STATEMENT

of

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on

Transforming the Federal Housing Administration for the 21st Century

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

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Thank you for holding this hearing and inviting the Mortgage Bankers Association (MBA)[1] to share its views on Transforming the Federal Housing Administration for the 21st Century. My name is Regina Lowrie and I am the President of Gateway Funding Diversified Mortgage Services, LP in Horsham, Pennsylvania and Chairman of the Mortgage Bankers Association. I am here today in support of the single-family proposals offered by FHA to amend the National Housing Act but hope that we can expand the scope of these initiatives to truly allow FHA to meet its mission in the 21st century.

In 1994, I founded Gateway with only seven employees and $1.5 million in startup capital. Over the past 12 years, I have grown the company to over 800 employees working in more than 58 offices, originating $3 billion in loans annually throughout Pennsylvania, Delaware, New Jersey and Maryland. I am proud of the work of Gateway, and of the mortgage industry itself, in providing opportunities for homeownership for families of this great land.

When I started Gateway, the programs of the Federal Housing Administration (FHA) were invaluable in enabling us to serve families who otherwise would have no other affordable alternative for financing their home. Ten years ago, FHA loans comprised 40 percent of Gateway's volume each year. We worked hard to be a good partner with FHA in administering its programs and together FHA and Gateway enabled tens of thousands of families to purchase their first home.

Today, though, the story is very different. While Gateway has grown significantly, our ability to use the FHA program has declined precipitously. Gateway has been able to adapt to changes in the mortgage markets, but FHA has been prevented from doing so. The needs of low- and moderate-income homebuyers, of first-time homebuyers, of minority homebuyers, and of senior homeowners have changed. FHA's programs though, have not followed their historic path of adaptation to meet these borrowers' changing needs.

The numbers are troublesome. In 1990, 13 percent of total originations in the U.S. were FHA-insured mortgages. In 2005, that number has dropped to just 3.5 percent. More importantly, in 1990, 28 percent of new home sales (which are typically a large first-time homebuyer market) were financed with FHA or VA; today that number has dropped to under 12%.

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[1] **MBA is the national association representing the real estate finance industry. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's website: www.mortgagebankers.org.**

The future of FHA is impaired by the perception today of some in the real estate industry. I would like to point out a story that ran in RealtyTimes® on June 21, 2005 in which a Baltimore, MD real estate agent unabashedly advises homebuyers to avoid FHA financing. The agent states: “Approved FHA loan recipients, same notice to you, don't bother bringing it to the table during a sellers market. More times than not, your offer will be rejected. We know that VA and FHA loans allow you the means of purchasing more home for the mortgage, but it only works if you are the only game in town.” His advice was based on the often true notion that FHA-insured financing is slower and more laborious than conventional financing.

This is a very unfortunate perspective, especially because FHA is vitally needed today.

MBA is committed to supporting FHA. Nowhere in Washington will you find a stronger supporter of the FHA and the programs it offers. Mortgage lenders are the private delivery system that allows FHA to reach borrowers with affordable financing opportunities, especially low- and moderate-income families, first-time homebuyers, and minorities. MBA members originate about 85% of single-family the FHA-insured mortgages each year. Every day, mortgage lenders sit down with the very families FHA seeks to serve to discuss how we can help them realize their dreams. Maybe we understand better than most that without FHA, many American families simply would not have had and will not have the opportunity to own the home they live in.

The Need for FHA

The FHA program is vital to many homebuyers who desire to own a home but cannot find affordable financing to realize this dream. While the FHA has had a number of roles throughout its history, its most important role today is to give first-time homebuyers the ability to climb onto the first rung of the homeownership ladder and to act as a vehicle for closing the homeownership gap for minorities and low- and moderate-income families.

Despite this country’s record high levels of homeownership, not all families share in this dream equally. As of the 4th quarter of 2005, the national homeownership rate stood at a near record 69.0 percent, but only 51.5 percent of minorities owned their own home. Only 48.6 percent of African-Americans and 50.0 percent of Latinos owned their own homes. This compares with 76.0 percent of non-Hispanic white households.

By the end of 2005, 84.3 percent of families earning more than the median income owned their own home, while only 53.1 percent of families below the median income owned their own home.

These discrepancies are tragic because homeownership remains the most important wealth-building tool the average American family has.

FHA's Record

More than any other nationally available program, FHA is increasingly focused on the needs of first-time, minority, and/or low- and moderate-income borrowers.

In 1990, 64 percent of FHA borrowers using FHA to purchase a home were first-time homebuyers. Today that rate has climbed to about 80 percent. In 1992, about one in five FHA-insured purchase loans went to minority homebuyers. That number in recent years has grown to more than one in three. Minorities make up a greater percentage of FHA borrowers than they do in the conventional market.

FHA is particularly important to those minority populations experiencing the largest homeownership gaps. Home Mortgage Disclosure Act (HMDA) data reveal that in 2004, 14.2 percent of FHA borrowers were African-Americans, compared with 5.4 percent of conventional borrowers. Hispanic borrowers made up 15.3 percent of FHA loans, while they only were 8.9 percent of the conventional market. Combined, African-American and Hispanic borrowers constituted 29.5 percent of FHA loans, doubling the conventional market's rate of 14.3 percent. In fact, in 2004, FHA insured nearly as many purchase loans to African-American and Hispanic families than were purchased by Fannie Mae and Freddie Mac combined.

The same data also shows us that over 57.9 percent of FHA borrowers earned less than $50,000, doubling the conventional market where only 27.6 percent of borrowers earned less than $50,000.

Ironically, as the above numbers reveal, FHA's mission to serve underserved populations has been increasingly focused during the same period as the decline in FHA's presence in the market. Thus we are losing FHA's impact at the very time when we need it most. The result is that American families are either turning to more expensive financing or giving up.

It is crucial that FHA keep pace with changes in the U.S. mortgage markets. While FHA programs can be the best and most cost-effective way of expanding lending to underserved communities, we have yet to unleash the full potential of these programs to help this country achieve important societal goals.

To be effective in the 21st century, FHA should be empowered to incorporate private sector efficiencies that allow it to change products and programs to meet the needs of today's homebuyers and anticipate the needs of tomorrow's mortgage markets, while at the same time being fully accountable for the results it achieves and the impact of its programs.

I will tell you that, under the strong leadership of Commissioner Brian Montgomery, FHA has undertaken significant changes to its regulations and its operations in a very short time. In the 10 months since the Commissioner was approved by the Senate, FHA has streamlined the insurance endorsement process, reformed appraisal requirements, and removed unnecessary regulations. He has instilled a spirit of change and a bias for action within FHA.

MBA compliments the Commissioner on his significant accomplishments to date, though we recognize that more work lies ahead. Lenders still report that FHA is difficult to work with and that oversight activities often focus on minor deficiencies in a loan file rather than focusing on issues of true risk to FHA's insurance funds. We are confident in the Commissioner's ability to address these and other issues.

FHA Background

FHA was created as a separate entity by the National Housing Act on June 27, 1934 to encourage improvement in housing standards and conditions, to provide an adequate home financing system by insurance of housing mortgages and credit, and to exert a stabilizing influence on the mortgage market. FHA was incorporated into the newly formed U.S. Department of Housing and Urban Development (HUD) in 1965. Over the years, FHA has facilitated the availability of capital for the nation's multifamily and single-family housing market by providing government insured financing on a loan-by-loan basis.

FHA offers multifamily and single-family insurance programs that work through private lenders to extend financing for homes. FHA has historically been an innovator. Over the past several decades, its mission has increasingly focused on expanding homeownership for those families who would otherwise either be unable to obtain financing or obtain financing with affordable terms. Additionally, the FHA program has been a stabilizing influence on the nation's housing markets due to the fact that it is consistently available at all times and in all places.

FHA Single-family Programs

Single-family FHA-insured mortgages are made by private lenders, such as mortgage companies, banks and thrifts. FHA insures single-family mortgages with more flexible underwriting requirements than might otherwise be available. Approved FHA mortgage lenders process, underwrite and close FHA-insured mortgages without prior FHA approval. As an incentive to reach into harder to serve populations, FHA insures 100 percent of the single-family mortgage loan balance as long as the loan is properly underwritten.

FHA has a strong history of innovating mortgage products to serve an increasing number of homebuyers. FHA was the first nationwide mortgage program; the first to offer 20-year, 25-year, and finally 30-year amortizing mortgages; and the first to lower downpayment requirements from 20 percent to ten percent to five percent to three percent. FHA was the first to ensure mortgage lending continued after local economic collapses or regional natural disasters.

FHA's primary single-family program is funded through the Mutual Mortgage Insurance Fund (MMIF), which operates similar to a trust fund and is completely self-sufficient. This allows FHA to accomplish its mission at little or no cost to the government. In fact, FHA's operations transfer funds to the U.S. Treasury each year, thereby reducing the Federal deficit. FHA has always accomplished its mission without cost to the taxpayer. At no time in FHA's history has the U.S. Treasury ever had to "bail out" the MMIF or the FHA.

Unleashing FHA's Potential

In order to unleash its potential, MBA believes changes should be made to three areas of FHA. FHA needs flexible authority to introduce new products and program changes, the ability to directly invest a portion of its revenues into technology improvements, and greater control in managing its human resources. These changes will allow FHA to become an organization that can effectively self-adapt to shifting mortgage market conditions and meet the homeownership needs of those families who continue to be unserved or underserved today.

Program Authority and Product Development

FHA programs are sometimes slow to adapt to changing needs within the mortgage markets. In today's market, an organization must be able to move quickly to solve problems and address needs.

A prime example of this problem can be found in the recent experience of FHA in offering hybrid Adjustable Rate Mortgage (ARM) products. A hybrid ARM is a mortgage product which offers borrowers a fixed interest for a specified period of time, after which the rate adjusts periodically at a certain margin over an agreed upon index. Lenders are typically able to offer a lower initial interest rate on a 30-year hybrid ARM than on a 30-year fixed rate mortgage. During the late 1990s, hybrid ARMs grew in popularity in the conventional market due to the fact that they offer borrowers a compromise between the lower rates associated with ARM products and the benefits of a fixed rate period.

In order for FHA to offer this product to the homebuyers it serves, legislative approval was required. After several years of advocacy efforts, such approval was granted with the passage of Public Law 107-73 in November 2001. Unfortunately, this authority was not fully implemented until the Spring of 2005.

The problem began when PL 107-73 included an interest rate cap structure for the 5/1 hybrid ARMs that was not viable in the marketplace. The 5/1 hybrid ARM has been the most popular hybrid ARM in the conventional market. As FHA began the rulemaking process for implementing the new program, they had no choice but to issue a proposed rule for comment with a 5/1 cap structure as dictated in legislation. By the time MBA submitted our comment letter on the proposed rule to FHA, we had already supported efforts within Congress to have legislation introduced that would amend the statute to change the cap structure. Our comments urged that, if passed prior to final rulemaking, the 5/1 cap fix be included in the final rule.

On December 16, 2003, Public Law 108-186 was signed into law amending the hybrid ARM statutes to make the required technical fix to the interest rate cap structure affecting the 5/1 hybrid ARM product. At this point, FHA was ready to publish a final rule. Regardless of the passage of PL 108-186, FHA was forced to go through additional rulemaking in order to incorporate the fix into regulation. Thus on March 10, 2004, FHA issued a Final Rule authorizing the hybrid ARM program, with a cap structure that made FHA's 5/1 hybrid ARM unworkable in the marketplace. It was not until March 29, 2005 that FHA was able to complete rulemaking on the amendment and implement the new cap structure for the 5/1 hybrid ARM product.

The hybrid ARM story demonstrates well the statutory straitjacket that FHA operates under. A four to six year lag in introducing program changes is simply unacceptable in today's market. Each year that a new program is delayed or a rule is held up, families who would benefit from the program either turn to more expensive alternatives or simply give up.

As such, MBA believes FHA needs greater autonomy so it can make technical changes in its programs and develop new products that will better serve those who are not adequately served by the conventional market. MBA supports FHA's proposed changes to the National Housing Act that would expand the flexibility FHA has to make program changes and to innovate needed product features. However, we believe that FHA should be afforded wider latitude to make program and product changes, to adapt to changing market conditions and to again be a leader in mortgage market innovations.

I would like to spend some time offering MBA's perspective on each of the proposed changes.

Downpayment Requirements

MBA supports the elimination of the complicated formula for determining the downpayment that is currently detailed in statute. The calculation is obviously outdated and unnecessarily complex. The calculation of the downpayment itself is often cited by originators as a reason for not offering the FHA product. They simply do not want to hassle with it. This section of the National Housing Act should be removed and the development of the calculation left to the FHA Commissioner to determine through regulation. MBA would suggest that the downpayment be calculated as a straight percentage of the lesser of the sales price or appraised value.

MBA supports the elimination of the statutory requirement that the borrower provide a minimum cash investment. Improving FHA's products with such downpayment flexibility is one of the most important innovations that FHA can be empowered to make. Independent studies have demonstrated two important facts: first, the downpayment is one of the primary obstacles for first-time homebuyers, minorities, and low- and moderate-income homebuyers. Second, the downpayment itself is not as important a factor in determining risk as are other factors, such as credit score.

The private market has already demonstrated that the downpayment can be replaced with other risk-mitigating features without significantly hurting performance. Certainly, many borrowers will be in a better financial position if they keep the funds they would have expended for the downpayment as a cash reserve for unexpected homeownership costs or life events.

We believe that FHA should be empowered to establish policies that would allow borrowers to qualify for a certain flexible downpayment and then decide the amount of the cash investment they would like to make in purchasing a home.

Adjusting Mortgage Insurance Premiums for Loan Level Risk

MBA recognizes that FHA may be able to serve more borrowers and do so with lower risk to the MMIF if they are able to adjust premiums based on the risk of each mortgage it insures. A flexible premium structure could also give borrowers greater choice in how they utilize the FHA program.

We caution, though, that creating a risk based premium structure will only be beneficial to consumers if there is a lowering of current premiums. We would not support simply raising current premiums for higher risk borrowers.

In December 2004, FHA eliminated the practice of refunding the unearned portion of the Up-front Mortgage Insurance Premium (UfMIP) to borrowers who prepay their FHA-insured mortgage early and go to another product. MBA was hopeful that the removal of the refund (which admittedly was an administrative cost for FHA and servicers) would have been followed by a correlated lowering of the UfMIP. This did not happen. The net effect was to actually raise the cost of the FHA program. MBA would not want to see the same thing happen under a risk-based premium structure.

Raising Maximum Mortgage Limits

MBA supports the proposal to raise FHA's maximum mortgage limits to 100 percent of an area's median home price (currently pegged at 95 percent) and to raise the ceiling to 100 percent of the conforming loan limit (currently limited to 87 percent) and the floor to 65 percent (currently 48 percent). This proposal is similar to that contained in H.R. 176 introduced by Representaitve Gary Miller (R-CA) and Representative Barney Frank (D-MA), which MBA supports.

There is a strong need for FHA financing to be relevant in areas with high home prices. MBA believes raising the limits to conforming limits in these areas strikes a good balance between allowing FHA to serve a greater number of borrowers without exceeding its mission or taking on excessive risk. In fact, MBA believes that such a move will improve FHA's portfolio performance.

Additionally, in many low cost areas, FHA's loan limits are not sufficient to cover the costs of new construction. New construction targeted to first-time homebuyers has historically been a part of the market in which FHA has had a large presence. MBA believes raising the floor will improve the ability of home builders to build modest homes in low-cost areas because first-time homebuyers will be able to use FHA-insured financing.

Lengthening Mortgage Term

MBA supports authorizing FHA to develop products with mortgage terms up to 40 years. Currently, FHA is generally limited to products with terms of no more than 30 years. Stretching out the term will lower the monthly mortgage payment and allow more borrowers to qualify for a loan while remaining in a product that continues to amortize. We think FHA should have the ability to test products with these features, and then, based on performance and homebuyer needs, to improve or remove such a product.

Consolidation of Single-Family Programs in the MMIF

FHA's proposal to place nearly all single-family mortgage programs within the MMIF certainly is worth considering. Currently, these products are in the General Insurance/Special Risk Insurance (GI/SRI) Fund, which effectively requires them to be scored individually and, if it is determined that the costs exceed the premiums, requires an appropriation from Congress. Such a change would most notably effect the 203(k), HECM, and condominium programs. To the extent that moving the programs to the MMIF allows FHA to obtain some cross-subsidization for products that serve an important social goal but may be more costly on average, MBA would be in support of such a change.

Improvements to FHA Condominium Financing

MBA supports changes to FHA's condominium program that will streamline the process for obtaining project approval and allow for greater use of this program. It is unfortunate to note that FHA insurance on condominium units has dropped at a higher rate than the overall decline in FHA's originations. This decline contradicts the fact that in costly markets, condominium units are typically the only type of housing within FHA's loan limits. Condominium units are also a large source of first-time homebuyer housing. FHA should have a much bigger presence in the condominium market.

Improvements to the Reverse Mortgage Program

Finally, MBA unequivocally supports all of the proposed changes to FHA's Home Equity Conversion Mortgage (HECM) program: the removal of the current 250,000 loan cap, the authorization of HECMs for home purchase and on properties less than one year old, and the creation of a single, national loan limit for the HECM program.

The HECM program has proven itself to be an important financing product for this country's senior homeowners, allowing them to access the equity in their homes without having to worry about making mortgage payments until they move out. The program has allowed tens of thousands of senior homeowners to pay for items that have given them greater freedom, such as improvements to their homes that have allowed them to age in place, or to meet monthly living expenses without having to move out of the family home.

MBA believes it is time to remove the program's cap because the cap threatens to limit the HECM program at a time when more and more seniors are turning to reverse mortgages as a means to provide necessary funds for their daily lives. MBA believes that the HECM program has earned the right to be on par with other FHA programs that are subject only to FHA's overall insurance fund caps. Additionally, removing the program cap will serve to lower costs as more lenders will be encouraged to enter the reverse mortgage market.

Additionally, authorizing the HECM program for home purchase will improve housing options for seniors. In a HECM for purchase transaction, a senior homeowner might sell a property they own to move to be near family. The proceeds of the sale could be combined with a reverse mortgage, originated at closing and paid in a lump sum, to allow a senior to purchase the home without the future responsibility of monthly mortgage payments. Alternatively, a senior homeowner may wish to take out a reverse mortgage on a property that is less than one year old, defined as "new construction" by FHA.

Finally, the HECM program should have a single, national loan limit equal to the conforming loan limit. Currently, the HECM program is subject to the same county-by-county loan limits as FHA's forward programs. HECM borrowers are disadvantaged under this system because they are not able to access the full value of the equity they have built up over the years by making their mortgage payments. A senior homeowner living in a high-cost area will be able to access more equity than a senior living in a lower cost area, despite the fact that their homes may be worth the same and they have the same amount of equity built up. Reverse mortgages are different than forward mortgages and the reasons for loan limits are different, too. FHA needs the flexibility to implement different policies, especially concerning loan limits.

Again, while we applaud these program changes, we believe that FHA should be granted wide latitude to implement program and product changes. Unless FHA is allowed to innovate they will always be following, not leading, the market in addressing the needs of first-time homebuyers, minorities and low and moderate income families that are not adequately served by the private market.

Technology

Technology's impact on U.S. mortgage markets over the past 15 years cannot be overstated. Technology has allowed the mortgage industry to lower the cost of homeownership and has allowed more borrowers to qualify for financing. The creation of automated underwriting systems, sophisticated credit score modeling, and business-to-business ecommerce are but a few examples of technology's impact.

FHA has been detrimentally slow to move from a paper-based process and it cannot electronically interface with its business customers in the same manner as the private sector. During 2004 and 2005, over 1.5 million paper loan files were mailed back and forth between FHA and its approved lenders and manually reviewed during the endorsement process. Despite the fact that FHA published regulations in 1997 authorizing electronic endorsement of loans, FHA was not able to implement this regulation until this past January, eight years after the fact. Complaints by lenders in transacting business with FHA are numerous.

FHA's integration with the industry as a whole is equally deficient. For instance, MBA created the Mortgage Industry Standards Maintenance Organization (MISMO) in 1999, to develop open industry data standards to facilitate the development and acceptance of fully electronic mortgage banking. The industry has released several subsequent versions of the standard. FHA has only adopted the first version, significantly disadvantaging it from garnering the efficiencies that come with an industry standard.

Additionally, as the mortgage industry hurls towards a completely electronic mortgage process, FHA struggles to obtain the simple ability to review and store documents in an electronic format like adobe acrobat ®.

MBA believes FHA cannot create and implement technological improvements because it lacks sufficient authority to use the revenues it generates to invest in technology. Improvements to FHA's technology will allow it to improve management of its portfolio, garner efficiencies and lower costs, which will allow it to reach farther down the risk spectrum to borrowers currently unable to achieve homeownership.

MBA proposes the creation of a separate fund specifically for FHA technology funded by revenues generated by the operation of the MMIF. MBA suggests the establishment of a revenue and a capital ratio benchmark for FHA, wherein, if both are exceeded, FHA can use a portion of the excess revenue generated to invest in its technology. Such a mechanism would allow FHA to invest in technology upgrades, without requiring additional appropriations from Congress or costing taxpayers a dime.

Human Resources

FHA is restricted in its ability to effectively manage its human resources at a time when the sophistication of the U.S. mortgage markets requires market participants to be experienced, knowledgeable, flexible, and innovative. Other Federal agencies, such as the Federal Deposit Insurance Corporation (FDIC), that interface with and oversee the financial services sector are given greater authority to manage their human resources. MBA believes that FHA should have similar authority if it is to remain relevant in providing homeownership opportunities to those families underserved by the private markets.

FHA should have more flexibility in its personnel structure than that which is provided under the regular Federal civil service rules. With greater control over the personnel structure, FHA could operate more efficiently and effectively at a lower cost. Further, improvements to FHA's ability to manage its human capital will allow FHA to attract and manage the talent necessary to develop and implement the strategies that will effectively provide opportunities for homeownership to underserved segments of the market.

FHA Multifamily Programs

While the focus of this hearing is on FHA's single-family programs, I would be remiss if I did not mention the importance of FHA's multifamily programs in providing decent, affordable housing to many Americans. There are a number of families and elderly citizens who either prefer to rent or who cannot afford to own their own homes. FHA's insurance of multifamily mortgages provides a cost-effective means of generating new construction or rehabilitation of rental housing across the nation.

While Commissioner Montgomery has not yet focused his attention on improving the multifamily programs, we hope that process improvements on the multifamily side of FHA will soon be discussed.

MBA's recommendations above, for (1) providing FHA greater flexibility to make program changes and develop new products, (2) allowing FHA to use revenues generated by the programs to improve technology, and (3) providing more flexibility to FHA in managing its human resources, are equally important for its multifamily programs. Any efforts to transform FHA for the 21st century should include FHA's multifamily programs.

Conclusion

FHA's presence in the single-family marketplace is smaller than it has been in the past and its impact is diminishing. Many MBA members, who have been traditionally strong FHA lenders, have seen their production of FHA loans drop significantly. This belies the fact that FHA's purposes are still relevant and its potential to help borrowers is still necessary.

The time to act is now. MBA calls upon this Subcommittee to advance legislative proposals that will allow FHA to be freed from overly burdensome processes and restrictions and empowered to adopt important product changes, to procure new technologies and to implement better management of its human resources. By doing so, Congress will empower FHA to be a vital part of today's mortgage market and expand opportunities to underserved homebuyers and renters.

If Congress does not act, MBA believes that consumer choice will be diminished and an increasing number of borrowers, especially first-time, minority, and low- and moderate-income borrowers, will be unable to find affordable homeownership financing.

On behalf of MBA, I would like to thank the Subcommittee for the opportunity to testify here today. MBA looks forward to working with Congress and HUD to improve FHA's ability to serve aspiring homeowners.