



**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410**

**Written Testimony of Julián Castro
Secretary of U.S. Department of Housing and Urban Development (HUD)**

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Thank you, Chairman Hensarling and Ranking Member Waters, for this opportunity to testify on the work of the Federal Housing Administration (FHA).¹

Over the last 80 years, FHA has played a critical role in building America's middle class. By offering a full faith and credit guarantee on mortgage loans, FHA encourages the private market to provide access to affordable credit, supporting the creation and preservation of affordable housing. FHA has helped more than 40 million families become homeowners and provided millions more with the opportunity to rent an affordable home.

Throughout its history, FHA has also stepped in to play a necessary countercyclical role – taking on the risk that was required to protect the market. During the recent economic crisis, FHA kept the housing market functioning by dramatically increasing volume and market share when private credit froze. Our single-family market share increased nearly seven-fold, from three percent before the crisis to a peak of more than 21 percent. Economists from Moody's Analytics have said that without FHA, home prices would have fallen a devastating 25 percent further.² FHA acted as it was designed to do, filling the void left by private credit.

In response to the independent actuary's analysis, FHA took early and aggressive action to safeguard taxpayer dollars. It did so even as such actions might make it harder for FHA to fulfill its mission mandate of providing access to credit during this difficult period. We strengthened underwriting standards, overhauled our loss mitigation process, and increased insurance premiums five times since 2010. The result of these actions is a \$21 billion improvement to the value of the Mutual Mortgage Insurance (MMI) Fund in just two years. With FHA's most recent independent actuarial analysis showing ongoing improvement, and the overall housing market's continued recovery, it is clear FHA has turned the page on the recession.

¹ For purposes of this testimony, FHA refers to the single family mortgage insurance programs.

² Griffith, John. "The Federal Housing Administration Saved the Housing Market" Center for American Progress, October 2012.

A Stronger Economy and a Growing Housing Market

When President Obama took office, our housing market was in free-fall, and rising unemployment and plunging house prices posed incredible challenges for families and the broader economy. The President took immediate action to address these issues and to protect the middle class. These steps helped millions of Americans stay in their homes, save money on their mortgages, and turn their communities around.

Thanks to the determination of hardworking families across the Nation, and the bold actions of the Obama Administration, our nation's economy is in a period of progress. Job growth is the strongest it's been since the technology boom of the 1990s. The unemployment rate is now lower than it was before the financial crisis. The Federal deficit is at its lowest level since 2007.

The housing market is also coming back as an engine of prosperity. Homeowners' equity has grown more than \$4 trillion since 2009. Homebuilding has doubled, helping construction workers get back on the job. Home prices have rebounded by approximately 20 percent over the last three years.³ Housing has reemerged as a source of stability and wealth building. I'm proud to say that the FHA has played an enormous role in this growth. For example, we've insured more than half the loans of first-time buyers in recent years. Building on this progress, FHA continues to look for new ways to expand opportunity for responsible families and to strengthen the housing market.

Mutual Mortgage Insurance Fund is Back in the Black

In order to effectively carry out FHA's mission, we have to ensure that our finances are strong. We have taken aggressive actions to improve FHA's portfolio performance which has improved our financial standing as measured by the independent actuarial analysis. The 2014 Annual Report to Congress on the Financial Health of the Mutual Mortgage Insurance Fund (MMIF)⁴ provided the results of the 2014 independent actuarial analysis. It showed that the MMIF is back in the black.

The value of the Fund is positive and has grown \$21 billion in value in the last two years. It gained nearly \$6 billion in value over the previous year and now stands at \$4.8 billion in economic value. The current capital ratio is .41 percent and we have over \$46 billion in available cash to pay claims. Across a number of measures, the portfolio has seen significant improvements, including:

- 27 percent drop in seriously delinquent rates since the beginning of 2013;
- 62 percent improvement in recovery rates since 2009;
- 61 percent reduction in foreclosure starts since 2012; and
- 83 percent decline in early payment defaults since 2007.

³ <http://www.fhfa.gov/DataTools/Downloads/Pages/House-Price-Index.aspx>

⁴ The MMIF serves the forward single family program, and since 2009, the Home Equity Conversion Mortgage program. It does not include the multifamily or healthcare programs.

In 2014 alone, we saw delinquency rates continue to decline by 14 percent and recovery rates improve by 16 percent.

FHA's aggressive approach was necessary to preserve and protect the MMIF. We strengthened underwriting standards, overhauled our loss mitigation process, increased annual insurance premiums five times since 2010, and made additional premium adjustments, like reinstating FHA's life-of-loan premium policy. All these actions have contributed to the stronger FHA we have today. As we look to the future, we must ensure that more Americans can participate in our Nation's economic progress.

FHA's historically high premiums were limiting affordability for our borrowers and this almost certainly discouraged some first time homebuyers from entering the market. The National Association of Realtors estimates that in 2014 between 234,000 and 255,000 creditworthy borrowers were priced out of the market because of high premiums.⁵ While necessary to properly price for risk, the premium increases from 2010 to 2014 raised FHA's annual premium 145 percent. Prior to the decision to lower the annual premium, FHA was collecting almost four times the amount needed to cover the risk posed by its newest borrowers. According to the independent actuary, for new loans insured in Fiscal Year (FY) 2014, FHA will collect an average \$17,000 in fees from borrowers over the lives of the loans. FHA expects that the average loss from borrowers for these loans will be \$4,700.

Further complicating matters, interest rates have fluctuated and fallen over the past several years, just as FHA premiums climbed. The benefit that would have accrued to potential borrowers and spurred first time homebuyers was partly eliminated by FHA's premium increases. In the absence of affordable interest rates in the last 5 years, the difficulties in the housing market would have been worse. With FHA firmly on the right track, our responsibility now is to provide responsible borrowers, who are ready to buy, with affordable options to purchase a home.

FHA Reduces Premiums by Half a Percentage Point and Boosts Economy

In recognition of these improvements, market factors, and FHA's mission, we reduced annual mortgage insurance premiums to a more reasonable level— from 1.35 percent to 0.85 percent. The reduction applies to single family, forward mortgages with case numbers issued on or after January 26, 2015. It does not apply to the following:

- Mortgages with amortization terms less than or equal to 15 years;
- FHA-to-FHA Streamline Refinance mortgages that were endorsed on or before May 31, 2009;
- Section 247 Hawaiian Homeland mortgages;
- FHA's reverse mortgage product, the Home Equity Conversion Mortgage (HECM); or
- Title I mortgages.

⁵ <http://www.consumerfed.org/pdfs/2015-01-07-1-07-PM-FHA-Premium-Coalition-Letter.pdf>

To qualify for FHA mortgage insurance, loans must be underwritten to FHA's standards—which we have recently strengthened—and lenders are required to perform extensive loss mitigation to keep borrowers in homes and prevent claims. This premium change does not change either of those requirements. Borrowers must still meet all qualifications for obtaining an FHA-insured loan and lender responsibilities have not changed. Families still have to qualify for an FHA loan—but when they do, they will find a more affordable path to homeownership.

As a result of this change, FHA's annual mortgage insurance premiums will still be 50 percent higher than their pre-crisis levels. FHA's other insurance premium policies remain in effect and unchanged. The upfront mortgage insurance premium will remain at 1.75 percent. FHA's requirement that insurance be paid for the life of the loan also remains in force. Between January 2001 and June 2013, it was possible for borrowers to cancel remittance of insurance premiums but retain FHA insurance on a loan, once the remaining principal balance was less than 78 percent of the initial loan. FHA reinstated this requirement in 2013 after it became clear that canceling this requirement negatively impacted FHA during the crisis.

This new premium level is sufficient to account for risk while still improving affordability and facilitating access for responsible, creditworthy borrowers. Our estimates show that this premium change will not alter FHA's positive trajectory and will not materially lengthen the amount of time it will take for FHA to return to the mandatory two percent capital reserve ratio, considering loan volume and improved risk profiles. The market has responded positively to this approach. In fact, the Mortgage Bankers Association believes that reducing premiums reduces the risk to the portfolio over time.⁶ Economists at Moody's Analytics recently released an independent report on FHA's premium reduction, which demonstrates that this action will help the economy and protect the long-term health of the Fund. The report found, "While there is no magic policy bullet, allowing the FHA to reduce its insurance premiums for first-time and lower-income homebuyers will provide a meaningful boost. It also will protect taxpayers, as the premiums are high enough to put the FHA on solid financial ground." Additionally, Moody's predicts that the cut will support 140,000 more jobs and close approximately one-tenth of the current labor market gap.⁷

In practical terms, the Administration estimates that this increased affordability will make it possible for nearly 250,000 new buyers to purchase their first houses over the next three years. We project we will expand the number of first time homebuyers served by FHA by over 16 percent over FY 2014. Moody's Analytics estimates a similar magnitude of effect with 45,000 additional households purchasing a home this year as a result of the decrease, and an additional 100,000 in 2016.⁸

The reduction will also help more than two million future homeowners save an average of \$900 per year over the next three years. FHA also anticipates between 100,000 to 200,000 households will refinance with FHA to take advantage of potential savings. These are dollars that can now

⁶ <http://www.ohiomba.org/wp-content/uploads/2014/12/MBA-Letter-to-Julian-Castro.pdf>

⁷ <http://www.housingwire.com/articles/32398-senators-mortgage-bankers-tell-hud-time-to-lower-fha-premiums>

⁸ <http://www.housingwire.com/articles/32747-moodys-fha-premium-cut-will-increase-home-sales-by-45000-this-year>

be used to pay for a child's education, to save for retirement or to spend at local, small businesses—benefiting the overall economy. The lower premium also increases home purchasing power by producing savings equivalent to a significant drop in the home price.⁹ This is critical given that increasing home prices, while good for the economy, present a serious barrier to entry for first time homebuyers.

Stronger Safeguards and Stronger Fund

FHA does not now and has never offered the toxic products that led to the housing crisis. FHA's strong underwriting standards remain in place, and borrowers must demonstrate an ability to repay their loan. This measured reduction in premiums is possible because FHA has also worked hard to strengthen its own finances to ensure it can serve future generations. Today's lending standards are not only stronger than the immediate pre-crisis period, but also much stronger than historical norms. For example, beginning in 2009, FHA instituted a credit score floor and requires manual underwriting for higher-risk borrowers. It has been and will continue to be policy to extend access only to borrowers who can sustain their payments on a well-underwritten and fully documented mortgage.

It is important to stress that this premium reduction has been made in such a way to ensure that the trajectory of the Fund remains strong and that FHA does not take on unnecessary or undue risk. FHA is appropriately positioned to continue to play its important roles of ensuring affordable access to credit for underserved borrowers and supporting the housing market during times of economic instability. This is decidedly a result of the aggressive and effective policies that FHA took to respond to the financial crisis:

- *Raising premiums five times.* Despite the difficulty in raising premiums during a recession, FHA made the necessary changes to increase receipts to the Fund. This was necessary in order to properly price for risk and continue to collect enough payments to account for increased losses as a result of the crisis. Between 2010 and 2014, FHA raised annual mortgage insurance premiums 145 percent. We also reinstated life-of-loan insurance. Our most recent action adjusts premiums but leaves them substantially higher than before the crisis.
- *Strengthening underwriting standards.* This included introducing a credit score floor and requiring a higher down payment for borrowers with credit scores below 580.
- *Continuing to avoid "toxic" or risky products.* This included products that had become popular in the private market during the period leading up to the crisis, like option ARM, interest only, and "no-doc" loans. FHA consistently required rigorous underwriting and the use of appropriate documentation.

⁹ <http://housingperspectives.blogspot.com/2015/01/what-effect-will-lower-fha-mortgage.html>

- *Addressed HECM losses.* Using the authority granted to FHA by the Reverse Mortgage Stabilization Act, FHA continues to make critical changes to reduce the volatility of the HECM reverse mortgage program and better protect consumers.
- *Improving risk management.* This included creating the Office of Risk Management and Regulatory Affairs, hiring a Chief Risk Officer, and developing new modeling tools to help FHA understand the impacts of policy and market conditions.

Other actions that have directly benefited the health of the Fund include:

- Working with Congress to eliminate seller-assisted down-payment assistance which posed a serious risk to the health of the MMIF.
- Imposing higher minimum net worth requirements for lenders which mitigates counterparty risk and ensures that entities have sufficient capital to remain in business.
- Introducing revised loss mitigation waterfall which evaluates at-risk or defaulted borrowers in a consistent manner and provides the right options to help homeowners and protect FHA.
- Expanding the pre-foreclosure sale program, helping borrowers avoid foreclosure and improves recoveries to FHA's MMIF.
- Revamping and expanding the note sale program through the Distressed Asset Sales Program (DASP) to better manage the Fund and further improve recoveries.

To date, foreclosure starts are down 61 percent from the 2012 peak and early payment delinquencies are at their lowest levels since 2007. FHA's newest books of business continue to perform very well, further increasing the Fund's value. FHA's 2014 Annual Report to Congress demonstrates that the MMIF's health has improved significantly and will continue to do so. Even if the financial contributions of FY 2014's settlements and the mandatory appropriation are excluded, the Fund would still have ended 2014 with a positive reserve – demonstrating continued improvement regardless of the effects of one-time events. The Administration estimates that the MMIF's value will still continue to increase by at least \$7 billion a year for the next several years.

Going forward, FHA will continue to execute on the policies that have allowed the MMIF to make this tremendous turnaround so quickly. Ongoing prudent Fund management will include:

- Keeping annual premiums significantly above their pre-crisis levels;
- Keeping upfront and life-of-loan mortgage premiums unchanged;
- Continuing major reforms of the HECM program which has been a significant strain on the performance of the Fund; and
- Continuing aggressive loss avoidance actions.

This progress has put us in a sound position to reduce premiums and bring new creditworthy borrowers into the market. To be clear, this premium change only makes an FHA loan more affordable for qualified families. All other FHA requirements will remain the same. As it has always done, FHA will continuously monitor the portfolio to identify and address new or emerging risks.

All these factors make FHA confident that the impact of this premium change on the Fund will be minimal. As we continue to manage the Fund responsibly we will deliver on the dual mission of ensuring access to affordable credit for underserved borrowers and strengthening and preserving the Fund for future generations of borrowers.

Transforming FHA

In addition to the efforts we are taking to strengthen the MMIF and make homeownership more affordable for creditworthy families, we also continue to focus on improving our organization across the board. For example, through our Multifamily Transformation efforts, the Office of Multifamily Housing¹⁰ which operates assisted housing programs for the elderly and disabled as well as Project Based Rental Assistance and FHA Multifamily programs is proactively making changes to better fulfill its mission, while doing more with less.

The Multifamily transformation, as amended by the Congress, will help the Office of Multifamily Housing better serve its customers and stakeholders, operate more efficiently, engage and fully utilize staff, and improve risk management. And we have already begun to see the powerful impact this new approach can have on the ground through the positive feedback from HUD staff and stakeholders who have already gone through the first wave of the transformation in the Southwest region. These efforts, when complete, will yield real benefits for our employees, our external partners, and families across the country.

Conclusion

At its heart, FHA helps to make the housing market fairer – ensuring that qualified but underserved families are able to take advantage of the benefits of homeownership. This is what has motivated FHA to adjust premiums to a reasonable extent, ensuring that they are appropriate to cover risk, affordable for borrowers, and sufficient to keep FHA’s finances strong. FHA has played an important role in opening the door to opportunity and growing the middle class. Given the economic recovery and the health of the MMIF, this moderate premium reduction is simply an important next step to continue to support our working and middle class families. Our Nation is smart enough to heed the lessons of the past without forsaking our future. The answer isn’t to stop supporting homeownership—it’s to do it right. FHA is on track and well positioned to continue its 80 year history of creating opportunities for hard-working Americans.

¹⁰ FHA multifamily housing programs are not part of the MMIF.