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Housing and Community Opportunity

Hearing on

"The Future of the Federal Housing Administration's Capital Reserves: Assumptions, Predictions and Implications for Homebuyers"

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Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)[1] on the future of the Federal Housing Administration's (FHA) capital reserves. I am David Kittle, Executive Vice President of Vision Mortgage Capital in Philadelphia, Pennsylvania, and MBA's Chairman.

I have been in the mortgage business and working with FHA insured loans since 1978. In 1983, 90 percent of the loans I closed as a loan officer were FHA loans (320 out of 343 loans made that year). From 1994 through 1999, FHA loans were about 38 percent of my company's business. I even financed my first home with an FHA mortgage. Over the last decade, prior to the current market crisis, FHA's prominence in and usefulness to the market dropped precipitously. As I will discuss, that is no longer the case today and is not likely to be the case going forward, and I commend the subcommittee for holding this important oversight hearing.

FHA is especially important to segments of the population who have needed a little extra help to achieve the dream of homeownership. More than any other nationally available program, FHA focuses on the needs of first-time, minority, and low-and moderate-income borrowers. According to recent data provided by the Department of Housing and Urban Development (HUD), both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. For example, as of August 2009, approximately 78 percent of FHA-insured home purchase loans were made to first-time homebuyers, and 30 percent were to minorities. Minorities also comprise a higher percentage of FHA borrowers than they do the conventional mortgage market.

MBA has always advocated for a strong and vibrant FHA. We have been calling for updates to FHA's scope and operations since well before the current market disruptions reestablished FHA's prominence as a catalyst for bringing liquidity to the housing finance system. With the increased growth of FHA, it is imperative that we move swiftly and take appropriate measures now to protect the safety and soundness of the agency. This requires a multifaceted approach: ensuring that FHA has the right resources; requiring high standards of mortgage bankers and mortgage brokers; creating credit policies that are prudent, but aligned with the mission of FHA; and ensuring that FHA is helping to provide market liquidity during a time of crisis. In support of these goals, we recommend measures such as, raising net work requirements for FHA-approved lenders and correspondents, permanently increasing the FHA loan limits, extending and

[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

raising the homebuyer tax credit, and establishing sensible consumer and lender protections for Home Equity Conversion Mortgages (HECM) borrowers. MBA believes that these actions will not only help FHA face current market challenges, but also ensure the agency's future viability.

<u>The Growth of FHA and the Status of the Mutual Mortgage Insurance Fund</u>

The pace and magnitude of FHA's recent growth is further evidence of its significance to the nation's housing market. In fiscal year (FY) 2009, FHA insured 829,300 home purchase loans, compared to 490,974 in FY 2008. Considering that just three years ago, FHA's share of originations was a paltry three percent, its current market share, which is greater than 30 percent, is truly astounding. MBA cites the following as the primary reasons for this dramatic growth:

- FHA loans usually require lower down payments than loans purchased by secondary market participants such as the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. The maximum loan to value (LTV) ratio for FHA-insured loans is 96.5 percent, compared to 95 percent for the GSEs.

- The Emergency Economic Stabilization Act of 2008 temporarily raised the FHA and GSE loan limits for much of the country, which made FHA a more viable option for many homebuyers. Those temporary loan limits were replaced by new loan limits included in the Housing and Economic Recovery Act of 2008 (HERA), which were later temporarily modified by the American Recovery and Reinvestment Act of 2009. These limits facilitated many more loan originations across a wider spectrum of home prices.

Prudence and sound risk management principles suggest that the substantial increase in FHA volume should be accompanied by an equally sizeable emphasis on quality controls. Heightened vigilance is also required to deter the unscrupulous brokers, lenders and borrowers who once plied their fraudulent trade in the subprime market from migrating to the FHA market.

FHA recently announced that its reserve account had dropped below its statutory two percent requirement. Although this account is a secondary account and FHA's primary account (which covers potential future losses on each book of business over its entire 30 years) is fully funded, the decrease has raised concerns about the stability of FHA. According to FHA, the agency's real combined capital reserve is $30 billion and exceeds a four percent capital ratio. MBA believes that the capitalization of the fund is adequate for now, but we believe it is important to institute operational and structural changes in order to secure FHA's future viability. FHA's recent decision to hire a Chief Credit Risk Officer for the first time in its 75-year history is a positive step in the direction of a comprehensive risk management framework, which MBA strongly supports.

It is also worthwhile to put the performance of FHA-insured loans into perspective. According to MBA's National Delinquency Survey for the second quarter of 2009, 13.7 percent of FHA loans were past due, and the number of FHA properties in foreclosure was 2.98 percent. During the previous decade, the FHA total past due rate has averaged about 11 percent. The increase to this point has been relatively modest, compared to other categories of loans, primarily because there has been such a large increase in the volume of FHA loans outstanding. MBA expects that FHA delinquency and foreclosure rates will increase as these loans mature. The factors driving the increase are the macroeconomic conditions that are impacting all loans – such as the continued declines in home prices, continued increase in unemployment rates and continued weak housing demand, which inhibits the ability of delinquent borrowers to sell their home.

Resources Necessary for Improved FHA Operations

MBA believes a critical requirement for achieving, sustaining and protecting the housing market's long-term vigor is ensuring that FHA has the resources it needs to operate in a high-tech real estate finance industry. FHA's staff levels have remained virtually unchanged even though its market share has risen from three to over 30 percent. This ratio of activity to resources is unsustainable because it stretches FHA beyond its capacity. MBA strongly supports H.R. 3146, the 21st Century FHA Housing Act, which would provide FHA with up to $72 million in funding to hire additional staff and upgrade compensation to be commensurate with that of other federal financial regulators. The bill also permits funding to upgrade technology. Modernized technology would enable FHA to better monitor lenders, protect against fraud, and generally be better equipped to handle the challenges of a modern marketplace.

MBA is grateful that Congress authorized $25 million in HERA to be allocated each year to FHA for improving staffing and technology. The Omnibus Appropriations Act of 2009[2] made $4 million available for FY 2009 and FY 2010 to be used "for planning, modernizing, improving and maintaining information technology applications and infrastructure supporting FHA." While this funding is appreciated, it is not nearly enough to address FHA's growing needs. We urge Congress to provide the full $25 million each fiscal year though 2013, as authorized under HERA. Furthermore, as in H.R. 3146, FHA should be given the statutory authority to use its future revenues to make additional technology upgrades as needed. Ensuring these resources are available to FHA not only helps support the viability of its products and services but it also protects the Mutual Mortgage Insurance Fund.

Recent FHA Credit Policy Changes

Given the growth in its market share, and the potential risk to its finances, it was prudent for Commissioner Stevens to make recent policy changes to the FHA program. MBA

[2] Pub. L. 111-8 (March 10, 2009).

supports the direction of these changes and expects to work closely with FHA to implement additional adjustments that will help put the agency on stronger financial footing.

Appraisals

As MBA stated in previous testimony, reliable and accurate collateral valuations are important tools to help FHA, lenders, and investors estimate their risk of loss in a home purchase or refinance transaction. Determining a property's value is not an exact science, and is even more difficult in markets where home prices are volatile or declining. As a method of promoting reliable and accurate appraisal practices, FHA-approved lenders are required to use FHA-approved appraisers.

MBA members continue to express concern regarding the ambiguity of various terms of the GSE Home Valuation Code of Conduct (HVCC), and we have undertaken several initiatives to obtain clarifying interpretations from the drafting parties: the GSEs, Federal Housing Finance Agency and New York Attorney General. We understand the guidance recently issued by FHA was an attempt to refine several of the more contentious HVCC terms such as permissible communications with appraisers and appraisal portability. MBA appreciates FHA's proactive attempt to add the agency's perspective in these areas. We also recognize that the HVCC is just one component of the supervisory framework governing appraisal practices, which also includes the Uniform Standards of Professional Appraisal Practices (USPAP) and other interagency guidance of the federal financial institution regulators. We are committed to working with all of these regulatory bodies to ensure that property valuations are reliably prepared by qualified professionals in an environment free from coercion.

Revised Streamline Refinance Transactions

FHA's refinance transactions are meant to allow borrowers to pay off an existing loan and refinance into one that offers a better financial option. Recently, some borrowers have been using streamline refinances as a loss mitigation tool, which is an improper use of the product. MBA supports the direction of the changes that FHA made to its streamline refinance program. Verifying documentation, determining net tangible benefit, and obtaining credit scores, when available, are all sound underwriting practices that MBA supports.

Net Worth Requirements and Modification of Mortgagee Approval Process

As a government housing finance program, FHA deserves, and borrowers should expect, exceptional quality standards. Because FHA-approved lenders and correspondents are the primary, and oftentimes the only, contact for most borrowers, MBA believes they should be held to the highest levels of accountability, knowledge and professionalism. For these reasons, MBA recommends raising FHA's existing qualification standards.

MBA believes one area where FHA should consider enhancing its quality controls is by setting higher net worth and bonding requirements for single-family mortgage correspondents and bankers to participate in the program. Net worth requirements enable lenders and correspondents to be held accountable for their actions, and provide tangible evidence of their "skin in the game."

Currently, FHA requires mortgagees (mortgage bankers) to have a minimum net worth of $250,000 in order to be qualified to underwrite FHA loans. Correspondents (mortgage brokers) must have a net worth of $63,000. MBA recognizes that differences in net worth and bonding requirements for mortgagees and correspondents are based on the principle that mortgagees have greater responsibilities to the public and investors. MBA believes, however, these standards should be increased to hold both groups to greater levels of accountability.

Specifically, MBA believes mortgage bankers should have a minimum corporate net worth of the greater of $500,000 or one percent of FHA loan volume up to a maximum of $1.5 million. Mortgage brokers should have a minimum corporate net worth requirement of the greater of $150,000 or 0.5 percent of FHA loan volume up to the minimum mortgage banker status (currently $250,000 unless it is increased to the $500,000 level recommended by MBA). Also, mortgage bankers and brokers should maintain a bond where required. The amount of the bond should be sufficient to provide reasonable protection to consumers and others.

FHA is proposing to modify the mortgagee approval process, thus eliminating the requirement for loan correspondents to receive independent FHA approval for origination eligibility. The FHA-approved mortgagee would then assume the responsibility and liability for the loans underwritten and closed by the broker. According to the FHA, this policy change is necessary because the agency does not have the resources to effectively manage and monitor the broker community. The shift in responsibility also aligns its policies with those of the GSEs. MBA agrees that FHA staff is stretched thin and requires additional resources to develop and implement quality control mechanisms, but eliminating the current broker requirements may not be the best solution. As this change must be done through the rulemaking process, MBA will provide extensive comments once the details of HUD's proposal are known.

HUD's Implementation of the S.A.F.E. Act

In response to the subcommittee's question, MBA is not certain how effective HUD's implementation of the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) has been at tracking and screening out unscrupulous originators.

MBA supported the establishment of a registry to track and ultimately weed out unscrupulous mortgage brokers and other loan officers. Bad actors not only present risks to FHA, but they are a stain on our industry and must be removed.

HUD's recent activity in implementing the S.A.F.E. Act, however, may divert HUD from the important task of ferreting out bad actors and could jeopardize the ability of the industry to keep borrowers in their homes when they are having difficulties keeping up with their mortgages.

Under the S.A.F.E. Act, signed into law July 30, 2008, states were required to enact licensing and registration laws for state-regulated mortgage originators by July 31, 2009 (or by next year if their legislatures meet biennially). On a parallel track, federal regulators are required to promulgate rules requiring federally-regulated depositories to register their employees in the National Mortgage Licensing System and Registry (NMLSR).

HUD's role is to determine whether state laws meet the S.A.F.E. Act's education, testing, license renewal and other qualification requirements. Where a state does not meet these requirements or fails to pass a law by the national deadline, HUD is charged with imposing its own licensing requirements consistent with the purposes of the statute. Considering HUD's pivotal role, the states have been looking to HUD as they enact their own laws. It is therefore imperative that HUD carry out its functions carefully and judiciously.

Regrettably, earlier this year HUD opined through a set of frequently asked questions (FAQs), *without inviting comment from the public or affected industries,* on several key issues. In its FAQs, HUD stated it was:

> "generally inclined to provide in rulemaking that the SAFE Act's definition of a loan originator covers an individual who performs a residential mortgage loan modification that involves offering or negotiating of loan terms that are materially different from the original loan, and that such individuals are subject to the licensing and registration requirements of the SAFE Act."[3]

MBA and other trade associations strongly disagree with this interpretation. In a letter to HUD in March, we provided detailed views that the S.A.F.E. Act was never intended to cover servicers and the plain language of the statute did not support such an interpretation. Most importantly, by forcing the training, qualification, licensing and registration of loan servicers under the S.A.F.E. Act, while considering the difficulties borrowers are facing today, this interpretation risks greatly increasing the costs and slowing the process of borrower relief, which is contrary to the enormous efforts of the administration, Congress, and our industry.

It is notable that in carrying out their registry responsibilities, other federal financial regulators have not adopted HUD's interpretation and instead have invited comment on this important issue through a proposed rule.

[3] HUD FAQ 5, Issuance Date Unknown

This past week, industry representatives met with the Office of Management and Budget (OMB) and HUD staff after learning that HUD's proposed rule implementing its S.A.F.E. Act responsibility was pending OMB review. The industry had anticipated that the proposal would include the interpretations in the FAQs. MBA and other trade associations requested that HUD withdraw the FAQs and address the servicer matter and other key issues with appropriate notice and public comment in accordance with the Administrative Procedures Act. We also asked that HUD follow the Administrative Procedures Act and consult with stakeholders going forward. While some states apparently acted on the strength of the FAQs and have not excluded servicers, others have excluded them or are silent on the point and await HUD's final review.

In sum, MBA believes that rather than engaging issues that are beyond HUD's responsibilities, or beyond the scope of the law, HUD's efforts should be directed to facilitating efforts to root out bad actors in the origination process for the benefit of FHA and the wider mortgage market. MBA will continue to work with HUD and the Financial Services Committee to help the S.A.F.E. Act achieve its important purpose.

Permanently Increase the FHA Loan Limits

As mentioned earlier, MBA believes that FHA's growth is partly due to the temporary increase in its loan limits for the single-family programs. The single-family loan limit for FHA varies throughout the nation according to home prices, ranging from $271,050 to $729,750. These higher loan limits will expire on December 31, 2009, when the limit in high-cost areas will drop to $417,000.

Currently, FHA, Ginnie Mae and the GSEs are the only significant sources of housing finance liquidity. MBA believes it is imperative for these entities to provide secondary market support to the broadest spectrum of home prices possible during this period of market instability and beyond. Therefore, MBA encourages Congress to establish a permanent FHA single-family loan limit of $625,500 and up to $729,750 in high-cost areas. We urge Congress to act on this issue soon as the current loan limits expire at the end of this year and loans are already in the pipeline for 2010.

Extending and Expanding the Tax Credit

The dramatic fall in home values over the past couple of years has been caused by one primary factor: an oversupply of housing. To address this, Congress created an $8,000 tax credit for new home buyers. This credit, along with lower mortgage rates, has helped to moderate the decline in home prices by stimulating demand. As many as 350,000 sales so far this year could be directly attributable to the tax credit, according to the National Association of Realtors. First-time buyers, who have been on the sideline, are taking advantage of the credit and are buying again, cutting into that oversupply of housing and buoying home values.

Allowing the credit to expire would put in jeopardy the recent signs of recovery we are beginning to see in the housing market. Congress should act quickly in order to avoid a potential rush of borrowers overwhelming lenders and settlement service vendors by demanding to close before the tax credit expires on November 30, 2009.

In fact, not only should the credit be extended, it should be expanded. Congress should extend it to all home buyers and increase the credit up to $15,000. In addition, Congress should make it available immediately, so that a borrower does not need to wait until his or her next tax return, but instead can use it to help make a downpayment on the house or pay closing costs.

Changes to the Single-Family Mortgage Insurance Program

There are several options to protecting the fund, including moving to a risk-based pricing structure, increasing the upfront premium, tightening credit guidelines, or a combination of these approaches. There are clearly pros and cons to each option. MBA would consider supporting any of these options or a combination thereof, depending on the details. Our members are in the process of developing policy recommendations that will help protect the fund and improve FHA programs for the future.

Home Equity Conversion Mortgage Program

Home Equity Conversion Mortgages (HECMs) are designed to help one of our most vulnerable populations, seniors, so it is critical that care be taken to prevent abuses. In an effort to be proactive in this area, MBA convened an executive level task force last year that created a reverse mortgage model bill for states. This model bill would protect both consumers and lenders and would offer a unified approach to these policies across states. Most of our recommendations were modeled after existing HECM policies. MBA is firm in its support for mandatory counseling for all reverse mortgage borrowers, as well as preventing cross-selling as a condition for receiving a reverse mortgage. We also tackle the sensitive issue of borrowers not paying their taxes and insurance by recommending a mandatory three-year escrow account for all reverse borrowers. This would ensure that no borrower would have his/her home foreclosed on for three years due to unpaid taxes or insurance.

This year, for the first time, FHA requested a subsidy of $798 million as part of the President's FY 2010 budget, to cover losses that might be incurred over the life of the loans originated in FY 2010. The House's version of the appropriations bill did not include any subsidy, while the Senate's version only included a subsidy of $288 million. These two bills are currently in conference. The result was that FHA needed to re-evaluate the HECM program. This evaluation led to the recently-announced change to the principal limit factors that became effective October 1, 2009. This change resulted in a 10 percent reduction to the principal limit. Although MBA understands the business rationale for this change from a risk perspective, it is critical to note that it is the consumers who are being negatively impacted because they are receiving lower proceeds for the same cost. MBA also objects to the short implementation time for such a significant policy change.

Some of the other choices for addressing the HECM shortfall include Congress appropriating a subsidy, FHA changing the upfront premium, or FHA reducing the HECM loan limit. MBA does not support a reduction in the existing loan limit. We are working with FHA and other industry groups to recommend a long-term solution that would keep the HECM program self-sustaining.

FHA Multifamily Programs

With all the focus on the residential real estate market, MBA must point out the continued – and even expanded – importance of FHA's multifamily programs in today's housing market.

During the current market downturn, affordable rental housing becomes a more urgent need for families and elderly individuals who either cannot afford to buy or who chose to rent. With the collapse of the commercial mortgage backed securities market, FHA is experiencing a significant increase in volume in its multifamily and healthcare programs. During FY 2008, FHA issued commitments for $3.6 billion in multifamily/healthcare mortgages. In FY 2009, FHA issued commitments for $5.5 billion – a more than 50 percent increase. And these numbers do not reflect substantial waiting lists for applications to be reviewed by FHA staff.

FHA's multifamily and healthcare programs are extremely staff-intensive, as each application must be thoroughly reviewed and approved by FHA staff prior to the issuance of a commitment. The need for additional staff and enhanced technology are as critical for these programs as they are for the single family programs.

MBA also wants to commend the Financial Services Committee for passing H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act, through the House last month. While FHA's multifamily loan limits are sufficiently high in most markets, in some areas of the country they are severely restricting the ability to use FHA insurance programs to finance rental housing. H.R. 3527 will increase the loan limits for elevator buildings and provide the HUD Secretary with additional discretion in extremely high cost areas (similar to that provided in Alaska and Hawaii today).

Conclusion

Thank you for the opportunity to testify. MBA appreciates all that FHA is doing to provide stability, liquidity and affordability during this difficult time in the housing finance market. As I have stated, now is the time for Congress and the mortgage industry to support the agency in order to protect the safety and soundness of the agency. MBA stands ready to work with Congress to enhance and sustain FHA now and in the future.