U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets"

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Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the current priorities of the Federal Housing Administration and the discussion draft legislative proposal to strengthen FHA, RHS, and Ginnie Mae. FHA is critically important to ensuring the continued availability of mortgage credit for single-family homes, multifamily properties, and healthcare facilities during this economic recovery. We share Congress' goal of ensuring that FHA will continue to fulfill its mission and enable responsible lending in a fiscally sound manner that protects taxpayers and facilitates the return of private capital.

FHA LEADERSHIP AND PRIORITIES

I am honored to have been asked to serve as Acting Assistant Secretary for Housing and Federal Housing Commissioner. I have served as HUD's Deputy Assistant Secretary for Multifamily Programs since May 2009. During the past two years, I have overseen significant growth in FHA's Multifamily portfolio while implementing strong risk management practices and leading the Administration's housing policy development in Multifamily Finance for both market rate and assisted properties. Prior to joining the Obama Administration, I was President and CEO of BRIDGE Housing, one of the largest developers of affordable and mixed income/mixed use housing in California, and I have more than three decades of experience in real estate and housing finance and results-driven organizational leadership.

It has been and will continue to be a pleasure to work with the many dedicated employees and leaders at HUD, including Bob Ryan, FHA's first Deputy Assistant Secretary for Risk Management and Regulatory Affairs.

As you know, Bob previously served as Acting Commissioner and is now Senior Advisor to the Secretary for Housing Finance, where he is leading policy development on housing finance issues, including the future of the GSEs and the government's role in the mortgage industry. I will be working closely with him, given the vital role FHA plays within the broader housing finance system.

As Acting FHA Commissioner, I will build upon Secretary Donovan's vision and leadership and focus on the following three priorities:

- Stabilizing the Housing Market and Assisting Homeowners to Avoid Foreclosure
- Ensuring the Continued Fiscal Health of FHA and Strengthening its Risk Management
- Ensuring Responsible Access to Credit and Liquidity, particularly for under-served communities.

Stabilizing the Housing Market and Assisting Homeowners to Avoid Foreclosure

While much progress has been made in stabilizing the single-family housing market, HUD and FHA are committed to continuing to improve upon efforts to assist responsible homeowners to avoid foreclosure. Through the combined efforts of FHA's Loss Mitigation, Making Home Affordable, Hardest Hit Fund, Emergency Homeowners Loan programs, and the HOPE Now alliance, more than 5 million homeowners have been helped to avoid foreclosure since April 2009, as reflected in the most recent Obama Administration Housing Scorecard.

[http://portal.hud.gov/hudportal/HUD?src=/initiatives/Housing_Scorecard].

The Administration is dedicated to helping homeowners who were negatively affected by the housing crisis and this month's scorecard shows signs of these programs working. Data shows improvements in home prices, which have increased three months in a row, and a reduction in foreclosure starts and completions, which have been trending downward since fall 2010. Although the data suggests improvement, we are still continuing to work with homeowners, lenders, servicers, and others so that this positive trend continues.

Recently Announced Unemployment Forbearance Programs. On July 7, 2011, the Obama Administration announced adjustments to FHA requirements that will require servicers to extend the forbearance period for FHA borrowers who qualify for the program from four months to 12 months and will make it easier for unemployed borrowers to qualify. In addition, effective October 1st 2011, the Administration will require servicers participating in the Making Home Affordable Program (MHA) to extend the minimum forbearance period to 12 months wherever possible under regulator and investor guidelines. These adjustments will provide much needed assistance for unemployed homeowners trying to stay in their homes while seeking re-employment. These changes are intended to set a standard for the mortgage industry in providing more robust assistance to unemployed homeowners in the economic downturn.

Established FHA Loss Mitigation Efforts. Homeowners with FHA-insured loans are eligible for a range of assistance tools to help protect them from foreclosure, and lenders are required to offer these loss mitigation tools to FHA borrowers.

Since the start of this Administration, nearly 450,000 borrowers have been able to retain their homes through FHA loss mitigation programs. Assistance is available through a variety of methods, including:

- Forbearance – delayed collection actions to give homeowners time to work on solutions;
- Partial claim – FHA pays the arrears and takes a second-lien position against the home, with no payments due until property sale;
- Loan modification – payments are reduced through modifications to the terms of the mortgage;
- Pre-foreclosure sale – FHA pays the loss on a homeowner sale of the property;
- Voluntary deed conveyance – taking the deed in-lieu-of a foreclosure action.

Using FHA's foreclosure avoidance tools, In FY2010, FHA-approved loan servicers assisted over 552,000 homeowners and completed final delinquency cures resulting in home retention for almost 183,000 homeowners. Over the first three quarters of FY2011, FHA-approved loan servicers assisted more than 493,000 homeowners, and completed final delinquency cures resulting in home retention for over 164,000 homeowners. Servicers of FHA insured loans must evaluate each defaulted homeowner and consider all loss mitigation techniques to determine which, if any, are appropriate. Foreclosure cannot be initiated until all loss mitigation options have been considered.

Improving Servicer Outreach and Performance in Preventing Foreclosures. FHA is working closely with lenders and servicers to improve their outreach and performance in assisting borrowers to avoid foreclosure. In February 2010, FHA's Office of Single Family Asset Management and the FHA National Servicing Center began conducting lender visits to identify best practices that could be shared with the broader servicing community to improve foreclosure mitigation across the industry. The visits were conducted with five overall objectives: (1) better understand in specific detail the process variations that exist at each lender for providing a delinquent FHA borrower with options to avoid foreclosure; (2) discuss specific borrower trends the lenders are experiencing; (3) identify borrower circumstances that prevent them from being qualified for various foreclosure prevention options; (4) receive suggestions from the lender that might improve the process for FHA loss mitigation; and, (5) understand the differences in default/foreclosure statistics as compared to national averages. Several significant findings have been identified and FHA has been sharing them with servicers, while continuing to meet with additional lenders & servicers to continue identifying best practices that will enable underperforming servicers to improve their success in preventing foreclosures.

For example, a large FHA Servicer set up a network of relationship managers in their branch offices nationwide to assist borrowers with loss mitigation and delinquency assistance, ensuring that borrowers encountering difficulties are able to meet face to face with a representative of the servicer. Another FHA-approved servicer studied ways to make contact with delinquent borrowers early in the delinquency and began reaching out to borrowers by non-customary means such as email, texts and other forms of electronic communication, resulting in significantly higher response rates from borrowers and enabling the servicer to better determine how they might assist them.

It is worth noting that these best practices are not limited to the FHA servicer population; HUD is collaborating with the broader servicer community to improve their foreclosure prevention activities across the entire industry, which will benefit all homeowners, not just those with an FHA-insured mortgage.

In addition to the work being done with servicers and lenders by FHA's Office of Single Family Asset Management and the FHA National Servicing Center, FHA's Office of Lender Activities and Program Compliance monitors and reports various servicing statistics for all of its servicers. The statistics include performance around early payment delinquency, loss mitigation, re-default rates and workout ratio. The information is used to measure servicer quality and help FHA improve the overall performance of those who service FHA loans. The information is made publicly available through the Obama Administration Housing Scorecard.

Even with the robust guidance and assistance offered by the Single Family offices mentioned above, there are times when enforcement actions are necessary. Cases involving widespread program abuse are referred to the Mortgagee Review Board for sanctions including reprimand, withdrawal and/or civil money penalties. Under this Administration, there has been a notable increase in the number of lenders referred to the Mortgagee Review Board for material violations of origination, underwriting and servicing requirements.

Housing Counseling. HUD's Housing Counseling Program is the only dedicated source of federal funding for the full spectrum of housing counseling services. In FY 2010, the more than 2,700 HUD-approved counselors throughout the nation provided invaluable counseling services to more than 2.1 million clients who sought education and assistance to make informed housing decisions. HUD supported housing counseling services address a broad array of housing choices, including pre-purchase and homebuyer education, foreclosure prevention, HECM counseling for seniors, rental counseling, homeless assistance, and avoidance of scams and predatory lending.

One striking example of the effectiveness of housing counseling is that in FY 2010 more than 469,000 clients who were delinquent on their mortgages successfully avoided foreclosure, preventing approximately $28 billion in losses to the economy. In stark contrast, foreclosures frequently occur without servicers and borrowers ever engaging in a discussion about potential options to prevent foreclosure or other alternatives available to borrowers such as a pre-foreclosure sale or voluntary deed conveyance, which are less damaging to a borrower's financial condition.

Through the FY2011 Continuing Resolution, H.R. 1473, housing counseling grant funds were eliminated. We are working closely with the House and Senate THUD appropriations subcommittees and greatly appreciate the efforts of Chairman Biggert, Ranking Member Gutierrez, Rep. Velazquez, and others on the Subcommittee to restore funding in the FY 2012 budget.

Simultaneously, HUD has been worked to streamline and expedite its Housing Counseling grant making process.

In addition to the Department-wide effort to obligate grant funds within 180 days of budget passage, internal Housing Counseling NOFA review processes have been streamlined and HUD is working with OMB to shorten timelines to enable faster NOFA publication. Finally, HUD has made changes to its grant application processes whereby experienced, proven applicants will be provided with a streamlined, abbreviated application. As a result of such efforts, the Department reduced its average NOFA posting time from 380 days in FY2010 to 60 days in FY2011. We are committed to ensuring that HUD's much needed Housing Counseling grant funds are made available to grantees as quickly as possible to ensure the provision of vital services to communities nationwide.

Impacts of REO properties on Neighborhood Stability. Due to the unprecedented foreclosure crisis, FHA has seen dramatic increases to its volume of real estate owned (REO) properties. In March of 2011, FHA's inventory of REOs rose to nearly 80,000. As is well known, elevated REO inventories can lead to concentrated vacancies in neighborhoods, which then can have a destabilizing effect on communities. To respond to these challenges, HUD has made dramatic changes to the way in which it manages its own REO properties and is actively coordinating with multiple agencies and organizations to address broader REO management.

New HUD REO management and marketing (M&M) strategies have increased accountability among M&M contractors, improved timeliness throughout the process, and reduced inventory in communities. Under the previous M&M II model, HUD had 23 contract areas (which covered the United States, the Caribbean, Guam and the Northern Mariana Islands). For each contract area, HUD designated one contractor to monitor lenders' compliance with FHA's conveyance standards, perform property maintenance services, and market and sell REOs. The new M&M III contract model has segregated the functions of mortgagee compliance, property maintenance, and marketing and selling REO properties into three separate contracts. The three contracts are as follows: (1) Mortgagee Compliance Manager (MCM) centralizes the oversight of all pre and post conveyance activity of HUD-approved mortgagees; (2) Field Service Managers (FSMs) are responsible for property maintenance and preservation services; and (3) Asset Managers (AMs) are responsible for the marketing and sale of REOs. This separation of functions created a system of checks and balances, thus eliminating conflicts of interest. In addition, multiple AMs and FSMs (covering one contract area) spur competition amongst the contractors and provide HUD with options in the event one contractor defaults or exhibits poor performance. The M&M III disposition model streamlines operations to capitalize on the expertise of its contractors and provides flexibility to meet changing market conditions in the REO industry.

As a result of these efficiency initiatives and despite the spike in properties being conveyed to us, FHA's inventory of REOs is down to 48,324.

Monthly sales were as low as 2,725 in December 2010, but rose to an all time high of 13,609 in June, 2011. The chart below reflects the high volume of property sales over the past four months:

Month End	Total Sales
April 2011	11,806
May 2011	12,676
June 2011	13,609
July 2011	11,392

For the first nine months of FY11, ending June 30, 2011, the ***average days to list*** and the ***average days to sell*** REOs decreased by 76 days (61 %) and 25 days (12 %), respectively, as compared to fiscal year 2010.
Through partnerships with local communities and non-profits, HUD continues to create new and operate traditional REO disposition and sales programs, including:

- **Asset Control Area Program** – which offers properties in revitalization areas to local governments and nonprofits at a 50% discount for resale to income eligible families (typically first-time homebuyers);
- **Good Neighbor Next Door Program** -which offers properties in underserved communities at a 50% discount to police officers, firefighters, teachers, and emergency medical technicians;
- **First Look** – which offers properties at discounts up to 30% for NSP grantees;
- **Dollar Home Sales Program** – which offers properties in HUD's inventory for 180 days or more to local governments for $1; and
- **Bulk Sales to PHAs for Disaster Relief** – which offers properties at a 50% discount to PHAs serving families in Presidentially-declared disaster areas (e.g., Alabama and Missouri)

In addition to the programs listed above, on August 10, 2011, FHFA, in consultation with HUD and the Department of the Treasury, issued a request for information (RFI) seeking input from a wide-range of stakeholders to explore new options for selling single-family REO properties held by Fannie Mae and Freddie Mac and FHA. To date, the Enterprises' and FHA's sales of REO proprieties have focused on sales of individual properties. With this RFI we are seeking more dynamic ways to transition this property, so that the Enterprises can move this inventory more quickly and in a way that is more beneficial to communities and home prices. Taking steps to transition some of this inventory through increased private investment into rental or other productive uses will help stabilize neighborhoods and home values at a crucial moment in our economy. Responses to the RFI are due by September 15, at which time FHFA, HUD and Treasury will begin to evaluate the ideas and options submitted.

In addition to the RFI we released, we continue to explore alternative strategies designed to help stabilize communities while also bringing value to our fund. One such strategy we are currently exploring on a pilot basis is our Mortgage Acquisition and Disposition Initiative ("601 – Note Sales Program"). The initiative gives the Department a second acquisition option: acquiring mortgages upstream as opposed to waiting until the borrower has lost their home to foreclosure and the property becomes an REO. Prior to participating in this program servicers are required to exhaust all of FHA's standard loss mitigation options. Once they have done so, rather than proceeding to foreclosure and eviction, they submit a claim and assign the defaulted mortgage to FHA with the borrower still in the home. This option aligns the interests of the servicer and FHA to review the mortgage and identify strategies for the borrowers to keep their homes.

Once they are assigned, FHA sells the mortgages to a new entity through open auctions, held quarterly. Regardless of the loan's performance, the entity who acquires the notes from FHA is prevented from foreclosing on the borrower for an additional six months. We feel that this program will be a welcomed addition to the Administration's foreclosure avoidance tool kit.

Ensuring the Continued Fiscal Health of FHA and Strengthening its Risk Management

Secretary Donovan and I recognize the critical importance of strong risk management efforts at FHA. That is why a top priority for me is to build on the work that has begun in establishing the new Office of Risk Management within FHA. There is still significant work that needs to be done to fully integrate the office and its activities into the ongoing operations of FHA. Mr. Ryan will continue to assist in this area during a transition to a new Deputy Assistant Secretary for Risk Management. We are currently moving forward in the process of evaluating candidates for that position and hope to announce the individual selected to lead this Office in the near future.

Under this Administration, FHA has engaged in a comprehensive effort to strengthen its risk management capabilities and processes to ensure the ongoing health of its insurance funds. We've strengthened credit and risk controls – toughening requirements on our Streamlined Refinance program, making several improvements to the appraisal process and condominium policies, and implementing a two-step credit score policy. At the same time, we've significantly increased our lender enforcement efforts to protect both our insurance funds and consumers. We are very grateful for the support that Congress has provided with our efforts to reduce fraud and risk. Through the $20 million Combating Mortgage Fraud funds that Congress granted HUD in FY2010, we have begun to implement several risk management and systems modernization reforms to incorporate modern risk and fraud tools and counterparty data consolidation. We look forward to continuing to work closely with Congress on all of these issues, and to further reduce risks to the American taxpayer.

In response to an increase in FHA insurance volume and the overall need to ensure proper risk management FHA's Multi-Family and Healthcare program offices have taken a number of steps to protect ourselves from emerging risks and retain the program's solvency. In an effort to decrease claims and save taxpayer dollars, we have imbedded risk management in all of our programs and processes. For example:

- We have tightened FHA lender approval and capital requirements.
- We enhanced oversight and monitoring of FHA lenders, and instituted a number of risk mitigation measures and guidance including: new loan closing documents for the first time in 40 years, a revised MAP Guide that compiles all relevant lender guidance that has been published by FHA, developed underwriter qualification standards, enhanced verification of property financial performance, expanded borrower mortgage credit analysis.
- We developed new credit policies and hold monthly reviews of the portfolio performance and of the new production data.
- We established a National Loan Committee, in addition to local committees to gain consensus on high dollar loans.

As important as FHA is at this moment to our nation's economy, it has not been immune to the larger housing recession. In November of 2010, for the second year, we reported to Congress that FHA's single-family capital ratio was below the required two percent level – at 0.50 percent of total insurance-in-force. That was a direct result of moving funds from the Capital Reserve Account to the Financing Account over a period of several years, and in anticipation of high net claim losses in the future, primarily on loans originated in FY2007 – FY2008. At the end of FY 2010, the Financing Account held nearly $29 billion, representing an additional 3.1 percent of insurance-in-force in addition to the $3.9 billion in the Capital Reserve Account, making total reserves held by FHA 3.6 percent of insurance-in-force.

The very large and strong FY 2009 and FY 2010 books-of-business are helping stabilize the MMI Fund in the face of high losses on the FY2006 to FY 2008 books. Our actions to raise single-family insurance premiums three times over the past 16 months—plus one large increase for HECM loans—are also providing revenues that will substantially offset expected future losses on earlier books. I would like to express my appreciation for this committee for helping pass legislation in the last congress that gave us the flexibility to raise our premiums. Credit quality on new endorsements is historically high, so that expected net credit costs on the FY 2010 and FY 2011 book are low while expected premium revenues are very high. As noted in our most recently released Quarterly Report to Congress on the MMI Fund, strong expected performance on new endorsements is also indicated by:

- The share of borrowers with credit scores of 620 or higher was 97.2 percent for the quarter; only 2.8 percent of borrowers had credit scores below 620. In contrast, 50.4 percent of borrowers had credit scores below 620 during the first quarter of 2008. The percentage of borrowers with credit scores of 720 or higher also continues to rise and is more than four times the level seen in the first quarter of 2008.

- In this quarter, 24.4 percent of all newly endorsed, fully-underwritten loans had LTVs below 90 percent. This is almost 10 percentage points greater than the 2008 Q4 low of 15.8% and also reflects a trend over the past ten years of fully-underwritten (non-streamline) refinance loans becoming more of a core component of FHA's insurance activity.

- The serious delinquency rate for the single-family portfolio at the end of Q2 2011 is 8.31 percent. This is substantially lower than the 9.05 percent rate observed one year earlier. Although the seasonally adjusted series (currently at 8.34 percent) rose slightly from the previous quarter, it is still trending downward over the longer horizon.

- Although the early-period delinquency rate rose a marginal 0.02% in the recent period, the overall quality of newly originated FHA loans, as measured by early-period delinquency rates, continues to be significantly stronger than historical levels. The much improved early delinquency rates are an indication that the FY2010 book should perform substantially better than did the FY 2009 book, which itself is performing substantially better than have the FY2007 and FY 2008 books.

We will present the upcoming FY2011 findings to the Congress in our full report scheduled for this coming November.

Ensuring Responsible Access to Credit and Liquidity

The past two and a half years that I have been at HUD have been a truly historic period for FHA. Most of the attention has been focused on our single family loan guarantee programs that became a crucial source of liquidity while the nation endured perhaps the most severe housing market downturns in its history and a virtual collapse of commercial home mortgage financing. FHA-insured lending went from under 3% of the market to as much as 30%, fulfilling its key countercyclical function of providing liquidity and stability amid distressed market conditions. FHA financing was instrumental in preserving homes and offering new ownership opportunities for millions of American families. And while FHA was not immune to the adverse financial effects of a record decline in home prices and a prolonged economic recession, it nonetheless has been able to continue to perform its crucial functions while maintaining a healthy balance sheet.

Perhaps less heralded, but no less important, has been the role that FHA has played in providing critical liquidity for multifamily developments, nursing homes, assisted living properties and hospitals. FHA's multifamily and healthcare programs are a critical component of the Department's efforts to meet the nation's needs for decent, safe and affordable housing. These sectors faced a severe contraction in the availability of conventional financing, as well as a near collapse of the tax exempt bond market. Driven by the constriction in the conventional mortgage market and improvements in HUD business operations, demand for FHA loan insurance for multifamily and healthcare programs has increased dramatically in the last 3 years. Mortgage commitment issuances rose from $4.3 billion in fiscal year 2008 to $16.2 billion in 2010. FHA's insured portfolio of Multifamily and Healthcare stands at $61 billion, with $16.5 billion in the application pipeline. FHA's prominent role in the multifamily and healthcare lending markets is anticipated to moderate but still continue in fiscal years 2012 and 2013.

Amid such growth for FHA multifamily and healthcare programs, FHA has been hard pressed to keep pace with the demand. Since 2008, firm commitments issued in FHA's multifamily programs have increased 197% while the number of FHA field staff has decreased considerably. Not surprisingly, processing times have increased as well. FHA's healthcare lending programs have faced similar difficulties. To identify opportunities to address these challenges and improve performance we started a comprehensive business re-engineering process. This process has concluded, been piloted in one of our Hubs, and rolled out to our field leadership. The re-engineering process focused on strengthening the way we manage through implementation of performance dialogues to establish and assess achievement toward targets; optimizing review processes and enhancing employee skills; and strengthening risk management through underwriting discipline and greater risk oversight. We look forward to further process improvements as these initiatives continue to develop.

In the current fiscal year, FHA under its General Insurance Fund has issued commitments exceeding $13 billion and will likely end the year with a total of about $17 billion in new multifamily and healthcare loan guarantees. FHA estimates that this new business will generate premium income and other receipts that exceed net costs by between $400 to $500 million.

Going forward, FHA is continuing to examine its business models and practices, with an eye towards continuing to improve its risk management capabilities while expediting processing and approval timelines. These efforts will further enable FHA to facilitate the availability of affordable housing in a responsible manner.

Even more significant than the positive impact FHA's multifamily and healthcare programs have on FHA's insurance funds is the impact that they have on their communities. In addition to providing needed care, healthcare facilities are community anchors, major employers, and contributors to quality of life. These institutions serve as strong economic engines for the regions in which they are located. Similarly, multifamily projects have significant impact on communities by expanding affordable housing options, spurring economic development activity, and creating jobs.

Using the widely respected IMPLAN economic model, FHA calculated the economic benefits for all hospitals and healthcare facilities that received mortgage insurance commitments in FY 2010. FHA issued insurance commitments for 58 hospital and residential care facilities in FY 2010. These projects are estimated to have created more than 38,000 new jobs, and yielded $4.3 billion in overall economic benefit during construction and an additional $2.5 billion in new economic activity annually.

Employing the same economic model, FHA estimates that the $3.78 billion of multifamily new construction loans endorsed by FHA in FY 2010 directly created 30,000 jobs and supported the creation of 45,000 additional indirect or induced jobs. In total, FHA-insured multifamily projects yielded approximately 75,000 jobs throughout the nation. Clearly, FHA's multifamily and healthcare new construction insurance programs offer much more than just financing for large projects – they create jobs and improve the quality of life in communities nationwide.

As FHA's multifamily and healthcare portfolios have grown, HUD has taken a number of steps to improve its risk management in these programs. FHA's lender approval and capital requirements have been strengthened and the oversight and monitoring of FHA-approved lenders has been enhanced. In addition, we have made changes to our underwriting and credit evaluation requirements, including revised underwriting standards, improved verification of property financial performance, and expanded borrower mortgage credit analysis. Finally, a loan committee approval structure has been established to better assess and analyze loans and their attendant risks prior to issuing a commitment.

History and Performance of FHA Healthcare Programs

The Subcommittee has also requested that I explain the rationale for FHA's participation in healthcare lending. FHA received authority to insure hospital loans in 1968, when Section 242 mortgage insurance for hospitals was enacted. Section 232 mortgage insurance for residential care facilities (nursing, assisted living, and board-and-care facilities) dates from 1959. FHA's Office of Healthcare Programs (OHP) administers both programs. Since the inception of these programs, nearly 400 mortgage insurance commitments have been issued for hospitals, totaling $15.6 billion, and over 4,000 mortgage insurance commitments have been issued through the Section 232 program, totaling $16 billion.

As is clear from the figures above, FHA has long been a significant source of mortgage financing for healthcare facilities.

Amid the recent economic downturn facing the nation, FHA's role in these markets has become even more prominent. In today's difficult financial environment, the traditional sources of capital for the financing of healthcare facilities have either diminished or become more risky. Compared to the alternatives, the long term, fixed interest rate products offered by FHA have become an attractive choice for many hospitals and residential care facilities. The availability of fixed rate, long-term FHA financing lowers the cost of capital for these facilities and therefore reduces the costs of the Medicare and Medicaid programs by lowering the cost of care.

Prudent underwriting and proactive monitoring and intervention when a healthcare facility becomes troubled have ensured that both programs yield a profit for the General Insurance Fund. The credit subsidy rates for FY11 and FY12 are negative and improving:

Program	2011	2012
Sec. 242 Hospitals	-3.67	-3.82
Sec. 232 Refinance	-1.54	-1.96
Sec. 232 New Construction/Rehab	-0.71	-1.34

In addition to a negative and improving credit subsidy rate, claim rates for these programs have remained stable at very low levels. For the past several years, claim rates for the 232 and 242 programs have been at or around 1%.

Critical Access Hospitals

I would also like to highlight the role that FHA plays in providing mortgage insurance for critical access hospitals in rural communities. The Section 242 program provides mortgage insurance for hospitals across the country, including 25 Critical Access Hospitals (CAHs) in rural communities. Critical Access Hospitals are small facilities that serve as the focal point of health care in remote, rural communities and, often, are the only source of emergency care in large geographical areas. Critical access hospitals meet all of FHA's financial eligibility criteria but may provide a slightly different offering of medical services than a traditional Section 242 eligible hospital. Critical Access Hospitals are approved by their respective licensing board because travel is difficult, and sometimes impossible, due to the terrain, weather and distance to other hospitals. Additionally, a critical access hospital – as the largest employer - is the "economic engine" for a region. In the past three years, the Critical Access Hospital projects supported by FHA mortgage insurance are estimated to have generated more than $1.1 billion in economic activity during construction and $246 million annually post-construction in their regions. We are appreciative of the Congress' long standing support for Critical Access Hospitals by amending Section 242 to permit these important facilities to be eligible for FHA insurance. This amendment expired July 31, 2011, and without action to once again extend Section 242 no additional Critical Access Hospitals will be eligible for FHA insurance. We are grateful to Rep. Hinojosa for introducing H.R. 2573, the Rural Health Care Capital Access Act of 2011, and to Senator Kohl for sponsoring companion legislation (S.1431, cosponsored by Senators Conrad, Johanns, Johnson, Roberts, Tester and Thune), which would provide this important extension for five additional years.

I look forward to working with Members of this Subcommittee to enable this important program to continue operating at no cost to taxpayers. In fact, these hospitals have contributed to the net receipts to the Treasury generated by the hospital portfolio, as discussed above

<u>COMMENTS ON DISCUSSION DRAFT OF FHA, RHS, AND GINNIE MAE LEGISLATION</u>

I appreciate the opportunity to share our current thoughts on the initial discussion draft developed by the Subcommittee. HUD shares the Subcommittee's goal of further strengthening FHA and welcomes the opportunity to work with Congress to increase access to credit, and strengthen risk management and lender enforcement. Many elements of this discussion draft are similar to H.R. 5072 in the 111th Congress, which passed the full House of Representatives 406-4 and was supported by the Administration. We appreciate the support of many members of the Committee for the introduction and passage of this bill. In particular, I would like to call your attention the following provisions:

Increasing Access to Credit by Supporting Small Lending Institutions. The FHA Reform Act provision dealing with third party loan originators has a direct impact on the ability of small lending institutions, including community banks that are not FHA-approved Direct Endorsement lenders, to participate in FHA programs. In an effort to better focus its oversight and risk management resources, FHA issued a regulatory change in April of 2010 whereby as of January 1, 2011, those entities that formerly participated in FHA programs as loan correspondents are no longer be able to close FHA loans that they have originated in their own names. So, while these entities are still be able to participate in the FHA program, without a statutory change they are required to close FHA loans in the name of the FHA-approved lender that sponsored and underwrote the loan. For such institutions, maintaining their brand with the consumer is of utmost importance, and closing loans in their name is crucial to this endeavor. An unintended consequence of the April, 2010 regulatory change is that ultimately, the inability to close FHA loans in their own name can adversely affect many small institutions, perhaps prompting them to choose not to originate FHA loans at all. This, in turn, can further constrict access to mortgage credit for consumers who do not have access to major lenders.

HUD strongly supports this provision. Permitting small lending institutions to continue offering FHA loan products is vital to ensuring the availability of mortgage credit nationwide, particularly for underserved communities. This provision is a reasonable and appropriate means to assist borrowers and small lenders without posing any additional risk to FHA.

Indemnification by FHA Mortgagees. Additionally, HUD is seeking Congressional authority to extend FHA's ability to hold all lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated and for which the error may have impacted the original loan decision, or in which fraud or misrepresentation were involved. FHA currently has this authority for loans originated through the Lender Insured (LI) process, which accounts for 70 percent of FHA loan volume, but only 29 percent of FHA-approved lenders.

FHA is asking that Congress grant explicit authority to require indemnification for loans that were improperly originated for the remaining 71 percent of FHA-approved lenders. Such authority would permit FHA to hold all underwriting lenders to the same standard by expanding the application of existing authority to other sources of counterparty risk.

Authority to Terminate FHA Mortgagee Origination and Underwriting Authority. HUD also seeks expanded authority to terminate the origination and/or underwriting authority of FHA-approved mortgagees. Via the Department's Credit Watch Termination Initiative (Credit Watch), FHA conducts quarterly evaluations of the origination and underwriting performance of FHA-approved lenders. Through this program, lenders with excessive default and claim rates compared to other lenders in the same HUD field office jurisdiction may have their origination or underwriting approval terminated for a period of six months. Since the creation of the Credit Watch Termination Initiative in 1999, FHA has terminated the origination or underwriting approval of 563 lender branches.
At present, FHA may only terminate a lender's authority in a specific HUD field office jurisdiction. The provision of the proposed legislation dealing with FHA's authority to terminate lenders would remove the current jurisdictional limitations and would permit the Department to take action to prevent irresponsible lenders from conducting FHA business in the specific geographic areas where their activities pose a threat to FHA and its insurance funds.

As an example, for a lender that operates throughout Texas, while FHA may terminate the lender's authority in the Fort Worth field office jurisdiction via Credit Watch due to excessive default and claim rates, the Department would have to terminate the lender's operations in the Dallas field office jurisdiction through a separate Credit Watch action. Limiting HUD's Credit Watch activities to field office jurisdictions prevents the Department from taking quick action to terminate poorly performing lenders in larger areas. Often, a lender's poor origination or underwriting performance is visible initially through excessive defaults and claims in a particular area, but over time grows to include all of the areas in which a lender operates. In the example above, were FHA granted the expanded authority it is seeking, the Department would be able to terminate the origination or underwriting authority of the Texas lender throughout the entire state, or even nationwide, if the lender's performance warranted such action.

While we are very supportive of the provisions discussed above, we would like to share our concerns with the following provisions:

GI/SRI Capital Reserve. As discussed above, the General Insurance / Special Risk Insurance (GI/SRI) funds provide financing for the FHA multifamily and healthcare loan guarantee programs and several very small specialized loan products. These accounts also continue to hold a sizable portfolio of single family loan guarantees (HECM, condominium, and rehabilitation loans) insured prior to FY 2009 when responsibility for new lending under these programs was transferred to the Mutual Mortgage Insurance Fund.

The Special Risk Insurance Fund exists almost entirely to handle the financing of subsidized loans made many years ago. The largest components are the Sec. 235 and 236 programs that were discontinued in the 1970s, although refinancing of those old FHA loans remain in this fund.

New lending under these legacy programs have almost all been terminated, and the limited volume of current activity is inconsequential.

The legislative discussion draft proposes the creation of separate capital reserve requirements, similar to the MMI capital reserve requirement, for the GI and SRI funds beyond their current statutory requirement to operate under Federal Credit Reform. While we share the goal of insuring that taxpayers are not exposed to unnecessary risk in the GI and SRI funds, the creation of a single new capital reserve requirement as structured in the discussion draft for these funds would not be feasible given the very different nature and operations of programs in the GI/SRI accounts. Additionally, as currently drafted, the legislation could require that HUD raise premiums on new multifamily and healthcare lending (the major active programs) in order to generate surplus capital to hold against existing portfolios of HECMs and inactive legacy programs. Further, because HUD has been running these programs with negative credit subsidy for many years, any new capital requirements would not recognize the substantial capital produced by receipts that HUD has paid to the Treasury on outstanding cohorts.

However, we are happy to work with Congress to develop more appropriate reporting benchmarks and/or other performance metrics to provide greater transparency into the performance of loans guaranteed in the GI and SRI funds. For instance, establishing metrics for loans originated in a prospective fashion is one possibility that could make benchmarking more feasible and reflect the current negative subsidy of the GI/SRI funds while accounting for the nuances associated with legacy portfolios residing in the funds.

Minimum Downpayment Guidelines for Single-Family Insurance. As currently structured in the discussion draft, we disagree with the proposal to increase the minimum down payment for all FHA borrowers to five percent. We believe it is essential for HUD to retain the flexibility to respond to market and loan performance conditions rather than being locked into a specific down payment structure. After extensive evaluation we have determined that such a proposal would adversely impact the housing market recovery and restrict access to credit for worthy borrowers.

A fundamental part of FHA's mission is to assist first-time homebuyers, who still make up 80 percent of all home-purchase loans insured by FHA. These households tend to have low levels of wealth, but that does not mean they are not credit worthy. Our analysis shows that, were a 5-percent down payment required during this past year, 345,000 families could have been shut out of the opportunity to become homeowners. That represents 40 percent of all FHA-insured homebuyers, and a significant portion of the overall housing market. This could result in forestalling the recovery of the housing market potentially leading to a double-dip in housing prices by significantly curtailing demand.

Furthermore, downpayment alone is not the only factor that influences loan performance. Loan underwriting requires a balancing of risk factors rather than a reliance upon any one factor. For example, the combination of downpayment and FICO score is a much better predictor of loan performance than just one of those components alone. For instance, loans with a loan-to-value (LTV) above 95% and a FICO score above 580 perform better than loans with LTV below 95% and a FICO score below 580, while loans with a LTV above 95% and a FICO score below 580 perform significantly worse than all other groups, as illustrated below.

FHA Single Family Insured Loan Claim Rates
Relative Experience by Loan-to-Value and Credit Score Values[1] - Ratios of each Combination's Claim Rateto that of the Lowest Risk Cell[2]

Loan-to-Value Ratio Ranges	Credit Score Ranges[3]			
	500-579	580-619	620-679	680-850
Up to 90%	2.6	2.5	1.9	1.0
90.1 - 95%	5.9	4.7	3.8	1.7
Above 95%	8.2	5.6	3.5	1.5

Source: US Department of HUD/FHA; March 2010.

It is for these reasons, rooted in a thorough review of actual FHA loan performance data, that HUD imposed FICO floors tied to downpayment rates, and realigned the premium structure to rely less upon the upfront premium—which is financed into the loan balance—and more on the annual premium—which is paid monthly by the borrower.

Transfer of Rural Housing Programs to HUD from USDA. Finally, I would like to address the proposal to transfer the administration and operations of Rural Housing programs to HUD from the Department of Agriculture. During this Administration, we have worked together very closely to align the agencies' rental programs through a White House Rental Policy Working Group that includes HUD, USDA, and Treasury. Through this group, we have begun with a benchmarking exercise for loan guarantee programs, as well as discussed policy issues such as whether the current programs serve distinct constituencies and purposes or whether there is significant overlap. Additionally, we have begun working toward the creation of a similar task force that also includes the Department of Veterans Affairs, to identify broader strategies to align housing policy throughout all government housing programs. Given the ongoing and initial stages of these various collaborations, we believe it makes sense to continue focusing for now on those efforts, rather than contemplating a more extensive reordering of the various federal agencies' roles in these programs, as outlined in the legislation.

CONCLUSION

Madam Chair and Ranking Member Gutierrez, strengthening the FHA won't solve all of our housing challenges – which is one reason the Administration is working to produce a more balanced, comprehensive national housing policy that supports homeownership and rental housing alike, providing people with the options they need to make good choices for their families.

[1] Based on experience of the FY 2005 – FY 2008 insurance cohorts, as of February 28, 2010. These ratios represent averages of the cell-level ratios in each cohort.
[2] Claim rates in the first row and last column are the low-risk cell and are represented by a ratio value of 1.00. Values in all other cells of this table are ratios of the cell-level claim rate to the claim rate of the low-risk group.
[3] Loan-level scores represent the decision FICO scores used for loan underwriting. This analysis includes all fully-underwritten loans, purchase and refinance, but excludes streamline refinance loans.

Further, as important as the FHA is at this moment, I want to emphasize that the elevated role it is playing is temporary – a bridge to economic recovery helping to ensure that mortgage financing remains available until private capital returns.

That means that while we must remain mindful that qualified, responsible families need to continue to be able to purchase a home, the changes and legislative requests that we have announced are crafted to ensure that FHA 1) appropriately manages its business as it plays an elevated role in the market at present, and 2) is able to step back to facilitate the return of the private sector as soon as possible. Until private entities can and will supply necessary levels of mortgage capital on their own, they need the FHA – and so does our housing market.

So, Chairman Biggert, while FHA must remain a key source of safe mortgage financing at a critical moment in our country's history, we recognize the risks that we face and the challenges of this temporary role that we play in today's market. And the bottom line is this: for the sake of both borrowers and American taxpayers, the loans that FHA insures must be safe and self-sustaining over the long-term. The Administration is committed to ensuring that they are – today and into the future. Thank you for the opportunity to testify. I would be pleased to answer any questions the members of the subcommittee may have.