U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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U.S. Department of Housing and Urban Development (HUD)
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Subcommittee on Housing and Insurance

"Sustainable Housing Finance: The Government's Role in Multifamily and Health Care Facilities Mortgage Insurance and Reverse Mortgages"

Thursday, May 16, 2013

Chairman Neugebauer, Ranking Member Capuano, and Members of the Committee, we welcome the opportunity to appear today before the sub-committee to discuss the critical importance of and the challenges facing the FHA's multifamily, healthcare and reverse mortgage programs.

The Role of FHA Programs in the Economic Recovery

When this Administration took office, the economy was on the brink. The nation was losing 753,000 jobs a month, our economy had shed jobs for 22 straight months and consumer confidence had fallen to a 40-year low. In the face of this turmoil, the Obama Administration took dramatic steps to prevent a complete financial meltdown. As a result, an economy that was shrinking is growing again. And, while this economic growth is promising, it is still fragile.

Through FHA programs, HUD has played a critical role in this recovery, enabling potential homebuyers and developers to finance transactions where other sources of credit were constrained as a result of the financial downturn. FHA was created during the Great Depression to provide mortgage financing to those who are not readily served by the market. During the most recent downturn, FHA expanded access to credit to segments of the mortgage finance market, including single family, multifamily and health care, that were underserved as a result of the credit crisis. Combined with historically low interest rates, and improvements in HUD business operations, FHA continues to see unprecedented, though steadily declining, demand for FHA insurance across all product lines.

Under the FHA's General and Special Risk Insurance Fund (GI/SRI), FHA insurance has long assisted the nation in meeting the need for safe, decent and affordable housing by facilitating access to financing to develop, rehabilitate and refinance multifamily rental housing and healthcare facilities, and from 1989-2008, FHA backed reverse mortgage or Home Equity Conversion Mortgage (HECM) loans were also insured under the GI/SRI Fund. While HECMs are no longer in the GI-SRI, they continue to serve an important role in meeting FHA's mission.

Home Equity Conversion Mortgage Program

The HECM program, authorized by section 255 of the National Housing Act (NHA), is FHA's reverse mortgage program. The HECM program enables an FHA approved mortgagee to extend insured mortgage financing to an eligible homeowner, 62 years of age or older, who wants to convert the equity in his or her home and withdraw some of that equity if they successfully complete mandatory housing counseling. The withdrawal of equity may take a variety of forms, as authorized by the NHA and selected by the mortgagor. The amount that a mortgagor is able to withdraw from the equity in the home under a HECM loan is determined by the "principal limit." Equity payments to the mortgagor may be in the form of monthly payments for life or a fixed term of years, in lump sum, or through a line of credit. The home, which serves as security for the mortgage, must be the mortgagor's principal residence for the duration of the loan.

The reverse mortgage offers an opportunity for seniors to age in place while also having access to cash at a time in life when many experience a reduction in income. Traditional debt, such as first- or second-lien home equity loans or lines of credit, can also provide cash, but the requirement for periodic repayment and an income sufficient to service the debt make this alternative approach less than an ideal solution for lower income seniors wishing to age in place. While the sale of a home may provide cash, it also entails moving to alternate housing where studies[1] have shown that most older Americans prefer aging in place. As a result of these considerations, the question of how retirees might be best able to use home equity—often their largest asset—to help fund their retirement has been brought to the forefront of financial planning discourse.

For older Americans, equity in the home has come to represent a major share of their total wealth. However, owner-occupied housing, as an asset, is largely indivisible—a home cannot easily be sold in increments as can a stock portfolio or have equity withdrawn gradually like a savings account. Thus, liquidating housing wealth to help meet cash needs during retirement is not easily accomplished. Converting home equity to cash generally requires the sale of the entire asset or the ability to issue debt against home equity.

A reverse mortgage is debt issued against home equity which can provide significant sums of cash without the sale of the home and without the need to make periodic repayments. Because no repayment of the mortgage balance is due until the borrower no longer occupies the home as his or her principal residence, traditional underwriting is not typically required to demonstrate the borrower's financial capacity (income) to service the debt.

The HECM loan is a reverse mortgage that offers lenders an FHA insured mortgage insurance guarantee. The HECM loan program was originally designed to meet the special needs of elderly homeowners by reducing the effect of the economic hardship caused by the increasing costs of meeting health, housing, and subsistence needs at a time of reduced income and to encourage and increase the involvement of mortgagees and participants in the mortgage markets in the making and servicing of reverse mortgages for elderly homeowners. The FHA guarantee, which is available so long as the loan is originated following FHA guidelines, enables lenders to provide better loan terms to borrowers than would be available without the FHA mortgage insurance guaranty.

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[1] Bayer, Ada-Helen, and Leon Harper. 2000. *Fixing to Stay: A National Survey on Housing and Home Modification Issues.* Washington, DC: AARP, available at: http://assets.aarp.org/rgcenter/il/home_mod.pdf

The Impact of HECM on the FY 2013 MMI Fund Budget Re-estimate

The President's budget forecasts that the FHA MMI Fund, which provides the fiscal capital to support FHA's single family and reverse mortgage guarantees, will use $943 million of its mandatory appropriation authority to supplement its reserves at the end of FY 2013. The MMI Fund currently has approximately $32 billion in cash available to pay claims, so this is not a cash on hand problem; it is one of setting aside the right size of loan loss reserves. The $943 million figure is based on an annual re-estimate of the reserves FHA will need to hold as of September 30, 2013, for the payment of expected losses over the next 30 years on its portfolio of guaranteed loans as of last September, based upon Federal Credit Reform Act (FCRA) scoring. This re-estimate is done as part of the development of the President's Budget.

The potential for a mandatory appropriation to the MMI Fund is largely due to the existing reverse mortgage portfolio. This product, particularly as it has been structured to date, is sensitive to borrower longevity, home prices, and economic conditions. Lower than anticipated home price appreciation substantially affected the expected performance of the portfolio relative to FY 2011 estimates. Further, changes to the ways in which borrowers utilize the HECM product have shifted the risk profile of the program.

Originally designed to be used like an annuity, in recent years market circumstances and lender preferences have shifted greater numbers of borrowers to take full draws via the Fixed Rate Standard product. Thus, borrowers are taking all of the funds available to them up-front and often do not have the resources necessary in later years to pay property taxes and insurance, thereby triggering a default on the loan. Due to these changes in usage and performance, the budget estimates that the use of the HECM program results in a negative value of $5.2 billion and a disproportionately negative impact to the Fund.

Since 2009, FHA has worked to re-evaluate the HECM program and make adjustments, where necessary, to ensure program sustainability, ensure the program maintains a negative subsidy, and reduce risks to the Insurance Fund.

On October 1, 2009, the principal limit factors reduced the available amount of funds to borrowers by 10%, thereby reducing program risk. A second reduction to the principal limit factors, ranging from 10-15%, occurred October 4, 2010, when the traditional one-size-fits-all HECM product that had existed since the program's inception was replaced by two new HECM products, Standard and Saver, both of which also substantially raised the annual mortgage insurance premium to offset risk. The Standard product is designed to appeal to seniors who need the most cash from HECM and who are less concerned about upfront loan costs. Standard raised the annual mortgage insurance premium from 0.5% of the outstanding loan balance to 1.25%, maintained the original upfront premium of 2% of the loan's maximum claim amount, and adopted new, lower principal limit factors. On the other hand, Saver is designed to minimize upfront costs to appeal to seniors who need less cash, and who may want a shorter term "bridge" loan to meet current needs. Saver also raised the annual premium to 1.25%, but reduced upfront premium to 0.01%, and adopted factors that are lower than the Standard factors.

In 2010, FHA revised its post endorsement technical review process to provide a more disciplined approach to reviewing HECM loans to ensure program requirements are met and implemented a new process to review FHA-approved lenders who service HECM loans. Additionally, in January 2011, HUD issued extensive guidance on the handling of property charge-related delinquencies with detailed requirements related to notifications to borrowers, reporting to HUD, loss mitigation and counseling support. Furthermore, in January 2011, HUD issued policy guidance requiring mortgagees to offer loss mitigation options that will allow the borrower to bring the mortgage into compliance with FHA's requirements.

And, with the results of the 2012 independent actuarial report, FHA took immediate action to better align the HECM program with its objective of enabling seniors to age-in-place. These changes, which will significantly impact consumer use of the program, will protect FHA from losses and reduce the likelihood of borrower defaults. In administrative guidance dated January 30, 2013, FHA consolidated the Fixed Rate Standard program with the Fixed Rate HECM Saver product, which will result in a reduction of the maximum amount of funds available to a HECM borrower.

Additionally, in an effort to reduce losses associated with the conveyance and disposition of properties mortgaged with a HECM, FHA will issue new incentives for estate executors of HECM borrowers to dispose of properties themselves rather than conveying them to HUD. Currently, executors are permitted to either sell such properties or convey them to HUD when the loan is called due and payable. Reversing the historical trend, over the past few years, larger numbers of executors have been choosing to convey these properties to FHA rather than sell them, adding costs and reducing recoveries for FHA. By incentivizing the sale of properties by executors, FHA is able to avoid property management, maintenance, and marketing costs associated with the REO disposition process, thereby reducing losses to the Fund on these properties.

Whether there will be an actual need for a mandatory appropriation from the Treasury General Fund to the MMI fund will not be determined until September 2013, and will be based on FHA's realized revenues and any other developments through the end of the fiscal year. Notably, any mandatory appropriation to FHA would not involve approval from Congress, as all federal loan programs have this standing authority. As we consider this potential mandatory appropriation, we must also acknowledge that FHA played a crucial, countercyclical role in bringing the housing market from the brink of collapse to a place where it is positive and growing again. This task did not come without its stresses which we are experiencing today. Nevertheless, FHA will remain vigilant in implementing the policies and practices discussed here to protect the Fund and make every effort to maintain a negative credit subsidy for the HECM program through FY 2014 and beyond.

To make such changes in a timely fashion and preserve the program for seniors, FHA is seeking explicit statutory authority to temporarily make changes to the HECM program via Mortgagee Letter while formal rule making is simultaneously in progress. Specifically, given this explicit authority, FHA would make the following changes via Mortgagee Letter in FY 2013:

- Limit the amount of the allowable draw;
- Where appropriate, mandate the use of escrow accounts or a set-aside to ensure continued and timely payment of property charges including taxes and insurance, and;
- Require the use of a financial assessment as part of the loan origination process to ensure the appropriateness of HECM products for potential borrowers.

In addition, the President's Budget proposes a statutory change to the National Housing Act to clarify the rights and responsibilities of the non-borrowing spouse on a HECM loan. HUD cannot effectively administer this program if the existence of a non-borrowing spouse prevents the loan from being due and payable following the death of mortgagor (borrowing spouse). The actuarial soundness of the program – which dictates the amount of money that a mortgagor can draw out of the equity in the home—is based on the value of the home, the interest rate on the note, and lastly but most importantly, the age of the youngest mortgagor.

As always, the Department is evaluating its existing program rules and requirements governing the HECM program and is pursing administrative action to the degree allowed under the current statute to address these structural issues. However, if we are unable to take the appropriate steps to ensure the HECM program is fiscally sound for the long run, HUD will have to take aggressive short terms steps to strengthen the program and address its impact to the Fund prior to FY 2014. With the support of Congress, FHA can make the HECM program financially sound ensuring that fiscally responsible seniors from all walks of life can continue to enjoy the benefits of homeownership during retirement.

Office of Multifamily Housing Programs

FHA insurance has long assisted the nation in meeting the need for safe, decent and affordable housing by facilitating financing to develop, rehabilitate and refinance multifamily rental housing. The financial recession, combined with historically low interest rates, and improvements in HUD business operations, led to an unprecedented increase in demand for FHA mortgage insurance. This was particularly pronounced in certain types of multifamily housing and in regions of the country where conventional lending was inaccessible absent federal credit enhancement. While multifamily new construction volumes have declined in recent years, falling from \$4.0 billion in FY 2010 to \$3.3 billion in FY 2012, multifamily refinance transactions, especially refinancing of loans already insured by FHA, have increased by 60 percent, from \$6.9 billion in FY 2010 to \$11.1 billion in FY 2012.

At a time when more than one-third of all American families rent their homes and over 8.5 million unassisted families with very low incomes spend more than 50 percent of their income on rent or live in severely inadequate conditions, it is more important than ever to provide a sufficient supply of affordable rental housing for families of modest means – particularly since, in many communities, affordable rental housing does not exist without public support for construction or preservation. FHA's ability to play a countercyclical role in the multifamily housing market helped keep private investment flowing when conventional financing resources had otherwise retreated from the market.

Demand for new FHA insurance for new construction and refinancing of multifamily properties increased more than six-fold from 2008 to 2012, rising from \$2.3 billion in FY 2008 to \$14.5 billion in FY 2012. By the end of 2012, FHA's portfolio of multifamily loan guarantees had an unpaid principal balance of \$59.8 billion on 10,542 loans. And today, while volume increases have stabilized, HUD expects elevated levels of mortgage insurance activity through FY 2013. A significant share of the demand for FHA insurance reflects the larger demand for rental housing, particularly in many metropolitan areas which face an inadequate supply of multifamily housing. The ongoing demand for new rental housing is directly attributable to two factors, both connected to the market downturn: (1) as many as 3.9 million former homeowners have been displaced by mortgage distress and are now in the rental market and (2) as many as 4.3 million new renter households, including many who postponed new household formation between 2008-2012 (for example, the number of 25 to 34 year olds living with parents was almost 50% higher in 2011 than in 2003).

In addition to providing critical liquidity to the marketplace, FHA insured multifamily developments also have a significant impact on communities by expanding affordable housing options, spurring economic development, and creating jobs. FHA estimates that the multifamily new construction loans endorsed by FHA in FY 2012 alone directly created 22,146 jobs, and supported the creation of 32,380 additional indirect or jobs. In total, FHA-insured multifamily projects yielded approximately 54,526 jobs throughout the nation. Clearly, FHA's multifamily new construction insurance program offers much more than just financing -- it creates jobs and improves the quality of life in communities nationwide.

While FHA's countercyclical role was crucial to mitigating the worst of the financial recession, its expanded footprint in multifamily finance is intended to be temporary. FHA sees its role today as encouraging the return of private capital back into the mortgage market while balancing the need to remain a supportive mechanism for all types of housing moving forward, particularly for underserved markets and for lower income families.

To that end, in order to continue to serve this role while private capital returns to the housing finance market, the Administration supports an additional $5 billion in commitment authority for the General and Special Risk Insurance Fund (GI/SRI). This would increase the total commitment authority available to FHA to endorse multifamily as well as healthcare loans for FHA insurance to $30 billion in FY 2013, up from the $25 billion level in FY 2012 and consistent with the President's FY 2014 budget request. This additional commitment authority will impose no cost on taxpayers and will enable FHA to continue to serve its crucial, countercyclical role in these markets, facilitating the financing of affordable multifamily housing, residential care facilities and urgently needed hospitals. Of particular importance here is the ability to insure refinance transactions which reduce risk to the fund by allowing facilities to take advantage of today's historically low interest rates, lowering their monthly payments. This fiscal year, we estimate that nearly 60 percent of the FHA-insured healthcare portfolio and 40 percent of the insured multifamily housing portfolio will seek refinancing opportunities through FHA. And, following the impact of Hurricane Sandy, we have experienced a three-fold increase in the number of concept meetings held for projects seeking FHA insured financing in the impact area.

Managing Risk and Building Efficiencies

The central role of housing in the U.S. economy demands that Federal agencies involved in housing policymaking manage programs and policies to support housing as a stable component of the economy, and not a vehicle for over-exuberant and risky investments. Since the start of this Administration, and in light of - though not necessarily because of - this heightened countercyclical role, FHA has taken a number of comprehensive steps to improve its risk management capabilities and processes to ensure the ongoing solvency of the FHA insurance funds. In Multifamily, we have engaged in a series of program specific steps to ensure that we are taking the appropriate steps to manage and mitigate risk. These changes reflect the first update to some of the standards governing FHA insured multifamily programs in 40 years. Leveraging the lending industry's best practices and standards, these changes are a much needed step to insure that FHA multifamily programs are sound and will continue to be available to fulfill our mission of providing liquidity to the multifamily market and decent, affordable rental housing to our nation's communities. These changes also ensure that FHA's multifamily programs are designed to meet the needs of communities across the nation.

During FY 2012, FHA implemented a Low-Income Housing Tax Credit Pilot Program establishing a Single Underwriter Role and separate lender approval for underwriting for more complex loans that combine FHA programs with Low-Income Housing Tax Credits. This pilot and the underwriter model are the basis for the proposed risk based processing and underwriter role in the proposed operating model changes.

This shift is a result of analyzing outcomes associated with the Multifamily Accelerated Processing (MAP) program, which show that certain FHA programs demand skilled lenders and underwriters with specialized knowledge. Currently, HUD offers the full range of FHA programs without regard to specialized expertise.

As part of risk mitigation, FHA has already implemented revised underwriting standards to raise debt service coverage ratios, lower loan to value and loan to cost ratios, increase project reserves and sponsor equity investment, and limit sponsor cash out. Underwriting ratios are now targeted to different property types based on their risk profiles, with lower ratios for subsidized affordable housing properties and higher ratios for market rate properties.

Breaking Ground. Completed in mid-FY 2012, Breaking Ground was an initiative in Multifamily Housing Development to reduce backlogs, improve time frames, and create an early warning system that allows for more effective risk management by creating extensive tools to monitor and access credit for multifamily insured loans. These tools include a stronger credit review of borrowers; an early warning system that targets loans early in the process that do not meet FHA underwriting criteria; and a dashboard monitoring tool to track accountability of field offices; and establishment of a queue in order to more efficiently manage workload and provide greater transparency to lenders.

Adopting this approach has produced positive results. Offices that had large application backlogs prior to Breaking Ground have reported processing efficiency improvements, methodically clearing out older applications – the number of applications in process for over 90 days dropped from 191 to 50 in just seven months. In addition, offices that began Breaking Ground without a large backlog have begun to meet aggressive application processing time cycles. The Department will continue to track these metrics and looks forward to reporting on these results.

Sustaining Our Investments. The Sustaining Our Investments initiative, which was fully implemented last month, has resulted in an overhaul of the processes used to manage the portfolio of the Office of Multifamily Asset Management. The initiative focuses on Risk Based Management – allowing project managers at both the Headquarters and field level to focus day-to-day operations on managing at-risk loans in the portfolio. Risk-based reports keyed on financial and physical risk triggers direct project managers to act early on potential problems with particular assets. The first step in this initiative was to complete a full ranking of FHA's entire multifamily market rate portfolio to better assess and address potential risk factors. The ranking of the non-insured portfolio is now underway and scheduled for completion this summer.

Loan Committee. FHA Multifamily has also implemented a new loan committee approval process, aligning Hub and Program Center commitment authority and practice to ensure consistency in underwriting throughout the regional offices, as well as to provide a platform to share best practices. Loan committees at the Hub and National levels provide oversight for high-risk transactions in the multifamily insurance program, based on loan size and a project's number of units. Loan committee approval processes are standard practice in the lending community and are an important tool to prudently manage credit risks and ensure the integrity and stability of the GI/SRI insurance fund.

Concentrated Risk. FHA Multifamily issued a Mortgagee Letter strengthening underwriting review requirements for mortgage insurance applications from borrowers whose FHA insured unpaid principal balances equal or exceed $250,000,000. The guidance meets an immediate need for clarity on how lenders and HUD Offices should treat borrowers with this level of insured debt. The Mortgagee Letters expands the scope of analysis and heightens the level of credit underwriting for these borrowers, thereby reducing the risk of defaults and claims.

Premium Increase. Given the unprecedented increase in the number and dollar volume of loans insured under the GI/SRI, particularly with respect to "market rate[2]" loans, in the President's FY 2013 Budget proposal, the Department announced proposed premium increases for programs in the GI/SRI. Implemented on October 1, 2012, this was the first premium increase in 10 years for these programs.

GI/SRI funds provide financing for the FHA multifamily and healthcare loan guarantee programs and several very small specialized loan products. This account also continues 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.

In contrast, premiums for single family programs situated in FHA Mutual Mortgage Insurance (MMI Fund) have been increased five times since 2010. As with the premium increases for MMI programs, higher premiums for market rate loans originated under the GI/SRI funds ensure that FHA products are priced appropriately to compensate for FHA's risk, consistent with current market conditions. This premium change should also have the indirect benefit of encouraging the return of private capital to the nation's mortgage markets.

Transforming the Multifamily Business Model

While these significant changes have truly changed the way FHA does business, our efforts to more effectively and efficiently serve our customers while managing risk to the portfolio will continue. Last month, we announced that beginning in late FY 2013, the Office of Multifamily Housing plans to begin changes to its operating model that includes reorganizing its Headquarters structure and consolidating Field Office Operations. Phased in over two and a half years, and scheduled for completion by FY 2016, this plan will increase efficiency and consistency, modernize our services, and once fully implemented has the potential to save an estimated $40 to $45 million in annual costs.

By taking proactive steps, the Office of Multifamily Housing Programs will better serve customers and stakeholders, by operating more efficiently and consistently and improving risk management, all in an era where HUD and agencies across the government are working diligently to determine how best to do more with less. This transformation builds upon the success of *Breaking Ground* and *Sustaining Our Investments* through four initiatives:

1. *Launching more routine and effective workload sharing across the country.* By more equitably distributing workloads in the areas of Production and Asset Management, Multifamily Housing will be able to reduce unevenly distributed pressure on staff and reduce customer wait times and the application backlog. A workload sharing pilot is already in process throughout the country, receiving positive feedback from customers and staff.
2. *Introducing risk-based processing and underwriters in the Office of Multifamily Production*. In order to increase processing efficiencies, improving customer service and more effectively manage risk, FHA Multifamily will segment and process applications according to their risk profile and complexity, assigning an underwriter to oversee the review of the application from start to finish, drawing in technical experts as needed.

[2] Generally, market rate housing covers a range of rental housing opportunities. In the FHA portfolio, market rate housing is generally affordable to those at approximately 80% of area median income.

3. *Creating Specialist Support in the Office of Multifamily Asset Management*. The newly created positions of Troubled Asset Specialist and Account Executives will allow Multifamily to assign the most experienced staff to focus on risky, complex or troubled assets, ensuring that the most skilled staff is engaged to manage risk to the portfolio. Other Account Executives with less expertise will focus on non-troubled portfolio while building the expertise and skill sets to manage more complex transactions.
4. *Streamlining organizational structures.* In headquarters, FHA Multifamily will reduce the number of offices by merging the Office of Housing Assistance and Grants Administration and the Office of Housing Assistance Contract Administration Oversight into other existing Headquarters offices. A dedicated Associate Deputy Assistant Secretary role will be created to support the field while leadership also examines other offices for ways to streamline and reduce duplication of efforts. In the field, 17 hubs will be consolidated into five – with each Hub/Region having a satellite office. A full implementation the total number of field offices with Multifamily presence will decline from 50 to 10. Impacted employees will have the ability to relocate, accept a buy-out, or take early retirement. All employees will have the opportunity to remain with the Department albeit possible in another location or role with the department.

Preserving Affordable Units in Small Multifamily Buildings

As part of the FY 2014 Budget, HUD is seeking legislation to facilitate lending to small multifamily properties which are an important provider of affordable, but unsubsidized, housing for low and moderate-income families. According to the 2010 American Community Survey, nearly one-third of renters live in 5 to 49 unit buildings. These buildings also tend to have lower median rents than do larger properties: $400 per month for 5-49 unit properties as compared to $549 per month for properties with 50 of more units. Because they are expensive to finance, particularly in this environment, these properties are at risk of divestment.

HUD is proposing two legislative changes-one change to the Section 542(b) Risk Share program that would allow the Department to explore flexibility with the 542(b) Risk Share program to work with experienced affordable housing lenders to make Risk Share loans to small properties and the second change would allow Ginnie Mae to securitize risk share loans under Section 542(b).These changes would allow HUD to enter into Risk Share agreements with qualified lenders –such as well-capitalized Housing Finance Agencies or Community Development Financial Institutions – that have demonstrated experience making loans to support affordable housing and neighborhood stabilization. Under these Risk Share agreements, qualified lenders could make refinance, acquisition or rehab loans available to small (5 to 49 unit) properties. Lenders approved by Ginnie Mae could then securitize those loans on the secondary market, increasing the availability of capital for more multifamily lending.

HUD's proposal to improve the resources available to small building owners is part of the Department's broader commitment to re-balance the nation's housing policy to support rental housing and neighborhood revitalization. As Federal and state budgets shrink and the need for quality, affordable rental housing is on the rise, it's critical that we support small businesses who are finding solutions that work for families and for local economies – especially when those solutions come at no cost to the taxpayer. We look forward to working with Congress to ensure the availability of these unsubsidized, affordable housing units.

Office of Healthcare Programs

FHA's healthcare programs are integral to HUD's community development mission and also serve as a critical resource to facilitate mortgage financing for the construction, renovation, acquisition, or refinancing of residential care and hospital facilities. These programs improve access to quality healthcare in communities across the country and help to reduce the cost of healthcare by reducing the debt service costs of healthcare facilities. As with other FHA programs, the healthcare programs play a critical role in ensuring the availability of financing for hospitals and residential care facilities for which traditional forms of financing have either been unavailable or cost prohibitive. These programs have played a critical role during the economic crisis and recovery as hospitals and residential care facilities have faced constrained access to credit. Particularly given our nation's aging population and increasing health care costs, strong support for quality, accessible health care is an essential component in achieving the Department's mission of strong, sustainable, inclusive communities and quality, affordable housing and services for all Americans.

The Office of Healthcare Programs is located within HUD's Office of Housing and all its programs are part of the Federal Housing Administration (FHA). The office administers healthcare mortgage insurance to support the continuum of care in communities across the United States, as authorized under Sections 232 and 242 of the National Housing Act. Through the Section 232 Mortgage Insurance for Residential Care Facilities, FHA insures mortgage loans for nursing homes, assisted living facilities, and board and care homes. Under Section 242, FHA provides mortgage insurance for hospital facilities across the nation which would otherwise not have access to financing to open their doors or continue to serve their communities. By enabling the more affordable financing and refinancing of underserved healthcare facilities nationwide, the programs decrease overall healthcare costs and help fulfill a capital financing need where that need cannot be satisfied by private markets. Also, as healthcare facilities are major economic engines that are often the leading providers of jobs in their local communities, these projects, including those insured by FHA, generate substantial economic activity in local communities and create much needed jobs. These programs, like all FHA insured mortgage programs, do so while operating at a negative credit subsidy, generating offsetting negative subsidy receipts to taxpayers.

Today, while the economy seems to be rebounding and with it, sources of private capital, we continue to expect high levels of mortgage insurance activity for FY 2014 due in large part to refinancing activity, particularly of loans already insured by FHA, as healthcare facilities take advantage of current low interest rates. Furthermore, following implementation of a final rule in 2013, hospitals can now obtain FHA-insured refinancing loans. As of March 31, 2013, the FHA's portfolio of healthcare loan guarantees had an unpaid principal balance of $28.3 billion on 2,898 loans.

Section 242: Hospital Insurance

In 1968, Section 242 of the National Housing Act was enacted to support the capital financing for urgently needed hospitals and encourage private lending. Since the Section 242 program's inception, over 400 mortgage insurance commitments have been issued for hospitals in 43 states and Puerto Rico. FHA serves all types of acute care hospitals nationwide, ranging from small rural facilities to large urban teaching hospitals. Since the inception of the program, 8% of hospitals nationwide have received FHA insured financing, with a large percentage of the portfolio consisting of rural or non-urban hospitals. The program has "graduates"—with the support of FHA, many hospitals gain financial strength and stability and are eventually able to refinance into conventional products. An example is Hillcrest Hospital in Waco, Texas, which received an FHA-insured loan in 2006 to replace its aging facility. The new hospital, completed in 2009, has been successful in providing services to the community and has also been successful financially. It merged with a strong hospital system and was able to repay its FHA-insured loan in March 2013 using conventional financing. Recently, the new Hillcrest served as the first-response trauma facility treating over 60 victims of the fertilizer plant explosion in west Texas.

As of March 31, 2013, FHA's Section 242 portfolio consists of 109 active loans for 84 hospitals, totaling $8.6 billion in unpaid principal balances. The program is mostly utilized by underserved, urgently-needed hospitals that have sound track records but are unable to secure capital to enable them to operate a financially stable facility at reasonable interest rates including small, financially strong, rural hospitals or large hospitals that serve a substantial indigent populations. By insuring mortgages for these hospitals, FHA enables the financing of projects such as construction, replacement, expansion, modernization, equipment purchases, or refinancing, at rates that ultimately reduce healthcare costs.

Due to strong underwriting and proactive asset management, the program operates at no cost to the taxpayer, has consistently maintained a cumulative net claim rate of less than 1%.

Section 232: Residential Care Facilities

Congress established Section 232 of the National Housing Act in 1959 to support the needs of a vulnerable aging population in residential care facilities across the country. Since then, over 7,000 Residential Care Facility mortgage insurance commitments have been issued in all 50 states under the Section 232 program. Under this authority, FHA provides mortgage insurance to residential care facilities nationwide including nursing homes, assisted living facilities, and board and care homes. The program's primary mission is to provide mortgage insurance for much needed nursing homes that provide for housing, care, and treatment of frail elderly and persons unable to live independently and require skilled nursing care.

As of March 31, 2013, FHA's Section 232 portfolio consists of 2,789 active loans for 2,680 residential care facilities, totaling $19.8 billion in unpaid principal balances. Loans insured under Section 232 support roughly 12% of the skilled nursing market in the United States, with 70% of the portfolio consisting of skilled nursing facilities. 28% of the Section 232 portfolio consists of assisted living facilities with the remaining 2% being board and care homes. HUD has implemented rigorous asset management and loan monitoring processes in recent years that has resulted in reducing defaults and maintaining a claim rate of less than 1%.

Evolution of FHA Healthcare Programs – Balancing Risk and Improving Processes

This Administration, in continuing to improve the program has brought in positive risk management changes to both balance risk and improve processes within the Office of Healthcare Programs. Given the unprecedented increase in the number and dollar volume of loans insured under GI/SRI, in FY 2013, premium increases for FHA's General Insurance and Special Risk Insurance healthcare programs were instituted to increase the stability of the insurance fund. With the premium increases, FHA Healthcare loans are priced more appropriately to encourage the return of private capital while, at the same time, continuing to ensure sufficient levels of available capital in these sectors.

> *Proactive Asset Management.* In FHA's Office of Healthcare Programs, weekly loan committees are held to review and approve loan submissions and to monitor healthcare industry trends and risks. By implementing proactive asset management using early intervention monitoring tools, the Office of Healthcare Programs succeeded in maintaining claim rates of less than one percent in both healthcare facility mortgage insurance programs in FY 2012.

LEAN Business Process Reengineering. LEAN Business Process Reengineering has also played an integral part in streamlining business operations within FHA's healthcare programs. Despite volume increases, LEAN Processing improvements reduced loan processing times while increasing risk management efforts. Revised program requirements and documents were established to enhance accountability for borrowers, operators, and lenders. To further manage risk in the healthcare portfolio, in areas of large risk concentrations, such as insuring portfolios of multiple healthcare facilities, reviews are conducted at both the corporate and individual loan levels. In the residential care facility mortgage insurance program, implementation of a Master Lease Structure to cross-collateralize properties not only works to improve the overall risk profile of FHA's healthcare portfolio, but ultimately reduces claims.

The Office of Healthcare Programs is in ongoing collaboration with HHS, CMS, and state public health departments to support efforts to ensure quality of care for the most vulnerable populations. Also, by incorporating state survey inspection results, cost reports, and data from other Federal and state agencies into FHA's underwriting and asset management procedures, the shared utilization of data and cross-collaboration has been instrumental in keeping healthcare claim rates low within FHA.

The Office of Risk Management conducts a separate analysis from the Program office for loans over a certain threshold. This third party review allows Risk Management to conduct a separate analysis of higher loan amounts to ensure risk factors are properly identified and mitigated. The Office of Risk Management works across all business lines (Single Family, Multifamily, and Healthcare) to identify and balance risk to the FHA mortgage insurance fund.

Critical Access Hospitals

As part of the efforts of FHA's Healthcare programs to strengthen communities by addressing specialized financing needs, HUD is seeking passage of the language in the THUD Appropriations Bill to permit rural Critical Access Hospitals to be eligible for FHA insurance. Before their eligibility expired in 2011, 29 Critical Access Hospitals received FHA-insured loans, with results that were positive, both in terms of loan performance and the jobs created by hospital construction projects. Also, quality of life improved in their communities; these hospitals by definition are geographically remote from other hospitals, and they provide not only emergency, outpatient, and acute inpatient services but also nursing and rehabilitation services that avoid the need for the elderly and recuperating patients to leave the community for care.

We appreciate the Congress' long standing support for Critical Access Hospitals by amending Section 242 to permit these important facilities to be eligible for FHA insurance, and hope that this language will be approved to allow Critical Access Hospitals to continue to be eligible for FHA insurance.

Conclusion

Each of these programs meet a critical need in targeted areas where private capital has been either unavailable or insufficient to meet the demands of the market – whether it be seniors looking for supplemental income through equity in their homes, critical access hospitals and hospitals that serve a unique targeted need, or affordable rental housing. We look forward to working with stakeholders and the committee to ensure that FHA has the tools it needs to more effectively manage the HECM program, so that it remains a viable option to seniors while putting the program on more sound fiscal footing, and so that the multifamily and healthcare programs have the commitment authority they need to ensure that healthcare providers and affordable housing developers can continue to meet the critical demands of their communities.

By targeting resources where they are most needed, making tough choices in order to do more with less, and ensuring the protection of taxpayer interests, FHA's Single Family, Multifamily, and Healthcare Programs, are ensuring more Americans have the opportunity to realize or maintain the economic security of the middle class and have access to safe, decent, affordable housing and healthcare opportunities. We remain focused on transforming the way we do business will ensure that we can continue to remain an effective support to the market – and that helps build the economy from the middle class out and ensures that we create opportunity for everyone, everywhere. Thank you.