STATEMENT

of

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on

H.R. 3043

"Zero Downpayment Pilot Program Act of 2005"

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

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Good morning, and thank you Mr. Chairman, for holding this hearing and inviting the Mortgage Bankers Association (MBA)[1] to share its views on H.R. 3043, the *Zero Downpayment Pilot Program Act of 2005*, introduced by Congressmen Tiberi and Scott on June 23, 2005. My name is Michael Petrie and I am President of P/R Mortgage & Investment Corp. (P/RMIC), Indianapolis, Indiana, Chairman of Greensfork Township State Bank, Spartanburg, Indiana, and Chairman of the MBA.

We are excited to present this testimony concerning the Federal Housing Administration (FHA) and the important role it can play in today's real estate finance system. In particular, MBA believes that FHA has the ability to offer a no downpayment home loan product that could affordably extend the opportunity of homeownership to families.

Homeownership Success

The U.S. currently enjoys one of the highest rates of homeownership it has ever seen with 69.1% of households owning their own home. This committee understands well the bedrock role that homeownership plays in the typical American family's financial health. You have heard the numerous stories of families that have benefited financially and socially from homeownership. You have read the numerous reports and studies that have validated these stories.

While FHA began this success story for the American family over 70 years ago, the private sector has continued this success story with innovations, especially over the past 15 years, in developing sophisticated credit-qualifying tools and a diverse array of mortgage products.

Over the past 15 years, tools such as Automated Underwriting Systems (AUS), risk-based pricing, and our national credit record system, have allowed mortgage lenders to better gauge risk and extend the opportunity of homeownership to more American families than ever before.

Along with the development of better tools has come the development of innovative mortgage products. These products have given the American homebuyer greater choice in meeting their financing needs. This country's high homeownership rate is a testament to the effectiveness of these tools and these mortgage products.

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[1] **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 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 2,900 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.**

Recently there has been much attention to the growth of certain mortgage products. Some have expressed concern that lenders are extending too much credit and that these loans may pose a risk to our home finance system. Others have expressed the concern that certain products are being offered to homebuyers for whom the products are not suitable. Additionally, MBA understands that the Office of the Comptroller of the Currency is currently considering developing guidance for their regulated institutions concerning appropriate policies with regards to evaluating the risk of these new products.

To all of these concerns, MBA responds: These are good reasons as to why this country needs a strong FHA, an FHA that is empowered to pilot products and specifically why we need H.R. 3043. H.R. 3043 will allow FHA to offer sound, no downpayment mortgage financing to homebuyers with required counseling and with all the protections that go along with FHA financing. FHA is well positioned to safely offer this product at affordable terms to higher-risk borrowers. FHA's loss mitigation program can ensure that these borrowers have an array of options at their disposal after they close on their loan, should they run into trouble.

There's nothing more productive that this Congress could do this year to help focus mortgage product innovation on meeting the needs of consumers, than by passing H.R. 3043.

Changes over the past year make an FHA zero downpayment product more important

Over a year ago, MBA testified before this subcommittee in support of an FHA zero downpayment product. At that time, some in Congress, and in the industry, were critical of H.R. 3175 *The Zero Downpayment Act of 2004*, introduced by Representative Tiberi (R-OH) during the 108th Congress. Most of the concerns were addressed by the Financial Services Committee and H.R. 3043 is very similar to H.R. 3175, as reported out of committee last year.

There have been many additional changes over the past year that make an FHA zero downpayment program even more relevant today. Below are some of these changes.

- The U.S. Government Accountability Office (GAO) issued a report in February 2005 entitled *Mortgage Financing Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*. The report encourages FHA to pilot new products and encourages Congress to give FHA the authority to do so. H.R. 3043, *The Zero Downpayment Pilot Program Act of 2005* is wholly consistent with this, and other, recommendations in the report.

- On March 1, 2005, the Department of Housing and Urban Development (HUD) completed its comprehensive report on certain downpayment assistance programs currently authorized by FHA[2]. The report was commissioned by HUD's Office of Housing after several reports were issued by HUD's Office of Inspector General (HUD IG) concerning certain downpayment assistance programs where the seller provides the downpayment indirectly to the homebuyer through a 501(c)(3) corporation. The HUD IG reports found that such programs had high default rates.

  The March 1, 2005 report found that borrowers utilizing these seller-provided downpayment assistance programs share the same risk profile as those that would be served by the proposed zero downpayment program. Importantly, though, the report also found that the vast majority of the 501(c)(3) corporations that arrange these seller-provided downpayments do not include the risk mitigation features that are included in H.R. 3043. H.R. 3043 would serve these same borrowers but in a more prudent manner by:

  - Requiring pre-purchase counseling of homebuyers to help them decide whether or not the product is a good fit for them; and

  - Mandating the use of additional credit risk tools such as FHA's Technology Open To Approved Lenders (TOTAL) mortgage scorecard.

  In 2004, FHA insured 159,366 loans where a nonprofit provided a downpayment. H.R. 3043, as a pilot, contemplates insuring 50,000. MBA believes that most of the borrowers under H.R. 3043 will come from the pool of borrowers that are currently served by these downpayment programs. H.R. 3043 will, therefore, serve the same borrower type being served by FHA today, but do so with appropriate risk mitigation tools that will result in a lower default rate.

  One of the report's recommendations asserts unequivocally: "Implement the proposed zero downpayment program. Because of the incentives to raise the property sales price to cover the cost of the downpayment assistance, seller-funded DA creates an illusion of equity."[3]

  FHA and the FHA borrower will recognize a net improvement to their financial health through their use a zero downpayment loan under H.R. 3043 than under current authorized programs.

[2] "An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations," Final Report, March 1, 2005, HUD Contract No: C-OPC-22550/M0001
[3] Ibid. page 102

- MBA's most recent National Delinquency Survey reveals that delinquencies and foreclosures of FHA loans have declined during the first quarter of 2005. This decline is consistent with the testimony of then FHA Commissioner Weicher before this committee in 2004, when he described FHA's foreclosure and delinquency rates as a "lagging economic indicator" and expected them to improve over the coming year.

- Finally, MBA understands that the Zero Downpayment Program proposal, as scored by the Congressional Budget Office (CBO) in the President's 2006 budget, is expected to have only a minimal cost over the next 5 years. We believe that CBO will have similar estimates of nominal costs when scoring H.R. 3043.

  These "costs" though, need to be put in perspective: even with a zero downpayment product, FHA's operations are still expected to continue to generate hundreds of millions of dollars for the U.S. government. This 5-year cost of H.R 3043 is likely to be comparable to the $50 million dollars that the House Appropriations Committee approved for the American Dream Downpayment Initiative for FY 2006 alone, and yet the Administration's zero downpayment program is expected to serve 150,000 homebuyers a year.

Unfortunately the Homeownership Gap has not changed over the past year

As outlined above, much has changed over the past year since the FHA Zero Downpayment Program was first proposed.

Unfortunately, some things have not changed.

While we can celebrate the U.S.'s high homeownership rate, that very same rate masks a glaring disparity: minorities have a much lower rate of homeownership than non-minorities, and low- and moderate-income families have a much lower rate of homeownership than those at or above median-income levels. This was true a year ago and, unfortunately, still remains very true today.

In the first quarter of 2005, while 76% of Non-Hispanic White households owned their own homes, only 49.3% of African-American households and 49.7% of Hispanic households owned their own homes. Additionally, while 84% of families earning more than $50,000 owned their own home, only 57% of families earning less than $50,000 owned their own home.

MBA believes these homeownership gaps are a problem.

Simply put: not all populations equally participate in the benefits of homeownership.
The gaps in homeownership rates are a result of several issues, and closing the homeownership gap will require several initiatives. H.R. 3043 deals directly with one prominent obstacle: the downpayment.

The downpayment hurdle appears to be a major obstacle for low- and moderate-income families. Several studies have identified the "wealth constraint" – that is the ability to save for a downpayment – as a major homeownership barrier for minority families. Practically by definition, the downpayment hurdle disproportionately affects low- and moderate-income families who may be able to make monthly housing payments without difficulty, but find it problematic to save for the downpayment.

MBA believes that in order to truly expand homeownership opportunities, we must overcome the downpayment challenge. We believe an FHA zero downpayment loan program is the appropriate tool for addressing this challenge.

FHA Can Do It

In the past, the amount of downpayment was considered a significant indicator of credit risk, that is, the willingness and ability of a borrower to make monthly payments on a mortgage. The benchmark was (and still is) that a 20% downpayment on a home provides lenders sufficient comfort that a borrower has the ability to handle the mortgage and provides the borrower a buffer of equity if they have to sell.

FHA began the trend of insuring mortgages with less than a 20% downpayment back in the late 1930s. Over the years, FHA has gradually, and successfully, lowered the amount of required downpayment. Today, FHA will insure a loan up to 97% of the value of a home, requiring the borrower to provide only a 3% downpayment. FHA has provided this insurance at no cost to the American taxpayer. In fact, FHA generates hundreds of millions of dollars each year for the U.S. Treasury. These funds effectively lower the deficit.

As downpayment requirements were lowered by FHA and subsequently by the private market, important advances were made in credit underwriting over the past 15 years, such as the emergence of Automated Underwriting Systems and a national credit reporting system. These advances have allowed lenders to more accurately gauge credit risk with less reliance on strict benchmarks like downpayment amounts.

Lenders have discovered (and studies have supported) that a borrower's credit profile is a more important indicator of the performance of a loan than is the amount of the downpayment. The national credit information system preserved under the Fair and Accurate Credit Transactions Act of 2003 allows lenders to efficiently access a borrower's credit information and effectively evaluate risk.

Given these facts, MBA believes it is time for FHA to address the downpayment challenge by offering a no downpayment product.

In looking to remove the downpayment as an obstacle to homeownership, MBA is not suggesting a "homeownership at all costs" strategy. Rather, we are advocating a targeted and measured attempt to remove the downpayment obstacle and close the homeownership gap among ethnic groups and economic classes.

FHA is well positioned to close the homeownership gap

FHA's single-family programs serve minorities at higher rates than the market at large. In 2003, nearly a third of all FHA borrowers were minorities, twice the rate of the conventional market. In fact, if you look at purchase loans, that is, loans that create homeowners, FHA served as many African-American and Hispanic families in 2003 as Fannie Mae and Freddie Mac combined. Additionally, nearly 80% of FHA purchase loans go to first-time homebuyers.

A significant number of FHA borrowers are low- and moderate-income borrowers. In 2003, approximately 58% of FHA's borrowers had an annual income under $50,000, while about 26% of conventional borrowers earned less than $50,000.

An FHA zero downpayment program will be good for consumers

FHA insurance is the appropriate means to close the homeownership gap among minorities and low- and moderate-income families.

As indicated before, the FHA program authorized under H.R. 3043 will not be the first no-downpayment mortgage product on the market. But it would be offered with features that should ameliorate risk for the families that need it. These important features include:

- H.R. 3043 mandates the homebuyers receive counseling by a HUD-approved counseling agency during the origination process.

- H.R. 3043 requires that loans be screened by FHA's Technology Open To Approved Lenders (TOTAL) mortgage scorecard. T.O.T.A.L. analyzes credit score among other factors in assessing a potential borrower.

- Homeowners with an FHA no downpayment loan will have the protections of FHA's extensive loss mitigation program, which offers them various options if they have problems after the closing of their loan.

With these safeguards, MBA is confident that the FHA zero downpayment product will allow good borrowers to become good homeowners.

MBA does have suggestions on minor improvements to H.R. 3043 that we believe would further strengthen an already strong program. Those ideas are as follows:

First, H.R. 3043 requires that counseling be conducted on an individual basis. MBA would suggest allowing classroom or group counseling under certain situations, as determined by the Secretary. Many state housing finance agencies and community-based not-for-profits, in conjunction with lenders, realtors, and other industry professionals, provide comprehensive homeownership counseling in classroom-based environment. This counseling is typically approved by Fannie Mae and Freddie Mac for meeting mandatory counseling requirements under their programs. We believe that, in order to make the counseling best fit the borrower and to ensure that the counseling requirement itself does not become a disincentive to use the program, the statute should not mandate individual counseling, but rather allow the Secretary to determine the form and content of the counseling.

Second, the statute should explicitly state that the additionally disclosure documents, such as those required under subsection l(4)(B)(ii)(II) and under subsection l(10), are generic disclosures that can be used to educate the borrower. If the a counselor or lender must draft transaction-specific documents each time a potential zero downpayment borrower approaches them, it would create a significant disincentive for lenders and brokers in originating loans under the program.

MBA applauds Congressmen Tiberi and Scott for introducing this bill and demonstrating their commitment to closing the homeownership gap. Once again, thank you for allowing MBA to testify today.

We would be happy to furnish any additional needed information to the committee as it considers this bill.

Thank you.