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Hearing before the United States House Committee on Financial Services, Subcommittee on Housing and Community Opportunity

United States House of Representatives

"Transforming the Federal Housing Administration for the 21st Century"

April 5, 2006

Thank you Chairman Ney and Ranking Member Waters for inviting me to be here today to testify on the Administration's proposed FHA Modernization Act.

The bill itself is really very simple, the proposal straightforward. It does just what its name suggests: it modernizes the 72-year-old Federal Housing Administration and restores the agency to its intended place in the mortgage market. Nothing more, nothing less. Yet, the impact of this bill may be tremendous.

Let me explain. FHA was created in 1934 to serve as an innovator in the mortgage market, to meet the needs of citizens otherwise underserved by the private sector, to stabilize local and regional housing markets, and to support the national economy. This mission is still very relevant, perhaps now more so than ever, and most of us would agree that FHA can and should continue to play its important role.

Unfortunately, over the last few years, the housing agency that helped bring the nation out of the Depression, the agency that helped our grandparents and our parents buy their first homes, the agency that stood by the oil patch and rust belt states in the 1980s when the entire real estate market sank in parts of California, Texas, Louisiana, Michigan, Ohio, New York and Pennsylvania – that agency became an almost invisible presence. President Bush committed the federal government and the housing industry to reach an additional five million minority homebuyers by the end of 2010, but the agency most suited to reaching these families was falling behind.

FHA was falling behind for a variety of reasons, from outdated business practices to cumbersome program requirements. Over the last six months, we have made significant changes, streamlining and realigning FHA's operating procedures. While these changes are good and long overdue, they are not enough, a point that FHA's industry partners have clearly conveyed. Therefore, FHA is now requesting that we amend the law to give FHA the flexibility it needs to fulfill its original mission in today's marketplace.

Over the last ten years, the industry changed dramatically. Reliance on automated underwriting systems and risk-based pricing is standard operating procedure today. A multitude of innovative new products were created. The secondary mortgage market was transformed into an investors' paradise, where the array of investment options seemed endless. While this transformation happened, FHA stayed the course; the world changed and FHA remained the same. Simply put, the dynamic mortgage market passed FHA by. For example, in Congressman Tiberi's district, FHA's volume has dropped from 3,096 loans in 2000 to 1,735 loans in 2005. For Congresswoman Harris, during that same time period, FHA's volume dropped from 2,354 to 621 loans. For Ranking Member Waters, FHA's volume has all but shriveled up from 2,207 loans in 2000 to just 34 loans in 2005.

And without a viable FHA, many homebuyers – first-time homebuyers, minority homebuyers and homebuyers with less-than-perfect credit – were left with fewer safe and affordable options. Hundreds of thousands of families heard the message that homeownership helps families build wealth and brings stability to communities. They wanted to share in the good times. Many of them were able to become homebuyers, but many of them paid a steep price to do so.

Without a viable FHA alternative, many homebuyers turned to high-cost financing and nontraditional loan products to afford their first homes. While low initial monthly payments seemed like a good thing, the reset rates on some interest-only loans are substantial and many families are unable to keep pace when the payments increase. In addition, prepayment penalties make refinancing cost-prohibitive. According to Moody's Economy.com, more than $2 trillion of U.S. mortgage debt, or about a quarter of all mortgage loans outstanding, comes up for interest rate resets in 2006 and 2007. While some borrowers will make the higher payments, many will struggle. Some will be forced to sell or lose their homes to foreclosure. The foreclosure rate for subprime loans is twice that of prime loans. And I think we can all agree that foreclosures are bad for families, bad for neighborhoods, and bad for the economy as a whole.

I know that you're as concerned as I am. I've seen the various pieces of legislation designed to regulate high-cost loans and the lenders who make these loans. We've all heard the warnings from the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Trade Commission regarding the risk of high-cost loans. And we're all aware of the state and local efforts to regulate this business.

All that said, the FHA Modernization Act is part of the solution. FHA reform is designed to give homebuyers who can't qualify for prime financing a choice again. The legislation will allow FHA to fulfill its original mission, just like it did in 1934, when the same kinds of circumstances existed. In 1934, interest-only loans and balloon loans were prevalent, so FHA was established to give the private sector a way to provide long-term, fixed-rate financing.

I said at the outset that this bill is very simple. It represents a simple solution to a complex problem that affects all of us in this nation. We can talk and talk and issue warnings and guidance. We can create regulations and restrictions and force homebuyers to educate themselves. But really, when it comes right down to it, wouldn't it be a whole lot easier simply to just offer families a better alternative?

I know my introduction was lengthy, but I want you to understand how important FHA reform is to homebuyers and to the industry as a whole. FHA's private sector partners – the brokers, the realtors, the lenders, the home builders – want to tell their clients about the FHA alternative. They want low- to moderate-income homebuyers to have a safer, more affordable financing option. They want FHA to be a viable player again.

Now let me explain a little bit about the simple changes we're proposing. For one, we're proposing to eliminate the complicated downpayment calculation and the traditional cash investment requirement that have been the hallmark of FHA for years. Before the rest of the market began offering low downpayment loans, FHA was often the best option for first-time homebuyers because it required only a minimal downpayment.

But, as I said before, the market passed FHA by. Last year, 43 percent of first-time homebuyers purchased their homes with *no* downpayment. Of those who did put money down, the majority put down two percent or less.

The downpayment is the biggest barrier to homeownership in this country, but FHA has no way to address the barrier without changes to its statute. The FHA Modernization Act proposes to permit borrowers to choose how much to invest, from no money down to one or two or even ten percent. Many first-time homebuyers choose to put less money down simply to save their hard-earned cash to purchase other items to furnish or update their homes. This kind of home-related buying is the reason the housing market contributes so significantly to the overall health of the national economy.

The bill also proposes to provide FHA the flexibility to set the FHA insurance premiums commensurate with the risk of the loans. For example, low downpayment loans would be priced higher, yet appropriately and reasonably to give homebuyers a fairly-priced option and to ensure that FHA's insurance fund is compensated for taking on the additional risk. FHA would also consider the borrower's credit profile when setting the insurance premium. FHA would charge lower-credit risk borrowers a lower insurance premium than it does today, and higher-credit risk borrowers would be charged a slightly higher premium. In so doing, FHA could reach deeper into the pool of prospective borrowers, while protecting the financial soundness of the FHA Fund.

The primary concerns with a risk-based pricing approach are that FHA will target people who shouldn't be homebuyers and charge them more than they should pay. I want to address these concerns directly. Our goal is to reach families who are capable of becoming homeowners and to offer them a safe and fairly-priced loan option.

With a risk-based premium structure, FHA can reach hard-working, credit-worthy borrowers – such as store clerks, bus drivers, librarians, and social workers – who, for a variety of reasons, do not qualify for prime financing. Some have poor credit scores due to circumstances beyond their control, but have put their lives back together and need a second chance. For some, the rapid appreciation in housing prices has simply outpaced their incomes. Many renters find it difficult to save for a downpayment, but have adequate incomes to make monthly mortgage payments and do not pose a significant credit risk. They simply need an affordable financing vehicle to get them in the door. FHA can and should be there for these families.

The higher premiums that FHA will charge some types of borrowers are still substantially lower than they would pay for subprime financing. Let me repeat that point: the higher premiums that FHA will charge some types of borrowers are still substantially lower than they would pay for subprime financing. The cost of a loan with a higher FHA insurance premium is still substantially lower than the cost of a loan with a higher interest rate. For example, if FHA charged a 3 percent upfront insurance premium for a $225,000 loan to a credit-impaired borrower versus that same borrower obtaining a subprime loan with an interest rate 3 percent above par, the borrower would pay over $255 more in monthly mortgage payments with the subprime loan and over $125,000 more over the life of the loan, if they kept it for a full 30-year term.

Moreover, as I stated earlier, FHA intends to lower the insurance premium for some borrowers. FHA will charge lower-risk borrowers a substantially lower premium than these types of borrowers pay today. For example, homebuyers with higher credit scores who choose to invest at least 3 percent in a downpayment may pay as little as half a percent upfront premium.

So, while FHA may charge riskier borrowers more (and less risky borrowers less) than it does today, the benefit is three-fold. First, FHA will be able to reach additional borrowers the agency can't serve today. There is nothing that upsets us more than to see people taken to the cleaners when they would have fared better with an FHA-insured product. Second, these borrowers will pay less with FHA than with a subprime loan. And finally, the FHA Fund will be managed in a financially sound manner, with adequate premium income to cover any losses.

Another change proposed in the FHA Modernization Act is to increase FHA's loan limits. FHA's loan limit in high-cost areas would rise from 87 to 100 percent of the GSE conforming loan limit and in lower-cost areas from 48 to 65 percent of the conforming loan limit. In between high and lower-cost areas, FHA's loan limit will increase from 95 to 100 percent of the local median home price. This change is extremely important and crucial in today's housing market. In many areas of the country, the existing FHA limits are lower than the cost of new construction. Buyers of new homes can't choose FHA financing in these markets. In other areas, FHA has simply been priced out of the market. For example, in 1999, FHA insured 127,000 loans in the state of California; in 2005, FHA insured only 5,000.

FHA is also proposing some changes to specific FHA products. For example, the bill proposes to permit FHA to insure mortgages on condominiums under its standard single family product. The existing condo program is very specialized and burdensome, as a result of outdated statutory provisions that were written at a time when condominiums were an unfamiliar form of ownership. Condos represent 25 percent of the new and 12 percent of the existing home market today and serve as one of the primary forms of affordable housing for first-time homebuyers. In fact, condos tend to be closer to city centers and offer lower income borrowers an opportunity to buy an affordable home without moving far from their jobs and away from the public transportation that gets them to those jobs. Therefore, FHA should be able to serve condo buyers, just like any other homebuyers, under its standard single family program.

Our reform bill also proposes to modernize the Title I manufactured housing program, eliminating the portfolio insurance feature from the program and increasing the loan limits to reflect the real cost of manufactured housing today. The existing statute restricts FHA claim payments to 10 percent of the value of a lender's loan portfolio. With portfolio insurance, lenders are not guaranteed coverage against loss and subsequently price their loans for additional risk. The higher loan costs, in turn, increase the likelihood of borrower default. With additional default risk, but insufficient coverage, the losses grew to unsustainable levels in the 1990s and Ginnie Mae pulled out of the program. Ginnie Mae has testified that with the elimination of this outdated insurance model it would reconsider participation in the Title I securities market, which will bring in more lenders and drive down the costs of manufactured home financing.

Finally, the FHA Modernization Act offers some changes to the Home Equity Conversion Mortgage (HECM) program, which enables senior homeowners, aged 62 years or older, to tap into their home equity to live comfortably in their golden years. The bill proposes elimination of the cap on the number of loans FHA can insure; a single, national loan limit set at conforming; and a new HECM for Home Purchase product to permit seniors to move from the family home to more suitable senior housing and convert the purchase loan into a HECM in a single transaction. Today, seniors who want to move, but need additional cash flow to pay their living expenses, must purchase a new home and take out a HECM in two distinct transactions, resulting in two sets of loan fees and charges.

Let me assure you that the changes we are proposing will not increase the overall risk of the MMI Fund or impose a potential cost on taxpayers. We are proposing to manage the Fund in a financially prudent way, beginning with the change in FHA pricing to match premiums with risk. This will avoid FHA being exposed to excessive risk, as it is today, because some borrowers who use FHA are under-charged for their risk to the Fund while others are overcharged. Of course, we will continue to monitor the performance of our borrowers very closely, and make adjustments to underwriting policies and/or premiums as needed.

I know I've talked a lot here today, but I want to convey to you how passionate I am about the proposed changes. I believe we have an opportunity to make a difference in the lives of millions of lower- and modest-income Americans. We have a chance to bring FHA back into business, to restore the FHA product to its traditional market position. To all those families who can buy a home with prime conventional financing, I say, "Go for it!" They're fortunate and they should take full advantage of that benefit. But for those who can't, FHA needs to be a viable option. And when people ask me why are we proposing these changes, I tell them these exact words: "Families need a safe deal, at a fair price. Families need a way to take part in the American Dream without putting themselves at risk. Families need FHA."

I want to thank you again for providing me the opportunity to testify here today on the FHA Modernization Act. I look forward to working with all of you to make these reforms a reality.