benefitted more individuals.

Moreover, it is important not to overlook the impact of the private MI deduction on the housing market, which is currently still undergoing a fragile recovery. With the grave state of the housing sector in recent years, extensions of the provision have ensured that there continue to be provisions aimed at stabilizing and strengthening the housing market in a responsible way. Maintaining incentives for this population of borrowers to access the housing market is crucial to reducing the nation's excess housing inventory and facilitating a full recovery of the housing market.

### *Reason for Temporary Nature and Appropriate Duration*

Although the legislation first proposing the private MI deduction would have made the provision permanent, the private MI deduction was put in place on a temporary basis when it was enacted in 2006. The private MI deduction was not designed to be a temporary provision; instead, it was intended to equalize the tax treatment of private MI premiums and mortgage interest, which is a permanent provision in the tax code. The most likely reason for the private MI deduction's temporary extensions is due to budget constraints.

Taken together, the private MI deduction reflects effective and efficient tax policy that fosters homeownership and equalizes the tax code treatment between private MI premiums and mortgage interest. As part of tax reform, Congress should make permanent the private MI deduction.

## CONCLUSION

Tax reform would provide an opportunity to comprehensively review the tax extenders and other tax policies and consider permanent solutions. H.R. 1018 is bipartisan legislation that would achieve this objective, breaking the constant cycle of expiration and extension. In the interim, however, we strongly urge Congress to extend the private MI deduction seamlessly and expeditiously.

Radian greatly appreciates the opportunity to submit this statement. We are pleased to serve as a resource to the Congress, the Committee, and the Subcommittee on these and related matters. We look forward to our continued work together on these important issues.