NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

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Before the House Committee on Financial Services Regarding "Transforming the Federal Housing Administration for the 21st Century"

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The National Community Reinvestment Coalition (NCRC) is honored to testify before you today. NCRC is the nation's economic justice trade association of 600 community organizations dedicated to increasing access to capital and credit for minority and low- and moderate-income borrowers and communities. The FHA program has been a very important means of extending mortgages to low- and moderate-income and minority families. FHA therefore has been a vital part of the national effort to increase and expand homeownership to these populations.

Mr. Chairman and other distinguished members of the Committee, we applaud your efforts to modernize FHA and update programs that have become antiquated. It is important that these programs remain relevant in today's lending market. Nonetheless we are concerned with some of the proposed reforms that will move FHA more towards private sector pricing patterns. We are also concerned about the proposal that would allow the FHA program to insure homes that are more expensive or consistent with the GSE conforming loan limits. Both of these proposals could have the likely outcome of reducing the numbers of low- and moderate-income and minority borrowers served by FHA. The mission of FHA is to serve low- and moderate-income families with affordable home loans. In general we believe that FHA should be modernized but these proposals would move FHA away from its original purpose.

Risk Based Pricing

NCRC believes that FHA must provide an alternative to subprime lending in order to provide a competitive impetus for pricing to be reduced for borrowers with impaired credit. The proposal to adopt a risk-based pricing mechanism for mortgage insurance would move FHA closer to the risk-based pricing in the subprime market. In other words, FHA pricing would more closely resemble subprime pricing. This move would be the opposite of what is needed. We need to retain and expand upon alternatives to subprime pricing in order to maintain competitive pressure on the subprime market to lower its pricing.

An example illustrates the how the proposed risk based pricing mechanism would move FHA pricing towards subprime pricing. Imagine two borrowers – Josh and Monica. Josh has seriously impaired credit, and is a B minus subprime borrower. Monica has a few nicks on her credit and is an A- minus subprime borrower. Right now, both Josh and Monica get charged roughly the same FHA mortgage insurance premium. Monica cross-subsidizes Josh's premium.

On the other hand if Josh and Monica were to go to the private sector market, Monica could probably get a near-prime loan rate of perhaps around 7 percent. Josh's APR would be much higher, possibly 9 or 10 percent. In contrast, the FHA program reduces the pricing disparity between Monica's and Josh's prices for loans. While this may not be the greatest deal for consumers like Monica, it protects consumers like Josh from onerous and high cost loans in the private market.

FHA's program has lost market share to subprime lenders in recent years. One possible reason for the risk-based premium proposal is to lure A- borrowers like Monica back into the FHA's program. If the risk-based premium approach is adopted, Josh would end up paying substantially more for his FHA loan. The difficulty with this possibility is that borrowers like Josh desperately need affordable alternatives to subprime pricing. While a number of subprime lenders are responsible, predatory lending is a subset of subprime lending. Moreover, abusive lending is particularly prevalent at the lower ends of the credit scoring spectrum since the more credit impaired borrowers are precisely the ones with fewest alternatives.

Currently, FHA loans are an important source of affordable loans for traditionally underserved borrowers. NCRC's data analysis shows that a greater percentage of low-income and minority borrowers receive FHA loans than conventional loans. For instance, African-Americans obtained 16.3 percent of government-insured lending but just 7.9 percent of conventional single family lending during 2004. The percent of government-insured lending to African-Americans was higher than the percent of households that were African-American (11.8 percent) while the percent of conventional lending was considerably below the percentage of households that were African-American. Moreover, the level of subprime lending (or loans with Annual Percentage Rates (APRs) above the triggers for price reporting in HMDA (Home Mortgage Disclosure Act) data) is very low in FHA lending. Lenders issued 746,930 prime government-insured loans and only 10,564 subprime government-insured loans in 2004. As a percent of total loans, subprime loans were 1.4 percent of government insured loans. In contrast, subprime loans were 11.5 percent of conventional home purchase loans in 2004.

As illustrated by the data analysis, a move to risk-based premium pricing could seriously undercut the current affordability of FHA loans for traditionally underserved borrowers. We understand that the proposals involve pricing for mortgage insurance premiums, not APRs reflected in the price reporting in HMDA data. The point about the data analysis, however, is to show the affordable alternative that FHA now provides. We cannot move dramatically away from FHA's vital place in the market as an affordable alternative.

Significant policy questions are whether a move to risk-based premium pricing is necessary to shore up the competitiveness of FHA lending or the safety and soundness of FHA lending. The questions witnesses were invited to answer whether risk-based premium pricing is needed so that the FHA program can offer loans with minimal downpayment requirements and other affordable features. NCRC is not convinced that a move to risk-based pricing is necessary to offer flexible and affordable mortgages. We have had discussions with a number of large lenders offering conventional mortgage loans with very minimal down payments without private mortgage insurance and to borrowers with low credit scores below 600 FICO scores. We ask HUD to more fully explore these types of products and additional credit counseling that may be needed as a complement to some of these products. Enhanced homebuyer counseling and careful underwriting appears to be a more promising path than moving towards a subprime pricing structure. By making FHA loans more costly for credit impaired borrowers, the chances increase that these borrowers will default, making the FHA program less safe and sound.

FHA Mortgage Limits

NCRC also opposes proposals to increase the maximum dollar amount of mortgages that FHA can insure. Currently the limits are 95 percent of the area's median home price and 87 percent of the Government Sponsored Enterprise (GSE) conforming loan limit. The proposal would change this to 100 percent of area median home price and 100 percent of GSE conforming loan limit. The "floor" would also be increased from 48 percent to 65 percent of the conforming loan limit.

In a number of metropolitan areas, median home prices and GSE conforming loan limits are very high. The proposal, therefore, would allow the FHA program to insure significantly more loans to middle- and upper-middle income families, and decrease their historical focus on low- and moderate-income borrowers. We ask HUD to intensify its efforts to reach minority and low- and moderate-income borrowers rather than Congress adopting a proposal that would further move FHA away from these traditionally underserved populations.

Creative Strategies

NCRC is pleased with aspects of the proposal that will update FHA and make the program more competitive. For instance, we applaud the proposal that would facilitate FHA mortgage lending for condominium units. Condominium units are an important component of affordable housing for low- and moderate-income families in high cost cities on the East and West coasts. In addition, we support proposals to offer FHA loan products with no downpayments, particularly for first time homebuyers. NCRC believes that no downpayment mortgages would be an effective means to compete with the private market, and would probably be more effective than moving to a risk-based pricing structure. Downpayment requirements remain a significant obstacle for first-time homebuyers. These reforms will assist in expanding homeownership to underserved communities.

Conclusion

We thank you, Mr. Chairman, for holding this hearing of great importance for the abilities of minorities and low- and moderate-income borrowers to buy affordable homes. We urge the Committee not to move FHA towards a risk-based pricing system and not to raise maximum loan amounts. As demonstrated above, NCRC believes it is critically important to preserve FHA as an affordable alternative to the subprime market. On the one hand, if FHA remains an affordable alternative, it serves as an important check and balance on the private market, keeping pressure on subprime lenders to lower their prices. On the other hand, if FHA pricing moves towards a subprime pricing structure, private sector prices for traditionally underserved families would likely increase. Coupled with increasing maximum mortgage amounts, risk-based pricing could slow down, if not stop, the upward trend in homeownership for minorities and low- and moderate-income families.